Heartland

FINANCIAL USA, INC.

Create Reward

ANNUAL REPORT 2002

“This strategic company is driven to succeed, enriched with resources to pursue opportunity and build relationships — to create reward.”

Financial Highlights

For the years ended December 31, 2002, 2001 and 2000

(Dollars in thousands, except per share data)

For The Year	**2002**	**2001**	**2000**
Net income available to common stockholders	**$ 18,867**	$ 11,414	$ 9,586
Cash dividends, common	**3,926**	3,560	3,465
Per Share Data			
Earnings per common share – basic	**$ 1.93**	$ 1.19	$ 1.00
Earnings per common share – diluted	**1.91**	1.18	0.98
Cash dividend, common	**0.40**	0.37	0.36
Book value at December 31	**12.60**	11.06	10.00
Market price at December 31	**17.25**	12.80	13.25
At Year End			
Total assets	**$1,785,979**	$1,644,064	$1,466,387
Total loans and leases, net of unearned	**1,175,236**	1,105,205	1,042,096
Total deposits	**1,337,985**	1,205,159	1,101,313
Total stockholders’ equity	**124,041**	107,090	96,146
Financial Ratios			
Return on average total assets	**1.13 %**	0.72 %	0.70 %
Return on average total stockholders’ equity	**16.44**	11.32	10.69
Average stockholders’ equity to average total assets	**6.86**	6.47	6.54
Total capital to risk-adjusted assets	**11.86**	10.89	9.90
Leverage ratio	**8.24**	7.53	7.25

This strategic company…

Our company is clearly focused on the future, yet based on timeless values, such as honesty, fairness and teamwork. We have grown large enough to be powerful (ranked in the top 100 U.S. bank holding companies), but we remain small enough to be personal. We possess a winning and distinctive business model: We are a consortium of strong, contemporary community banks. With more than $1.7 billion in assets, we can compete with today's megabanks in almost every way. We work quickly but effectively, simplifying and streamlining procedures, yet maintaining maximum customer contact. Our ultimate advantage is where we do business. We are firmly rooted and actively involved in our customers' communities. At Heartland Financial we think global—but live next door.

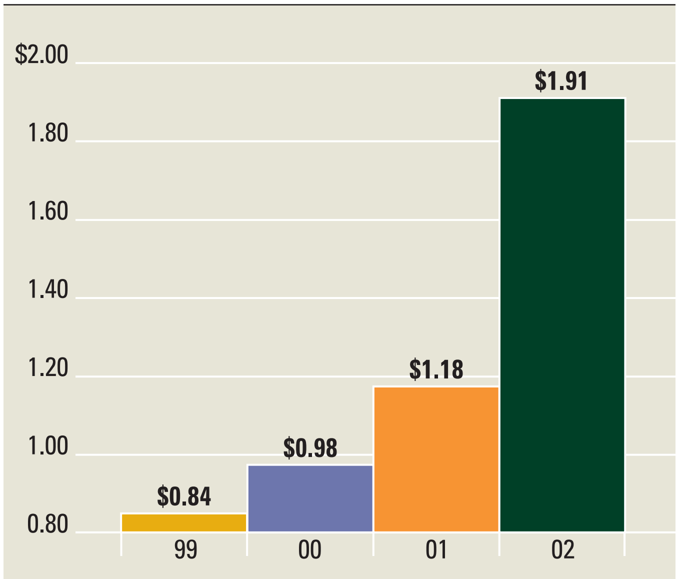
With decades of successful community banking experience, President and CEO Lynn B. Fuller provides LEADERSHIP, *expertise and vision for Heartland Financial.*

Driven to succeed…

We strongly believe in our mission, methods and business model. Our continuing success validates this belief. Clearly, high-performance community banking works. We're exceeding customer expectations, increasing shareholder value and serving communities. One important component of our success is our people. Heartland managers are goal-driven, but dedicated to creating a progressive work atmosphere where people thrive. Our staff members are empowered and engaged; they become vital, trusted financial advisors to our customers. In turn, our customers, impressed by outstanding customer service, utilize additional bank products and services, and become even more valuable customers. It's the cycle of success at Heartland.

Earnings per Share – Diluted

As of December 31



Skilled and motivated managers like Diana Lucero, Vice President, New Mexico Bank & Trust, set the stage for current and future SUCCESS *by offering customers outstanding guidance.*

Forward-thinking investments in technology provide Heartland Financial with CUSTOMER-TRANSPARENT *support functions that facilitate economies of scale—and guarantee competitive pricing.*

Enriched with resources to…

In any industry, it's important to maintain a generous supply of technological, financial and human resources. In community banking, where we provide the "small bank touch with the big bank punch," abundance is imperative. At Heartland, our technological resources are strong, with all banks in our consortium on one integrated system, able to cost-effectively offer customers every modern financial service. Financially, our resources are outstanding, with annual growth in assets, strong income and earning performance and a solid rate of return. Yet it is our human resources that set us apart. We believe the difference between a good bank and a great bank is people. Therefore, it is our strategy to hire smart, honest, enthusiastic and motivated associates—to achieve greatness.

Heartland Community Banking Model

Strong Community Banks	Resources for Revenue Enhancement	Customer-Transparent Cost Savings
Differentiate + Decisions at customer contact point + Personal touch	Financial services provider with support systems and staff	Gain economies of scale to remain price competitive

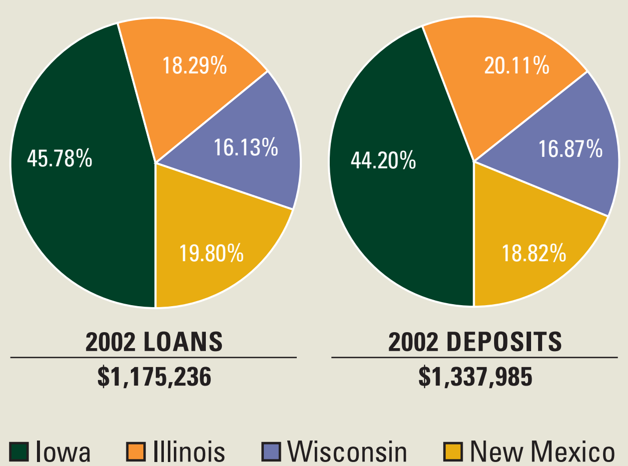
Pursue opportunity and...

At Heartland, we're always out there, prospecting for new banks, researching new services, seeking out opportunities to grow and strengthen our market share. We've expanded our geographic boundaries far beyond our original Mid-western beginnings, penetrating growth markets like the Southwest. Along the way, we've expanded our product line and attracted new audiences, including large commercial customers. We also continue to enhance our delivery capacity, building new branches and renovating existing offices wherever we go. Enterprising and aggressive, we are focused on profitable growth. Yet we do so with great regard for our mission. We grow carefully, with prudent business judgment, exhibiting the characteristics of a good corporate citizen, and remaining customer-focused. At Heartland, smart growth is optimal growth.

Loans and Deposits by State

For year ended December 31, 2002

(Dollars in Thousands)



Rancher, contractor and New Mexico Bank & Trust customer Mike Mechenbier exemplifies the successful commercial entrepreneurs Heartland Financial has attracted in NEW MARKETS.

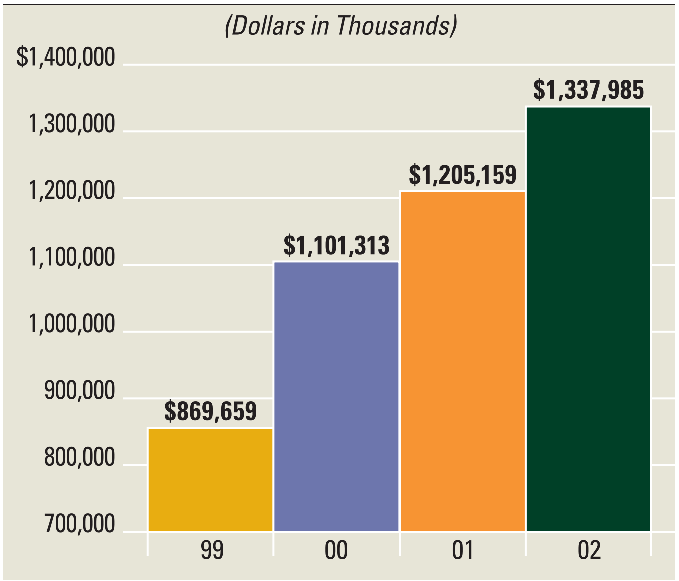
Heartland Financial's commitment to TRAINING *its people to form quality customer relationships is demonstrated by enthusiastic leaders such as Lu Ann Bowman, Vice President, Retail Sales, Dubuque Bank & Trust.*

Build relationships to…

A strong foundation is necessary when constructing a building —or building a business. At Heartland Financial, our foundation is built upon relationships. And we are strengthening that foundation every day. It's important work. Our relationships with shareholders, managers, employees, customers and communities are essential to our success. Our staff, at every level of the organization, shares the commitment to provide superior customer satisfaction. To meet that goal, we empower our people to accomplish extraordinary things. And our customers respond accordingly. In the community, we reach out through well-selected boards of directors at each location who communicate Heartland's values, neighborhood by neighborhood. By strengthening our relationships, we strengthen our business.

Deposits

As of December 31

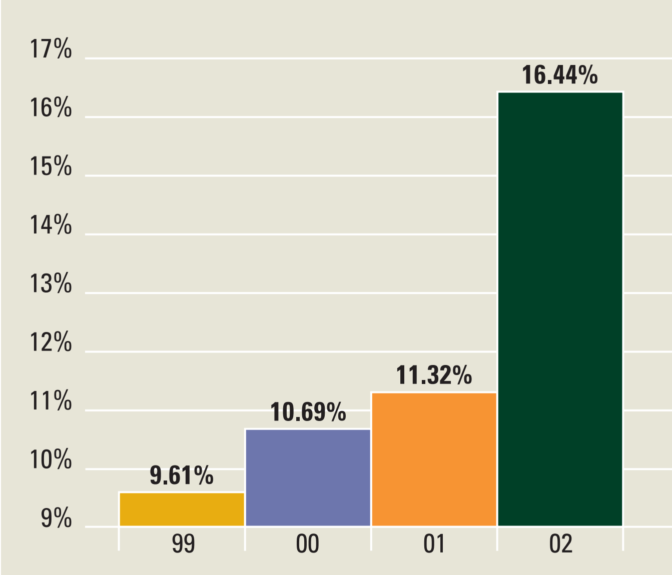


Create reward.

That's the bottom line. Our mission and purpose is to create reward. Ambitious, hard-working people and forward-thinking companies deserve financial reward, and we are here to help them realize it. Whether these enterprising people are our stockholders, customers, employees or members of the communities we serve, it is our purpose to balance their needs and help them prosper. It's that simple. Yet it is not achieved without great effort. It's an integrated process that encompasses our work ethic, integrity and resources, and culminates in our mission: to increase wealth. At Heartland Financial, contemporary community banking continues to succeed. And as we succeed, we create reward.

Return on Equity

As of December 31



John K. Schmidt, President, Dubuque Bank & Trust, and Rick Dickinson, Director, Greater Dubuque Development Corporation, are among community leaders supporting a $188-million Mississippi River recreational and cultural development project, including America's River, which will have a POSITIVE IMPACT *on this Iowa community.*

HEARTLAND EXECUTIVES

Lynn B. Fuller
Chairman of the Board, President and Chief Executive Officer

Kenneth J. Erickson
Executive Vice President, Chief Credit Officer

John K. Schmidt
Executive Vice President, Chief Financial Officer

Edward H. Everts
Senior Vice President, Operations

Douglas J. Horstmann
Senior Vice President, Lending

Mel E. Miller
Senior Vice President, Chief Investment Officer

Paul J. Peckosh
Senior Vice President, Trust

Jacquie M. Manternach
Vice President, Finance

Janet M. Quick
Vice President, Finance

Lois K. Pearce
Vice President, Corporate Secretary and Transfer Agent

HEARTLAND DIRECTORS

Lynn B. Fuller
Chairman of the Board

James F. Conlan
Director

John W. Cox, Jr.
Director

Mark C. Falb
Director

Thomas L. Flynn
Director

John K. Schmidt
Director

Robert Woodward
Director

MEMBER BANK DIRECTORS

DUBUQUE BANK AND TRUST COMPANY

Directors

Richard C. Cody
James F. Conlan
James Etheredge
Denis D. Faber, M.D.
Mark C. Falb
Thomas L. Flynn
Lynn B. Fuller
Lynn S. Fuller
James P. Gantz
Charlie Glab
Sandra J. Hirstein
Robert J. Kehl
Ralph Manternach
Dolores McHugh, BVM
Jerry L. Murdock
John K. Schmidt
Robert Woodward

DB&T Directors Emeriti

J. B. Crahan
Thomas M. Flynn
Duncan Glab
R. D. McDonald
B. L. Murray
Robert F. Neuwoehner
Susan Rink, BVM

FIRST COMMUNITY BANK

Directors

Wayne C. Campbell
Robert C. Carson
Lynn B. Fuller
James E. Hankes
Joseph W. Kamps
Dr. Michael A. Klauser
Richard L. Lofton
Richard Logsdon, CPA
Paul D. Long
John H. Smith

FCB Directors Emeriti

George Eichacker, CPA
J. Agnew Rovane

GALENA STATE BANK AND TRUST COMPANY

Directors

John W. Cox, Jr.
Lynn B. Fuller
Melvin L. Gratton
Terrance S. Heim
David Jansen
Jerry L. Murdock
John P. O'Boyle
Leo A. Oldenburg
James B. Vincent

GSB Directors Emeriti

Vincent A. Berning
Keith Clayton
Delbert Muehleip
Betty Rausch

NEW MEXICO BANK & TRUST

Directors

Nadyne C. Bicknell
George L. Clark
James A. Clark
Lynn B. Fuller
Dan Hardisty
John M. Jennings
R. Greg Leyendecker
Sherman McCorkle
Douglas G. Nichols
Ben F. Spencer

RIVERSIDE COMMUNITY BANK

Directors

Janyce L. Albert
Thomas E. Belmont
Willard C. Brenner
Steven J. Elsberg
Lynn B. Fuller
Burkhard Geissler
Scott A. Hendee
Theodore C. Klint
Dan G. Loescher
Peter T. Roche
Michael J. Rogers
Jean E. Vitale

WISCONSIN COMMUNITY BANK

Directors

James E. Bradley
David M. Fink
James L. Finley
Lynn B. Fuller
Clarence A. Peters, CPA
Robert A. Reffue
Carl W. Ross
Russell J. Schuler
Larry Swalheim
Kevin S. Tenpas
Harvey L. Wendel
Thomas J. Wilkinson
Robert O. Witte
Marshall D. (Bud) Zwygart

WCB Directors Emeriti

Galen C. Hartung
Chester G. Hoel

CITIZENS FINANCE CO.

Directors

James F. Conlan
Mark C. Falb
Thomas L. Flynn
Lynn B. Fuller
Lynn S. Fuller
Robert Woodward

ULTEA, INC.

Directors

Kenneth J. Erickson
Lynn B. Fuller
Keith J. Kreps
Robert O. Schlytter

CONSOLIDATED BALANCE SHEETS

December 31, 2002 and 2001 (Dollars in thousands, except per share data)

	Notes	2002	2001
Assets:			
Cash and due from banks	4	$ 61,106	$ 45,738
Federal funds sold and other short-term investments		39,886	47,812
Cash and cash equivalents		100,992	93,550
Time deposits in other financial institutions		1,677	564
Securities:	5		
Trading, at fair value		915	1,528
Available for sale – at fair value (cost of $381,398 for 2002 and $318,342 for 2001)		389,900	323,689
Loans and leases:	6		
Held for sale		23,167	26,967
Held to maturity		1,152,069	1,078,238
Allowance for loan and lease losses	7	(16,091)	(14,660)
Loans and leases, net		1,159,145	1,090,545
Assets under operating leases		30,367	35,427
Premises, furniture and equipment, net	8	35,591	31,482
Other real estate, net		452	130
Goodwill		16,050	16,050
Core deposit premium and mortgage servicing rights	9	4,879	4,655
Other assets		46,011	46,444
TOTAL ASSETS		**$1,785,979**	**$1,644,064**
Liabilities and Stockholders' Equity:			
LIABILITIES:			
Deposits:	10		
Demand		$ 197,516	$160,742
Savings		511,979	493,374
Time		628,490	551,043
Total deposits		1,337,985	1,205,159
Short-term borrowings	11	161,379	160,703
Other borrowings	12	126,299	143,789
Accrued expenses and other liabilities		36,275	27,323
TOTAL LIABILITIES		**1,661,938**	**1,536,974**
STOCKHOLDERS' EQUITY:	16, 17, 18, 19		
Preferred stock (par value $1 per share; authorized, 184,000 shares, none issued or outstanding)		–	–
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, 16,000,000 shares and 12,000,000 shares at December 31, 2002 and December 31, 2001, respectively; issued 9,905,783 shares at December 31, 2002 and December 31, 2001)		9,906	9,906
Capital surplus		16,725	18,116
Retained earnings		94,048	79,107
Accumulated other comprehensive income		4,230	3,565
Treasury stock at cost (59,369 shares at December 31, 2002, and 226,031 shares at December 31, 2001, respectively)		(868)	(3,604)
TOTAL STOCKHOLDERS' EQUITY		**124,041**	**107,090**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		**$1,785,979**	**$1,644,064**

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31, 2002, 2001 and 2000 (Dollars in thousands, except per share data)

	Notes	2002	2001	2000
Interest Income:				
Interest and fees on loans and leases	6	$ 83,553	$ 89,452	$ 87,653
Interest on securities:				
Taxable		13,132	14,143	11,824
Nontaxable		2,757	1,790	1,814
Interest on federal funds sold		322	1,981	911
Interest on interest bearing deposits in other financial institutions		248	243	333
Total Interest Income		100,012	107,609	102,535
Interest Expense:				
Interest on deposits	10	31,395	45,783	43,141
Interest on short-term borrowings		2,643	4,515	6,986
Interest on other borrowings		8,294	8,322	8,551
Total Interest Expense		42,332	58,620	58,678
NET INTEREST INCOME		57,680	48,989	43,857
Provision for loan and lease losses	7	3,553	4,258	2,976
Net interest income after provision for loan and lease losses		54,127	44,731	40,881
Noninterest Income:				
Service charges and fees		8,089	6,308	5,357
Trust fees		3,407	3,148	3,088
Brokerage commissions		658	615	846
Insurance commissions		765	807	862
Securities gains, net		790	1,489	501
Loss on trading account securities		(598)	(417)	–
Impairment loss on equity securities		(267)	(773)	(244)
Rental income on operating leases		14,602	15,446	14,918
Gains on sale of loans		4,656	2,738	521
Valuation adjustment on mortgage servicing rights		(469)	–	–
Other noninterest income		1,124	900	1,130
Total Noninterest Income		32,757	30,261	26,979
Noninterest Expenses:				
Salaries and employee benefits	15	28,571	25,182	23,645
Occupancy	16	3,178	3,014	2,876
Furniture and equipment		3,273	3,144	2,989
Depreciation on equipment under operating leases		11,555	11,805	11,199
Outside services		4,318	3,433	2,634
FDIC deposit insurance assessment		209	208	228
Advertising		1,917	1,588	1,482
Goodwill amortization		–	1,057	1,057
Core deposit premium amortization		495	615	757
Other noninterest expenses		9,255	8,287	7,203
Total Noninterest Expenses		62,771	58,333	54,070
Income before income taxes		24,113	16,659	13,790
Income taxes	14	7,523	5,530	4,211
INCOME FROM CONTINUING OPERATIONS		16,590	11,129	9,579
Discontinued operations:				
Income from operation of discontinued branch (including gain on sale of $2,602)		3,751	469	12
Income taxes		1,474	184	5
Income on discontinued operation		2,277	285	7
NET INCOME		**$ 18,867**	**$ 11,414**	**$ 9,586**
EARNINGS PER COMMON SHARE – BASIC		**$ 1.93**	**$ 1.19**	**$ 1.00**
EARNINGS PER COMMON SHARE – DILUTED		**$ 1.91**	**$ 1.18**	**$ 0.98**
CASH DIVIDENDS DECLARED PER COMMON SHARE		**$ 0.40**	**$ 0.37**	**$ 0.36**

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

For the years ended December 31, 2002, 2001 and 2000 (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, 2000	$ 9,707	$ 15,339	$ 65,132	$ (1,511)	$ (2,094)	$ 86,573
Net Income – 2000			9,586			9,586
Unrealized gain (loss) on securities available for sale				4,003		4,003
Reclassification adjustment for net gains realized in net income				257		257
Income taxes				(1,448)		(1,448)
Comprehensive income						12,398
Cash dividends declared:						
Common, $0.36 per share			(3,465)			(3,465)
Purchase of 291,501 shares of common stock					(5,197)	(5,197)
Sale of 322,937 shares of common stock	199	3,473			2,165	5,837
Balance at December 31, 2000	$ 9,906	$ 18,812	$ 71,253	$ 1,301	$ (5,126)	$ 96,146
Net Income – 2001			11,414			11,414
Unrealized gain (loss) on securities available for sale				3,796		3,796
Unrealized gain (loss) on derivatives arising during the period, net of reclassification of $46				350		350
Reclassification adjustment for net security gains realized in net income				(716)		(716)
Income taxes				(1,166)		(1,166)
Comprehensive income						13,678
Cash dividends declared:						
Common, $0.37 per share			(3,560)			(3,560)
Purchase of 79,256 shares of common stock					(1,026)	(1,026)
Sale of 140,798 shares of common stock		(696)			2,548	1,852
Balance at December 31, 2001	$ 9,906	$ 18,116	$ 79,107	$ 3,565	$ (3,604)	$ 107,090
Net Income – 2002			18,867			18,867
Unrealized gain (loss) on securities available for sale				3,630		3,630
Unrealized gain (loss) on derivatives arising during the period, net of reclassification of $667				(2,100)		(2,100)
Reclassification adjustment for net security gains realized in net income				(523)		(523)
Income taxes				(342)		(342)
Comprehensive income						19,532
Cash dividends declared:						
Common, $0.40 per share			(3,926)			(3,926)
Purchase of 95,543 shares of common stock					(1,348)	(1,348)
Sale of 262,205 shares of common stock		(1,391)			4,084	2,693
BALANCE AT DECEMBER 31, 2002	**$ 9,906**	**$ 16,725**	**$ 94,048**	**$ 4,230**	**$ (868)**	**$ 124,041**

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2002, 2001 and 2000 (Dollars in thousands)

	2002	2001	2000
Cash Flows from Operating Activities:			
Net income	**$ 18,867**	**$ 11,414**	**$ 9,586**
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**15,203**	16,616	16,167
Provision for loan and lease losses	**3,553**	4,283	3,301
Provision for income taxes less than (in excess of) payments	**1,996**	(635)	41
Net amortization (accretion) of premium (discount) on securities	**4,420**	1,285	(39)
Securities gains, net	**(790)**	(1,489)	(501)
(Increase) decrease in trading account securities	**613**	(1,528)	–
Loss on impairment of equity securities	**267**	773	244
Loans originated for sale	**(278,650)**	(207,332)	(42,991)
Proceeds on sales of loans	**287,106**	201,565	36,273
Net gain on sales of loans	**(4,656)**	(2,738)	(521)
Decrease (increase) in accrued interest receivable	**235**	1,603	(4,091)
Increase (decrease) in accrued interest payable	**491**	(1,597)	2,641
Other, net	**199**	(4,923)	(4,119)
Net cash provided by operating activities	**48,854**	**17,297**	**15,991**
Cash Flows from Investing Activities:			
Purchase of time deposits	**(1,068)**	–	(600)
Proceeds on maturities of time deposits	**3**	959	5,180
Proceeds from the sale of securities available for sale	**47,086**	65,010	34,442
Proceeds from the maturity of and principal paydowns on securities held to maturity	–	–	6,353
Proceeds from the maturity of and principal paydowns on securities available for sale	**151,099**	109,436	48,260
Purchase of securities available for sale	**(263,566)**	(267,354)	(81,918)
Net increase in loans and leases	**(109,282)**	(55,118)	(132,761)
Purchase of bank-owned life insurance policies	–	(8,568)	–
Increase in assets under operating leases	**(6,495)**	(11,663)	(11,409)
Capital expenditures	**(7,398)**	(4,602)	(3,647)
Cash and cash equivalents received for sale of operation	**30,469**	–	–
Net cash and cash equivalents received in acquisition of subsidiaries	–	–	18,603
Net cash received from minority interest stockholders	–	–	780
Proceeds on sale of OREO and other repossessed assets	**1,192**	790	815
Net cash used by investing activities	**(157,960)**	**(171,110)**	**(115,902)**
Cash Flows from Financing Activities:			
Net increase in demand deposits and savings accounts	**58,758**	111,338	26,090
Net increase (decrease) in time deposit accounts	**77,802**	(7,492)	111,248
Net increase in short-term borrowings	**676**	20,794	25,795
Proceeds from other borrowings	**7,840**	69,381	26,463
Repayments of other borrowings	**(25,330)**	(28,448)	(32,308)
Purchase of treasury stock	**(1,348)**	(1,026)	(5,197)
Proceeds from sale of common stock	**2,076**	1,689	19
Dividends	**(3,926)**	(3,560)	(3,465)
Net cash provided by financing activities	**116,548**	**162,676**	**148,645**
Net increase in cash and cash equivalents	**7,442**	8,863	48,734
Cash and cash equivalents at beginning of year	**93,550**	84,687	35,953
Cash and cash equivalents at end of period	**$ 100,992**	**$ 93,550**	**$ 84,687**
Supplemental disclosures:			
Cash paid for income/franchise taxes	**$ 6,648**	$ 6,365	$ 3,890
Cash paid for interest	**$ 41,841**	$ 61,790	$ 57,068
Securities held to maturity transferred to securities available for sale	**$ –**	$ 2,154	$ –
Acquisitions:			
Assets acquired	**$ –**	$ –	$ 119,837
Cash paid for purchase of stock	**$ –**	$ –	$ (14,364)
Cash acquired	–	–	32,967
Net cash received for acquisitions	**$ –**	$ –	$ 18,603
Notes issued for acquisition	**$ –**	$ –	$ 3,820
Common stock issued for acquisition	**$ –**	$ –	$ 5,773

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

One

Summary of Significant Accounting Policies

Nature of Operations – Heartland Financial USA, Inc. ("Heartland") is a multi-bank holding company primarily operating full-service retail banking offices in Dubuque and Lee Counties in Iowa; Jo Daviess, Hancock and Winnebago Counties in Illinois; Dane, Green, Sheboygan and Brown Counties in Wisconsin; and Bernalillo, Curry and Santa Fe Counties in New Mexico, serving communities in and around those counties. The principal services of Heartland, through its subsidiaries, are FDIC-insured deposit accounts and related services, and loans to businesses and individuals. The loans consist primarily of commercial and commercial real estate and residential real estate.

Principles of Presentation – The consolidated financial statements include the accounts of Heartland and its subsidiaries: Dubuque Bank and Trust Company; Galena State Bank and Trust Company; Riverside Community Bank; Wisconsin Community Bank; New Mexico Bank & Trust; First Community Bank; Citizens Finance Co.; ULTEA, Inc.; DB&T Insurance, Inc.; DB&T Community Development Corp.; DBT Investment Corporation; Heartland Capital Trust I; Heartland Capital Trust II and Heartland Financial Statutory Trust II. All of Heartland's subsidiaries are wholly-owned except for New Mexico Bank & Trust, of which Heartland was an 86.47% owner on December 31, 2002. All significant intercompany balances and transactions have been eliminated in consolidation.

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses.

Trading Account Securities – Trading securities represent those securities Heartland intends to actively trade and are stated at fair value with changes in fair value reflected in noninterest income. During the first quarter of 2001, Heartland began purchasing securities, on a limited basis, with the intent of actively trading those securities.

Securities Available for Sale – Available for sale securities consist of those securities not classified as held to maturity or trading, which management intends to hold for indefinite periods of time or that may be sold in response to changes in interest rates, prepayments or other similar factors. Such securities are stated at fair value with any unrealized gain or loss, net of applicable income tax, reported as a separate component of stockholders' equity. Security premiums and discounts are amortized/accreted using the interest method over the period from the purchase date to the maturity or call date of the related security. Gains or losses from the sale of available for sale securities are determined based upon the adjusted cost of the specific security sold. Unrealized losses judged to be other than temporary are charged to operations for both securities available for sale and securities held to maturity.

Securities Held to Maturity – Securities which Heartland has the ability and positive intent to hold to maturity are classified as held to maturity. Such securities are stated at amortized cost, adjusted for premiums and discounts that are amortized/accreted using the interest method over the period from the purchase date to the maturity date of the related security.

Loans and Leases – Interest on loans is accrued and credited to income based primarily on the principal balance outstanding. Income from leases is recorded in decreasing amounts over the term of the contract resulting in a level rate of return on the lease investment. The policy of Heartland is to discontinue the accrual of interest income on any loan or lease when, in the opinion of management, there is a reasonable doubt as to the timely collection of the interest and principal. When interest accruals are deemed uncollectible, interest credited to income in the current year is reversed and interest accrued in prior years is charged to the allowance for loan and lease losses. Nonaccrual loans and leases are returned to an accrual status when, in the opinion of management, the financial position of the borrower indicates that there is no longer any reasonable doubt as to the timely payment of interest and principal.

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

Net nonrefundable loan and lease origination fees and certain direct costs associated with the lending process are deferred and recognized as a yield adjustment over the life of the related loan or lease.

Loans held for sale are stated at the lower of aggregate cost or estimated fair value. Loans are sold on a nonrecourse basis with either servicing released or retained, and gains and losses are recognized based on the difference between sales proceeds and the carrying value of the loan.

Allowance for Loan and Lease Losses – The allowance for loan and lease losses is maintained at a level estimated by management to provide for known and inherent risks in the loan and lease portfolios. The allowance is based upon a continuing review of past loan and lease loss experience, current economic conditions, volume growth, the underlying collateral value of the loans and leases and other relevant factors. Loans and leases which are deemed uncollectible are charged off and deducted from the allowance. Provisions for loan and lease losses and recoveries on previously charged-off loans and leases are added to the allowance.

Premises, Furniture and Equipment – Premises, furniture and equipment are stated at cost less accumulated depreciation. The provision for depreciation of premises, furniture and equipment is determined by straight-line and accelerated methods over the estimated useful lives of 18 to 39 years for buildings, 15 years for land improvements and 3 to 7 years for furniture and equipment.

Other Real Estate – Other real estate represents property acquired through foreclosures and settlements of loans. Property acquired is carried at the lower of the principal amount of the loan outstanding at the time of acquisition, plus any acquisition costs, or the estimated fair value of the property, less disposal costs. The excess, if any, of such costs at the time acquired over the fair value is charged against the allowance for loan and lease losses. Subsequent write downs estimated on the basis of later evaluations, gains or losses on sales and net expenses incurred in maintaining such properties are charged to operations.

Intangible Assets – Intangible assets consist of goodwill, core deposit premiums and mortgage servicing rights. Goodwill represents the excess of the purchase price of acquired subsidiaries' net assets over their fair value. On July 1, 2001, Heartland adopted Financial Accounting Standards Board Statement No. 142 (FAS 142), "Goodwill and Other Intangible Assets." On September 30, 2002, Heartland adopted Financial Accounting Standards Board Statement No. 147 (FAS 147), "Acquisitions of Certain Financial Institutions." FAS 142 and 147 eliminates amortization of goodwill associated with business combinations. All goodwill amortization was discontinued during 2002. Heartland assesses goodwill for impairment annually, and more frequently in the presence of certain circumstances. Impairment exists when the carrying amount of the goodwill exceeds its implied fair value.

Core deposit premiums are amortized over ten years on an accelerated basis. Periodically, Heartland reviews the intangible assets for events or circumstances that may indicate a change in the recoverability of the underlying basis, except mortgage servicing rights which are reviewed quarterly.

Mortgage servicing rights associated with loans originated and sold, where servicing is retained, are capitalized. The values of these capitalized servicing rights are amortized in relation to the servicing revenue expected to be earned. The carrying values of these rights are periodically reviewed for impairment. For purposes of measuring impairment, the rights are stratified into certain risk characteristics including loan type, note rate, prepayment trends and external market factors. A valuation allowance of $469 thousand was required as of December 31, 2002, and no valuation allowance was required as of December 31, 2001.

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

(Dollars in thousands)

	2002	2001
Balance, beginning of year	$ 1,174	$ 556
Originations	2,499	1,626
Amortization	(761)	(1,008)
Valuation allowance	(469)	–
Balance, end of year	**$ 2,443**	**$ 1,174**

Mortgage loans serviced for others were $395.1 million and $268.6 million as of December 31, 2002 and 2001, respectively. Custodial escrow balances maintained in connection with the loan servicing portfolio were approximately $1.8 million and $1.2 million as of December 31, 2002 and 2001, respectively.

Income Taxes – Heartland and its subsidiaries file a consolidated federal income tax return. Heartland and its subsidiaries file separate income or franchise tax returns as required by the various states.

Heartland has a tax allocation agreement which provides that each subsidiary of the consolidated group pay a tax liability to, or receive a tax refund from Heartland, computed as if the subsidiary had filed a separate return.

Heartland recognizes certain income and expenses in different time periods for financial reporting and income tax purposes. The provision for deferred income taxes is based on an asset and liability approach and represents the change in deferred income tax accounts during the year, including the effect of enacted tax rate changes. Deferred tax assets are recognized if their expected realization is "more likely than not."

Treasury Stock – Treasury stock is accounted for by the cost method, whereby shares of common stock reacquired are recorded at their purchase price.

Trust Department Assets – Property held for customers in fiduciary or agency capacities is not included in the accompanying consolidated balance sheets, as such items are not assets of the Heartland banks.

Earnings Per Share – Amounts used in the determination of basic and diluted earnings per share for the years ended December 31, 2002, 2001 and 2000 are shown in the table below:

(Dollars in thousands)

	2002	2001	2000
Income from continuing operations	$ 16,590	$ 11,129	$ 9,579
Discontinued operations:			
Income from operations of discontinued branch (including gain on sale of $2,602)	3,751	469	12
Income taxes	1,474	184	5
Income from discontinued operations	2,277	285	7
Net income	$ 18,867	$ 11,414	$ 9,586
Weighted average common shares outstanding for basic earnings per share[(1)]	9,792	9,602	9,628
Assumed incremental common shares issued upon exercise of stock options[(1)]	64	103	130
Weighted average common shares for diluted earnings per share[(1)]	9,856	9,705	9,758
Earnings per common share – basic	$ 1.93	$ 1.19	$ 1.00
Earnings per common share – diluted	1.91	1.18	0.98
Adjusted earnings per share from continuing operations – basic[(2)]	1.69	1.16	0.99
Adjusted earnings per share from continuing operations – diluted[(2)]	1.68	1.15	0.98
Earnings per common share – basic[(3)]	1.93	1.30	1.11
Earnings per common share – diluted[(3)]	1.91	1.28	1.09
Adjusted earnings per share from continuing operations – basic[(4)]	1.69	1.27	1.10
Adjusted earnings per share from continuing operations – diluted[(4)]	1.68	1.26	1.09

[(1)] *In thousands.*

[(2)] *Excludes the discontinued operations of our Eau Claire branch and the related gain on sale in the fourth quarter of 2002.*

[(3)] *Excludes goodwill amortization discontinued with the adoption of FAS 142 on January 1, 2002, and the adoption of FAS 147 on September 30, 2002.*

[(4)] *Excludes goodwill amortization discontinued with the adoption of FAS 142 on January 1, 2002, and the adoption of FAS 147 on September 30, 2002, and the discontinued operations of our Eau Claire branch and the related gain on sale in the fourth quarter of 2002.*

Cash Flows – For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and other short-term investments. Generally, federal funds are purchased and sold for one-day periods.

Effect of New Financial Accounting Standards – In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 143 (FAS 143), "Accounting for Asset Retirement Obligations," which addresses the recognition and measurement of obligations with the retirement of tangible long-lived assets. FAS 143 is effective January 1, 2003, with early adoption permitted. Heartland adopted FAS 143 effective January 1, 2003, and the adoption of the Statement did not have a material effect on the financial statements.

In July 2001, the FASB issued Statement No. 141, "Business Combinations," (FAS 141) and Statement No. 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, as well as all purchase method business combinations completed after June 30, 2001. FAS 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill. FAS 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of FAS 142. FAS 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment. Heartland adopted the provisions of FAS 141 immediately, and FAS 142 effective January 1, 2002. Goodwill and intangible assets acquired in business combinations completed before July 1, 2001, continued to be amortized and tested for impairment in accordance with the appropriate pre-FAS 142 accounting requirements prior to adoption of FAS 142.

In October 2002, the FASB issued Statement No. 147 (FAS 147), "Acquisitions of Certain Financial Institutions," which amends Statement No. 72 (FAS 72), "Accounting for Certain Acquisitions of Banking or Thrift Institutions," and no longer requires the separate recognition and subsequent amortization of goodwill. FAS 147 also amends Statement No. 144 (FAS 144), "Accounting for the Impairment or Disposal of Long-Lived Assets," to include in its scope core deposit intangibles. Heartland adopted FAS 147 on September 30, 2002. As of December 31, 2002, Heartland had unamortized goodwill in the amount of $16.1 million and unamortized core deposit premiums in the amount of $2.4 million. Amortization expense related to goodwill was $1.1 million for the years ended December 31, 2001 and 2000. Amortization expense related to core deposit intangible assets was $495, $615 and $757 thousand for the years ended December 31, 2002, 2001 and 2000, respectively.

The table below reconciles reported earnings for the years ended December 31, 2002, 2001 and 2000, to "adjusted" earnings, which exclude goodwill amortization.

In August 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes both Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of Accounting Principles Board (APB) Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business (as previously defined in that Opinion). FAS 144 retains the fundamental provisions in FAS 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with FAS 121. For example, FAS 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. FAS 144 retains the basic provisions of Opinion No. 30 on how to present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike FAS 121, an impairment assessment under FAS 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under FAS 142. Heartland adopted FAS 144 effective January 1, 2002, and applied FAS 144 to the sale of Wisconsin Community Bank's branch in Eau Claire, Wisconsin.

In June 2002, the FASB issued Statement No. 146 (FAS 146), "Accounting for Costs Associated with Exit or Disposal Activities," which addresses financial accounting and reporting of costs

(Dollars in thousands, except earnings per share data)

	Year Ended Dec. 31, 2002	Year Ended Dec. 31, 2001			Year Ended Dec. 31, 2000		
	Reported Earnings	**Reported Earnings**	**Goodwill Amort.**	**"Adjusted" Earnings**	**Reported Earnings**	**Goodwill Amort.**	**"Adjusted" Earnings**
Income from continuing operations before taxes	**$ 24,113**	$ 16,659	$ 1,057	$ 17,716	$ 13,790	$ 1,057	$ 14,847
Income taxes	**7,523**	5,530	–	5,530	4,211	–	4,211
Income from continuing operations	**$ 16,590**	$ 11,129	$ 1,057	$ 12,186	$ 9,579	$ 1,057	$ 10,636
Net income	**$ 18,867**	$ 11,414	$ 1,057	$ 12,471	$ 9,586	$ 1,057	$ 10,643
Earnings from continuing operations per share – basic	**$ 1.69**	$ 1.16	$ 0.11	$ 1.27	$ 0.99	$ 0.11	$ 1.11
Earnings from continuing operations per common share – diluted	**$ 1.68**	$ 1.15	$ 0.11	$ 1.26	$ 0.98	$ 0.11	$ 1.09
Earnings per share – basic	**$ 1.93**	$ 1.19	$ 0.11	$ 1.30	$ 1.00	$ 0.11	$ 1.10
Earnings per share – diluted	**$ 1.91**	$ 1.18	$ 0.11	$ 1.28	$ 0.98	$ 0.11	$ 1.09

associated with exit or disposal activities. Under FAS 146, such costs will be recognized when the liability is incurred, rather than at the date of the commitment to an exit plan. FAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early adoption permitted. Heartland adopted FAS 146 on January 1, 2003, and the adoption of the Statement did not have a material effect on the financial statements.

In November of 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This Interpretation describes the disclosures to be made by a guarantor in interim and annual financial statements about obligations under certain guarantees the guarantor has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 will not have a material effect on Heartland's financial statements. Heartland adopted the disclosure provisions of FIN 45 effective December 31, 2002.

In December 2002, the FASB issued Statement No. 148 (FAS 148), "Accounting for Stock-Based Compensation – Transition and Disclosure," an amendment to FASB Statement 123. FAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 to require more prominent disclosures in both annual and interim financial statements about the method used on reported results. FAS 148 is effective for financial statements for fiscal years ending after December 15, 2002. Heartland has adopted the disclosure provisions of FAS 148.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities." FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling interest. The recognition and measurement provisions of this Interpretation are effective for newly created variable interest entities formed after January 31, 2003, and for existing variable interest entities, on the first interim or annual reporting period beginning after June 15, 2003. Heartland adopted the disclosure provisions of FIN 46 effective December 31, 2002, and will adopt the provisions of FIN 46 for newly formed variable interest entities effective January 31, 2003, which will not have a material effect on Heartland's financial statements. Heartland has three existing variable interest entities related to low income housing partnerships and will adopt the provisions of FIN 46 for those entities on July 1, 2003. The total amount of assets in these entities at December 31, 2002, was approximately $4.5 million.

Stock-Based Compensation – Heartland applies APB Opinion No. 25 in accounting for its Stock Option Plan and, accordingly, no compensation cost for its stock options has been recognized in the financial statements. Had Heartland determined compensation cost based on the fair value at the grant date for its stock options under FAS 148, Heartland's net income would have been reduced to the pro forma amounts indicated as follows:

(Dollars in thousands, except earnings per share data)

	2002	2001	2000
Net income as reported	**$ 18,867**	$ 11,414	$ 9,586
Pro forma	**18,619**	11,112	9,231
Earnings per share – basic as reported	**$ 1.93**	$ 1.19	$ 1.00
Pro forma	**1.90**	1.16	0.96
Earnings per share – diluted as reported	**$ 1.91**	$ 1.18	$ 0.98
Pro forma	**1.89**	1.14	0.95

Pro forma net income only reflects options granted in 2002, 2001, 2000, 1999, 1998, 1997 and 1996. Therefore, the full impact of calculating compensation cost for stock options under FAS 123 is not reflected in the pro forma net income amounts presented above because compensation is reflected over the options' vesting period, and compensation cost for options granted prior to January 1, 1996, is not considered.

Reclassifications – Certain reclassifications have been made to prior periods' consolidated financial statements to place them on a basis comparable with the current period's consolidated financial statements.

Two
Discontinued Operations

On December 15, 2002, Heartland sold the assets and liabilities of its Eau Claire, Wisconsin, branch of Wisconsin Community Bank due to the fact that the branch did not achieve critical mass in the marketplace. The sale allows Heartland to redirect assets to markets where the assets can be more productively and profitably employed. Loans sold totaled $34.3 million and deposits assumed by the buyer totaled $6.7 million. As part of the sale agreement, Wisconsin Community Bank subsequently purchased loans of $4.3 million from the buyer. Prior to the application of the direct costs of $133 thousand, the transaction resulted in a gain on sale of $1.6 million, net of tax. These amounts are included in the line item "Income from operation of discontinued branch." The branch's pretax profit or loss, for the periods presented, is also reflected in this line item. Additionally, included in this line item are the following amounts of net interest income for the branch for the years ended December 31, 2002, 2001 and 2000, respectively: $1.2 million, $906 thousand and $684 thousand.

Three
Acquisitions

Heartland regularly explores opportunities for acquisitions of financial institutions and related businesses. Generally, management does not make a public announcement about an acquisition opportunity until a definitive agreement has been signed.

In February of 2003, Heartland entered into an agreement with a group of Arizona business leaders to establish a new bank in Mesa. Pending regulatory approval, the new bank is expected to begin operations in the summer of 2003. Heartland's portion of the $15.0 million initial capital investment is $12.0 million.

Heartland intends to fund this transaction through its revolving credit line.

On January 1, 2000, Heartland completed its acquisition of National Bancshares, Inc., the one-bank holding company of First National Bank of Clovis in New Mexico. First National Bank of Clovis had four locations in the New Mexico communities of Clovis and Melrose, with $120.1 million in assets and $97.5 million in deposits at December 31, 1999. The total purchase price for National Bancshares, Inc. was $23.1 million, of which $5.8 million was paid in common stock of Heartland to National Bancshares, Inc.'s Employee Stock Ownership Plan and $3.8 million in notes payable over three or five years, at the stockholders' discretion, bearing interest at 7.00%. As provided in the merger agreement, participants in the Employee Stock Ownership Plan elected to receive a cash payment totaling $4.6 million for 255,180 of the 319,009 shares of Heartland's common stock originally issued to them. Heartland merged First National Bank of Clovis into its New Mexico bank subsidiary, New Mexico Bank & Trust, immediately after the closing of the National Bancshares, Inc. acquisition. As a result of this affiliate bank merger, Heartland's ownership in New Mexico Bank & Trust increased from its initial 80% to approximately 88%. The acquisition of National Bancshares, Inc. has been accounted for as a purchase; accordingly, the results of operations of First National Bank of Clovis are included in the consolidated financial statements from the acquisition date. The resultant acquired deposit base intangible of $2.0 million is being amortized over a period of 10 years.

Four

Cash and Due from Banks

The Heartland banks are required to maintain certain average cash reserve balances as a member of the Federal Reserve System. The reserve balance requirements at December 31, 2002 and 2001, were $5.2 and $3.3 million, respectively.

Five

Securities

The amortized cost, gross unrealized gains and losses and estimated fair values of available for sale securities as of December 31, 2002 and 2001, are summarized as follows:

(Dollars in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2002				
Securities available for sale:				
U.S. government corporations and agencies and treasuries	$ 98,088	$ 3,251	$ –	$101,339
Mortgage-backed securities	185,216	2,353	(251)	187,318
Obligations of states and political subdivisions	67,810	3,648	(67)	71,391
Total debt securities	351,114	9,252	(318)	360,048
Equity securities	30,284	157	(589)	29,852
TOTAL	**$381,398**	**$ 9,409**	**$ (907)**	**$389,900**

(Dollars in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2001				
Securities available for sale:				
U.S. government corporations and agencies and treasuries	$ 76,797	$ 2,543	$ (106)	$ 79,234
Mortgage-backed securities	182,179	1,764	(282)	183,661
Obligations of states and political subdivisions	29,493	1,575	(120)	30,948
Corporate debt securities	521	2	–	523
Total debt securities	288,990	5,884	(508)	294,366
Equity securities	29,352	262	(291)	29,323
TOTAL	**$318,342**	**$ 6,146**	**$ (799)**	**$323,689**

The amortized cost and estimated fair value of debt securities available for sale at December 31, 2002, by estimated maturity, are as follows. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

(Dollars in thousands)

	Amortized Cost	Estimated Fair Value
Securities available for sale:		
Due in 1 year or less	$ 97,242	$ 98,432
Due in 1 to 5 years	170,371	174,596
Due in 5 to 10 years	40,143	41,683
Due after 10 years	43,358	45,337
TOTAL	**$351,114**	**$360,048**

As of December 31, 2002, securities with a fair value of $200.3 million were pledged to secure public and trust deposits, short-term borrowings and for other purposes as required by law.

Gross gains and losses related to sales of securities for the years ended December 31, 2002, 2001 and 2000, are summarized as follows:

(Dollars in thousands)

	2002	2001	2000
Securities sold:			
Proceeds from sales	**$ 46,796**	$ 65,010	$ 34,442
Gross security gains	**941**	2,233	1,084
Gross security losses	**151**	744	583

During the years ended December 31, 2002 and 2001, Heartland incurred other than temporary impairment losses of $267 and $773 thousand on equity securities available for sale.

Six

Loans and Leases

Loans and leases as of December 31, 2002 and 2001, were as follows:

(Dollars in thousands)

	2002	2001
Loans:		
Commercial and commercial real estate	$ 743,520	$ 651,479
Residential mortgage	145,931	168,912
Agricultural and agricultural real estate	155,596	145,460
Consumer	120,853	127,874
Loans, gross	1,165,900	1,093,725
Unearned discount	(2,161)	(3,457)
Deferred loan fees	(811)	(633)
Loans, net	1,162,928	1,089,635
Direct financing leases:		
Gross rents receivable	9,765	13,129
Estimated residual value	4,336	4,921
Unearned income	(1,793)	(2,480)
Direct financing leases, net	12,308	15,570
Allowance for loan and lease losses	(16,091)	(14,660)
LOANS AND LEASES, NET	**$ 1,159,145**	**$ 1,090,545**

Direct financing leases receivable are generally short-term equipment leases. Future minimum lease payments as of December 31, 2002, were as follows: $4.4 million for 2003, $4.0 million for 2004, $3.2 million for 2005, $1.2 million for 2006, $924 thousand for 2007 and $353 thousand thereafter.

As Dubuque Bank and Trust Company is the largest subsidiary of Heartland, the majority of the loan portfolio is concentrated in northeast Iowa, northwest Illinois and southwest Wisconsin.

Loans and leases on a nonaccrual status amounted to $3.9 and $7.3 million at December 31, 2002 and 2001, respectively. The allowance for loan and lease losses related to these nonaccrual loans was $774 thousand and $2.0 million, respectively. All loans were subject to a related allowance at December 31, 2002, and December 31, 2001, as Heartland's allowance adequacy methodology identifies a specific allocation for each credit. The average balances of nonaccrual loans for the years ended December 31, 2002, 2001 and 2000, were $6.3, $7.0 and $3.2 million, respectively. For the years ended December 31, 2002, 2001 and 2000, interest income which would have been recorded under the original terms of these loans and leases amounted to approximately $272, $557 and $323 thousand, respectively, and interest income actually recorded amounted to approximately $57, $188 and $107 thousand, respectively.

Loans and leases on a restructured status amounted to $0 and $354 thousand at December 31, 2002 and 2001, respectively. The allowance for loan and lease losses related to these nonaccrual loans was $0 and $150 thousand for the same periods. All loans were subject to a related allowance at December 31, 2002 and 2001, as Heartland's allowance adequacy methodology identifies a specific allocation for each credit. The average balances of restructured loans for the years ended December 31, 2002, 2001 and 2000, were $119, $355 and $367 thousand, respectively. For the years ended December 31, 2002, 2001 and 2000, interest income which would have been recorded under the original terms of these loans and leases amounted to approximately $9, $32 and $28 thousand, respectively, and interest income actually recorded amounted to approximately $9, $9 and $28 thousand, respectively.

Loans are made in the normal course of business to directors, officers and principal holders of equity securities of Heartland. The terms of these loans, including interest rates and collateral, are similar to those prevailing for comparable transactions and do not involve more than a normal risk of collectibility. Changes in such loans during the year ended December 31, 2002 and 2001, were as follows:

(Dollars in thousands)

	2002	2001
Balance, beginning of year	$ 26,912	$ 24,433
Advances	24,357	46,935
Repayments	(19,328)	(44,456)
Balance, end of year	**$ 31,941**	**$ 26,912**

Seven

Allowance for Loan and Lease Losses

Changes in the allowance for loan and lease losses for the years ended December 31, 2002, 2001 and 2000, were as follows:

(Dollars in thousands)

	2002	2001	2000
Balance, beginning of year	$ 14,660	$ 13,592	$ 10,844
Provision for loan and lease losses from continuing operations	3,553	4,258	2,976
Provision for loan and lease losses from discontinued operations	(329)	25	325
Recoveries on loans and leases previously charged off	1,410	542	585
Loans and leases charged off	(3,203)	(3,757)	(2,280)
Additions related to acquisitions	–	–	1,142
BALANCE, END OF YEAR	**$ 16,091**	**$ 14,660**	**$ 13,592**

Eight

Premises, Furniture and Equipment

Premises, furniture and equipment as of December 31, 2002 and 2001, were as follows:

(Dollars in thousands)

	2002	2001
Land and land improvements	$ 6,610	$ 5,279
Buildings and building improvements	29,899	26,144
Furniture and equipment	20,960	19,428
Total	57,469	50,851
Less accumulated depreciation	(21,878)	(19,369)
PREMISES, FURNITURE AND EQUIPMENT, NET	**$ 35,591**	**$ 31,482**

Depreciation expense on premises, furniture and equipment was $2.8 million for 2002, $2.7 million for 2001 and $2.7 million for 2000.

Nine

Intangible Assets

The gross carrying amount of intangible assets and the associated accumulated amortization at December 31, 2002 and 2001, are presented in the tables below.

(Dollars in thousands)

	December 31, 2002	
	Gross Carrying Amount	Accumulated Amortization
Intangible assets:		
Core deposit premium	$ 4,492	$ 2,056
Mortgage servicing rights	3,346	903
TOTAL	**$ 7,838**	**$ 2,959**
UNAMORTIZED INTANGIBLE ASSETS		**$ 4,879**

(Dollars in thousands)

	December 31, 2001	
	Gross Carrying Amount	Accumulated Amortization
Intangible assets:		
Core deposit premium	$ 4,492	$ 1,561
Mortgage servicing rights	1,963	239
TOTAL	**$ 6,455**	**$ 1,800**
UNAMORTIZED INTANGIBLE ASSETS		**$ 4,655**

Projections of amortization expense for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of December 31, 2002. What Heartland actually experiences may be significantly different depending upon changes in mortgage interest rates and market conditions. The following table shows the estimated future amortization expense for amortizable intangibles assets:

(Dollars in thousands)

	Core Deposit Premium	Mortgage Servicing Rights	Total
Year Ended December 31,			
2003	$ 404	$ 698	$ 1,102
2004	353	582	935
2005	353	465	818
2006	353	349	702
2007	353	232	585

Ten

Deposits

The aggregate amount of time certificates of deposit in denominations of one hundred thousand dollars or more as of December 31, 2002 and 2001, were $126.2 and $111.5 million, respectively. At December 31, 2002, the scheduled maturities of time certificates of deposit were as follows:

(Dollars in thousands)

	2002
2003	$ 313,230
2004	103,774
2005	83,550
2006	27,281
2007	100,221
Thereafter	434
TOTAL	**$ 628,490**

Interest expense on deposits for the years ended December 31, 2002, 2001 and 2000, was as follows:

(Dollars in thousands)

	2002	2001	2000
Savings and money market accounts	**$ 6,530**	$ 11,858	$ 13,866
Time certificates of deposit in denominations of $100,000 or more	**4,505**	8,220	6,001
Other time deposits	**20,360**	25,705	23,274
INTEREST EXPENSE ON DEPOSITS	**$ 31,395**	**$ 45,783**	**$ 43,141**

Eleven

Short-Term Borrowings

Short-term borrowings as of December 31, 2002 and 2001, were as follows:

(Dollars in thousands)

	2002	2001
Securities sold under agreements to repurchase	**$ 99,004**	$ 108,592
Federal funds purchased	**28,325**	10,175
U.S. Treasury demand note	**6,550**	10,211
Citizens short-term notes	**2,500**	2,500
Notes payable to unaffiliated banks	**25,000**	29,225
TOTAL	**$ 161,379**	**$ 160,703**

On September 28, 2000, Heartland entered into a credit agreement with two unaffiliated banks to replace an existing term credit line, as well as to increase availability under a revolving credit line. Under the new unsecured revolving credit lines, Heartland may borrow up to $50.0 million at any one time. At December 31, 2002 and 2001, $25.0 and $29.2 million, respectively, was outstanding on the revolving credit lines. The additional credit line was established primarily to provide additional working capital to the nonbanking subsidiaries and to meet general corporate commitments.

All repurchase agreements as of December 31, 2002 and 2001, were due within six months.

Average and maximum balances and rates on aggregate short-term borrowings outstanding during the years ended December 31, 2002, 2001 and 2000, were as follows:

(Dollars in thousands)

	2002	2001	2000
Maximum month-end balance	**$ 161,379**	$ 162,744	$144,604
Average month-end balance	**140,282**	151,139	122,777
Weighted average interest rate for the year	**1.96%**	3.96%	5.79%
Weighted average interest rate at year-end	**1.59**	1.39	5.60

Twelve

Other Borrowings

Other borrowings at December 31, 2002 and 2001, were as follows:

(Dollars in thousands)

	2002	2001
Advances from the FHLB; weighted average maturity dates at December 31, 2002 and 2001, were February 2005 and May 2004, respectively; and weighted average interest rates were 5.04% and 5.37%, respectively	**$ 72,481**	$ 86,486
Notes payable on leased assets with interest rates varying from 3.17% to 9.50%	**14,245**	22,193
Trust preferred securities	**38,000**	33,000
Contracts payable to previous stockholders of National Bancshares, Inc. for acquisition due over a three-or five-year schedule at 7.00% through January 2004	**1,255**	2,110
Contracts payable for purchase of real estate	**318**	–
TOTAL	**$ 126,299**	**$ 143,789**

The Heartland banks are members of the Federal Home Loan Bank ("FHLB") of Des Moines, Chicago, or Dallas. The advances from the FHLB are collateralized by the banks' investment in FHLB stock of $26.7 and $25.6 million at December 31, 2002 and 2001, respectively. Additional collateral is provided by the banks' one-to-four unit residential mortgages, commercial and agricultural mortgages and securities pledged totaling $195.8 million at December 31, 2002, and $123.8 million at December 31, 2001.

On June 27, 2002, Heartland completed an offering of $5.0 million of variable rate cumulative capital securities representing undivided beneficial interests in Heartland Financial Capital Trust II. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. The proceeds are being used for general corporate purposes. Interest is payable quarterly on March 30, June 30, September 30 and December 30 of each year. The debentures will mature and the capital securities must be redeemed on June 30, 2032. Heartland has the option to shorten the maturity date to a date not earlier than June 30, 2007. 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 this offering, the balance of deferred issuance costs included in other assets was $163 thousand as of December 31, 2002. These deferred costs are amortized on a straight-line basis over the life of the debentures.

On December 18, 2001, Heartland completed an offering of $8.0 million of variable rate cumulative capital securities representing undivided beneficial interests in Heartland Statutory Trust II. The proceeds from the offering were used by Heartland Statutory Trust II to purchase junior subordinated debentures from Heartland. The proceeds are being used for general corporate purposes, including the repayment of $8.0 million of indebtedness on the revolving credit lines. Interest is payable quarterly on March 18, June 18, September 18 and December 18 of each year. The debentures will mature and the capital securities must be redeemed on December 18, 2031. Heartland has the option to shorten the maturity date to a date not earlier than December 18, 2006. 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 this offering, the balance of deferred issuance costs included in other assets was $237 thousand as of December 31, 2002. These deferred costs are amortized on a straight-line basis over the life of the debentures.

On October 21, 1999, Heartland completed an offering of $25.0 million of 9.60% cumulative capital securities representing undivided beneficial interests in Heartland Capital Trust I, a special purpose trust subsidiary of Heartland formed for the sole purpose of this offering. The proceeds from the offering were used by Heartland Capital Trust I to purchase junior subordinated debentures from Heartland. Interest is payable quarterly on March 31, June 30, September 30 and December 31 of each year. The debentures will mature and the capital securities must be redeemed on September 30, 2029. Heartland has the option to shorten the maturity date to a date not earlier than September 30, 2004. 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 this offering, the balance of deferred issuance costs included in other assets was $1.0 million as of December 31, 2002. The deferred costs are amortized on a straight-line basis over the life of the debentures.

All of the capital securities qualified as Tier 1 capital for regulatory purposes as of December 31, 2002 and 2001.

Future payments at December 31, 2002, for all other borrowings were as follows:

(Dollars in thousands)

2003	$ 10,157
2004	22,659
2005	24,165
2006	20,538
2007	40
Thereafter	48,740
TOTAL	**$126,299**

Thirteen

Derivative Financial Instruments

Heartland's use of derivative financial instruments relates to the management of the risk that changes in interest rates will affect its future interest payments. Heartland utilizes an interest rate swap contract to effectively convert a portion of the variable interest rate debt to fixed interest rate debt. Under the interest rate swap contract, Heartland agrees to pay an amount equal to a fixed rate of interest times a notional principal amount, and to receive in return an amount equal to a specified variable rate of interest times the same notional principal amount. The notional amounts are not exchanged and payments under the interest rate swap contract are made monthly. Heartland is exposed to credit-related losses in the event of nonperformance by the counterparty to the swap contract. This risk is minimized by entering into the contract with a large, stable financial institution.

As of December 31, 2002, Heartland had an interest rate swap contract to pay a fixed interest rate of 4.35% and receive a variable interest rate of 1.52% based on $25.0 million of indebtedness. This contract expires on November 1, 2006. The fair market value of the interest rate swap contract was recorded as a liability of $1.7 million as of December 31, 2002.

There was no ineffectiveness recognized on this interest rate swap during the year. All components of the derivative instrument's gain or loss were included in the assessment of hedge effectiveness. For the period ended December 31, 2002, there were no cash flow hedges discontinued related to forecasted transactions that are probable of not occurring.

As of December 31, 2002, $1.1 million of deferred net expense on derivative instruments included in other comprehensive income are expected to be reclassified to net income during the next twelve months.

Fourteen

Income Taxes

Income taxes for the years ended December 31, 2002, 2001 and 2000, were as follows:

(Dollars in thousands)

	Current	Deferred	Total
2002:			
Federal	$ 6,591	$ 967	$ 7,558
State	1,156	283	1,439
TOTAL	**$ 7,747**	**$ 1,250**	**$ 8,997**
2001:			
Federal	$ 5,310	$ (540)	$ 4,770
State	1,037	(93)	944
TOTAL	**$ 6,347**	**$ (633)**	**$ 5,714**
2000:			
Federal	$ 3,504	$ (86)	$ 3,418
State	850	(52)	798
TOTAL	**$ 4,354**	**$ (138)**	**$ 4,216**

Temporary differences between the amounts reported in the financial statements and the tax basis of assets and liabilities result in deferred taxes. No valuation allowance was required for deferred tax assets. Based upon Heartland's level of historical taxable income and anticipated future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that Heartland will realize the benefits of these deductible differences. Deferred tax assets and liabilities for the years ended December 31, 2002 and 2001, were as follows:

(Dollars in thousands)

	2002	2001
Deferred tax assets:		
Tax effect of net unrealized loss on derivatives reflected in stockholders' equity	$ 653	$ –
Securities	112	240
Allowance for loan and lease losses	5,798	5,635
Deferred compensation	1,427	789
Organization and acquisitions cost	265	244
Net operating loss carry forwards	608	708
Other	52	140
Gross deferred tax assets	$ 8,915	$ 7,756
Deferred tax liabilities:		
Tax effect of net unrealized gain on securities available for sale reflected in stockholders' equity	$ (3,175)	$ (2,001)
Tax effect of net unrealized gain on derivatives reflected in stockholders' equity	–	(131)
Premises, furniture and equipment	(6,085)	(4,452)
Lease financing	(2,627)	(2,791)
Tax bad debt reserves	(549)	(580)
Purchase accounting	(954)	(895)
Prepaid expenses	(309)	(272)
Mortgage servicing rights	(911)	(643)
Other	(130)	(176)
Gross deferred tax liabilities	$(14,740)	$(11,941)
NET DEFERRED TAX ASSET (LIABILITY)	**$ (5,825)**	$ (4,185)

The actual income tax expense differs from the expected amounts (computed by applying the U.S. federal corporate tax rate of 35% for 2002, 2001 and 2000, to income before income taxes) as follows:

(Dollars in thousands)

	2002	2001	2000
Computed "expected" amount	$ 9,752	$ 5,995	$ 4,831
Increase (decrease) resulting from:			
Nontaxable interest income	(944)	(610)	(624)
State income taxes, net of federal tax benefit	935	614	520
Goodwill and other intangibles not deductible	78	270	291
Graduated income tax rates	–	(36)	(100)
Tax credits	(792)	(440)	(440)
Other	(32)	(79)	(262)
Income taxes	$ 8,997	$ 5,714	$ 4,216
Effective tax rates	32.3%	33.4%	30.5%

Heartland has investments in certain low-income housing projects totaling $4.5 million and $4.7 million as of December 31, 2002 and 2001, respectively, which are included in other assets in the consolidated financial statements. These investments are expected to generate federal income tax credits of approximately $440 thousand per year through 2005. In April of 2002, a 99.9% ownership in a limited liability company was acquired that provided approximately $352 thousand historic rehabilitation tax credits for the 2002 tax year.

Fifteen

Employee Benefit Plans

Heartland sponsors a retirement plan covering substantially all employees. Contributions to this plan are subject to approval by the Heartland Board of Directors. The Heartland subsidiaries fund and record as an expense all approved contributions. Costs charged to operating expenses were $1.7 million for 2002, $761 thousand for 2001 and $692 thousand for 2000. This plan includes an employee savings program, under which the Heartland subsidiaries make matching contributions of up to 2% of the participants' wages. Costs charged to operating expenses with respect to the matching contributions were $294 thousand for 2002, $275 thousand for 2001 and $262 thousand for 2000.

On January 1, 2002, Heartland merged its non-contributory, defined contribution pension plan into the retirement plan covering substantially all employees. Annual contributions were based upon 5% of qualified compensation as defined in the plan. Costs charged to operating expense were $761 thousand for 2001 and $692 thousand for 2000.

Sixteen

Commitments and Contingent Liabilities

Heartland leases certain land and facilities under operating leases. Minimum future rental commitments at December 31, 2002, for all non-cancelable leases were as follows:

(Dollars in thousands)

2003	$ 536
2004	672
2005	586
2006	465
2007	307
Thereafter	711
TOTAL	**$ 3,277**

Rental expense for premises and equipment leased under operating leases was $700 thousand for 2002, $707 thousand for 2001 and $687 thousand for 2000.

In the normal course of business, the Heartland banks make various commitments and incur certain contingent liabilities that are not presented in the accompanying consolidated financial statements. The commitments and contingent liabilities include various guarantees, commitments to extend credit and standby letters of credit.

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 December 31, 2002 and 2001, commitments to extend credit aggregated $391.1 and $325.3 million and standby letters of credit aggregated $11.8 and $11.6 million, respectively. Heartland enters into commitments to sell mortgage loans to reduce interest rate risk on certain mortgage loans held for sale and loan commitments. At December 31, 2002 and 2001, Heartland had commitments to sell residential real estate loans totaling $56.7 and $30.8 million, respectively. Heartland does not anticipate any material loss as a result of the commitments and contingent liabilities.

Seventeen

Stock Plans

Heartland's Stock Option Plan is administered by the Compensation Committee of the Board of Directors whose members determine to whom options will be granted and the terms of each option. Under the Stock Option Plan, 1,200,000 common shares have been reserved for issuance. Directors and key policy-making employees are eligible for participation in the Stock Option Plan. Options may be granted that are either intended to be "incentive stock options" as defined under Section 422 of the Internal Revenue Code or not intended to be incentive stock options ("non-qualified stock options"). The exercise price of stock options granted will be established by the Compensation Committee, but the exercise price for the incentive stock options may not be less than the fair market value of the shares on the date that the option is granted. Each option granted is exercisable in full at any time or from time to time, subject to vesting provisions, as determined by the Compensation Committee and as provided in the option agreement, but such time may not exceed ten years from the grant date. At December 31, 2002 and 2001, respectively, there were 59,369 and 201,717 shares available for issuance under the Stock Option Plan.

Under the Stock Option Plan, stock appreciation rights ("SARS") may also be granted alone or in tandem with or with reference to a related stock option, in which event the grantee, at the exercise date, has the option to exercise the option or the SARS, but not both. SARS entitle the holder to receive in cash or stock, as determined by the Compensation Committee, an amount per share equal to the excess of the fair market value of the stock on the date of exercise over the fair market value at the date the SARS or related options were granted. SARS may be exercisable for up to ten years after the date of grant. No SARS have been granted under the Stock Option Plan.

A summary of the status of the Stock Option Plan as of December 31, 2002, 2001 and 2000, and changes during the years ended follows:

	2002 Shares (000)	2002 Weighted-Average Exercise Price	2001 Shares (000)	2001 Weighted-Average Exercise Price	2000 Shares (000)	2000 Weighted-Average Exercise Price
Outstanding at beginning of year	842	$12	798	$12	760	$11
Granted	48	13	45	13	40	18
Exercised	(230)	8	–	–	–	–
Forfeited	(48)	9	(1)	18	(2)	16
Outstanding at end of year	612	$13	842	$12	798	$12
Options exercisable at end of year	366	$12	522	$ 9	389	$ 9
Weighted-average fair value of options granted during the year	$2.57		$3.00		$4.41	

As of December 31, 2002 and 2001, options outstanding had exercise prices ranging from $8 to $18 per share and a weighted-average remaining contractual life of 5.22 and 4.28 years, respectively.

The fair value of stock options granted was determined utilizing the Black Scholes Valuation model. Significant assumptions include:

	2002	2001	2000
Risk-free interest rate	**4.88%**	5.36%	5.00%
Expected option life	**10 Years**	10 Years	10 Years
Expected volatility	**15.35%**	16.03%	13.04%
Expected dividends	**3.03%**	2.77%	2.00%

In 2001, Heartland adopted a Director Short-Term Incentive Plan. Under the Director Short-Term Incentive Plan, the aggregate number of shares that could be obtained by the directors was set at 150,000. The exercise price of stock options granted was established by the Compensation Committee at the fair market value of the shares on the date that the options were granted. Each director was eligible to receive non-qualified options to acquire up to no more than 7,500 shares. Under the Director Short-Term Incentive Plan, 127,065 shares were issued, and under the terms of the Director Short-Term Incentive Plan, all remaining shares were considered to be forfeited at December 31, 2001.

In 1996, Heartland adopted the Heartland Employee Stock Purchase Plan ("ESPP"), which permits all eligible employees to purchase shares of Heartland common stock at a price of not less than 85% of the fair market value on the determination date (as determined by the Committee). A maximum of 400,000 shares is available for sale under the ESPP. For the years ended December 31, 2002 and 2001, Heartland approved a price of 100% of fair market value at December 31, 2001 and 2000, respectively. At December 31, 2002 and 2001, respectively, 23,751 and 12,355 shares were purchased under the ESPP at no charge to Heartland's earnings.

During each of the years ended December 31, 2002, 2001 and 2000, Heartland acquired shares for use in the Stock Option Plan and the ESPP. Shares acquired totaled 95,543, 79,256 and 291,501 for 2002, 2001 and 2000, respectively.

Eighteen

Stockholder Rights Plan

On June 7, 2002, Heartland adopted a stockholders' rights plan (the "Rights Plan"). Under the terms of the Rights Plan, on June 26, 2002, the Board of Directors distributed one purchase right for each share of common stock outstanding as of June 24, 2002. Upon becoming exercisable, each right entitles the registered holder thereof, under certain limited circumstances, to purchase one-thousandth of a share of Series A Junior Participating preferred stock at an exercise price of $85.00. Rights do not become exercisable until ten business days after any person or group has acquired, commenced, or announced its intention to commence a tender or exchange offer to acquire 15% or more of Heartland's common stock. If the rights become exercisable, holders of each right, other than the acquiror, upon payment of the exercise price, will have the right to purchase Heartland's common stock (in lieu of preferred shares) having a value equal to two times the exercise price. If Heartland is acquired in a merger, share exchange or other business combination or 50% or more of its consolidated assets or earning power are sold, rights holders, other than the acquiring or adverse person or group, will be entitled to purchase the acquiror's shares at a similar discount. If the rights become exercisable, Heartland may also exchange rights, other than those held by the acquiring or adverse person or group, in whole or in part, at an exchange ratio of one share of Heartland's common stock per right held. Rights are redeemable by Heartland at any time until they are exercisable at the exchange rate of $.01 per right. Issuance of the rights has no immediate dilutive effect, does not currently affect reported earnings per share, is not taxable to Heartland or its shareholders, and will not change the way in which Heartland's shares are traded. The rights expire on June 7, 2012.

In connection with the Rights Plan, Heartland designated 16,000 shares, par value $1.00 per share, of Series A Junior Participating preferred stock. These shares, if issued, will be entitled to receive quarterly dividends and a liquidation preference. There are no shares issued and outstanding and Heartland does not anticipate issuing any shares of Series A Junior Participating preferred stock except as may be required under the Rights Plan.

Nineteen

Regulatory Capital Requirements and Restrictions on Subsidiary Dividends

The Heartland banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Heartland banks' financial statements. The regulations prescribe specific capital adequacy guidelines that involve quantitative measures of a bank's assets, liabilities and certain off balance sheet items as calculated under regulatory accounting practices. Capital classification is also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Heartland banks to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2002 and 2001, that the Heartland banks met all capital adequacy requirements to which they were subject.

As of December 31, 2002, the most recent notification from the FDIC categorized each of the Heartland banks as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Heartland banks must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed each institution's category.

The Heartland banks' actual capital amounts and ratios are also presented in the table below.

(Dollars in thousands)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2002						
Total Capital (to Risk-Weighted Assets)						
Consolidated	$ 158,010	11.86%	$ 106,596	8.0%	N/A	–
Dubuque Bank and Trust Company	58,288	11.02	42,304	8.0	$ 52,880	10.0%
Galena State Bank and Trust Company	15,919	12.27	10,380	8.0	12,975	10.0
First Community Bank	9,278	12.53	5,922	8.0	7,403	10.0
Riverside Community Bank	11,680	11.58	8,072	8.0	10,090	10.0
Wisconsin Community Bank	24,783	13.28	14,929	8.0	18,662	10.0
New Mexico Bank & Trust	28,676	10.87	21,103	8.0	26,379	10.0
Tier 1 Capital (to Risk-Weighted Assets)						
Consolidated	$ 141,918	10.65%	$ 53,298	4.0%	N/A	–
Dubuque Bank and Trust Company	52,450	9.92	21,152	4.0	$ 31,728	6.0%
Galena State Bank and Trust Company	14,487	11.17	5,190	4.0	7,785	6.0
First Community Bank	8,352	11.28	2,961	4.0	4,442	6.0
Riverside Community Bank	10,591	10.50	4,036	4.0	6,054	6.0
Wisconsin Community Bank	22,449	12.03	7,465	4.0	11,197	6.0
New Mexico Bank & Trust	25,378	9.62	10,551	4.0	15,827	6.0
Tier 1 Capital (to Average Assets)						
Consolidated	$ 141,918	8.24%	$ 68,883	4.0%	N/A	–
Dubuque Bank and Trust Company	52,450	8.03	26,118	4.0	$ 32,648	5.0%
Galena State Bank and Trust Company	14,487	7.61	7,613	4.0	9,516	5.0
First Community Bank	8,352	7.67	4,355	4.0	5,443	5.0
Riverside Community Bank	10,591	7.01	6,045	4.0	7,556	5.0
Wisconsin Community Bank	22,449	8.41	10,676	4.0	13,345	5.0
New Mexico Bank & Trust	25,378	8.13	12,491	4.0	15,614	5.0
As of December 31, 2001						
Total Capital (to Risk-Weighted Assets)						
Consolidated	$ 135,770	10.89%	$ 100,099	8.0%	N/A	–
Dubuque Bank and Trust Company	54,802	10.35	42,363	8.0	$ 52,954	10.0%
Galena State Bank and Trust Company	13,996	11.91	9,402	8.0	11,753	10.0
First Community Bank	9,230	11.47	6,440	8.0	8,050	10.0
Riverside Community Bank	9,651	10.80	7,150	8.0	8,938	10.0
Wisconsin Community Bank	20,001	11.52	13,892	8.0	17,366	10.0
New Mexico Bank & Trust	24,997	10.48	19,073	8.0	23,841	10.0
Tier 1 Capital (to Risk-Weighted Assets)						
Consolidated	$ 121,112	9.71%	$ 50,049	4.0%	N/A	–
Dubuque Bank and Trust Company	49,334	9.32	21,182	4.0	$ 31,773	6.0%
Galena State Bank and Trust Company	12,700	10.81	4,701	4.0	7,052	6.0
First Community Bank	8,223	10.21	3,220	4.0	4,830	6.0
Riverside Community Bank	8,787	9.83	3,575	4.0	5,363	6.0
Wisconsin Community Bank	17,829	10.27	6,946	4.0	10,419	6.0
New Mexico Bank & Trust	22,177	9.30	9,536	4.0	14,305	6.0
Tier 1 Capital (to Average Assets)						
Consolidated	$ 121,112	7.53%	$ 64,336	4.0%	N/A	–
Dubuque Bank and Trust Company	49,334	7.45	26,502	4.0	$ 33,128	5.0%
Galena State Bank and Trust Company	12,700	7.21	7,044	4.0	8,805	5.0
First Community Bank	8,223	7.04	4,674	4.0	5,843	5.0
Riverside Community Bank	8,787	6.92	5,082	4.0	6,352	5.0
Wisconsin Community Bank	17,829	8.14	8,756	4.0	10,945	5.0
New Mexico Bank & Trust	22,177	7.83	11,323	4.0	14,153	5.0

The ability of Heartland to pay dividends to its stockholders is dependent upon dividends paid by its subsidiaries. The Heartland banks are subject to certain statutory and regulatory restrictions on the amount they may pay in dividends. To maintain acceptable capital ratios in the Heartland banks, certain portions of their retained earnings are not available for the payment of dividends. Retained earnings which could be available for the payment of dividends to Heartland totaled approximately $45.9 million as of December 31, 2002, under the most restrictive minimum capital requirements.

Twenty

Fair Value of Financial Instruments

Following are disclosures of the estimated fair value of Heartland's financial instruments. The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts Heartland could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

(Dollars in thousands)

	December 31, 2002	
	Carrying Amount	Fair Value
Financial assets:		
Cash and cash equivalents	$ 100,992	$ 100,992
Time deposits in other financial institutions	1,677	1,677
Trading securities	915	915
Securities available for sale	389,900	389,900
Loans and leases, net of unearned	1,175,236	1,225,412
Financial liabilities:		
Demand deposits	$ 197,516	$ 197,516
Savings deposits	511,979	511,979
Time deposits	628,490	663,250
Short-term borrowings	161,379	161,379
Other borrowings	126,299	165,133

	December 31, 2001	
	Carrying Amount	Fair Value
Financial assets:		
Cash and cash equivalents	$ 93,550	$ 93,550
Time deposits in other financial institutions	564	564
Trading securities	1,528	1,528
Securities available for sale	323,689	323,689
Loans and leases, net of unearned	1,105,205	1,126,512
Financial liabilities:		
Demand deposits	$ 160,742	$ 160,742
Savings deposits	493,374	493,374
Time deposits	551,043	564,043
Short-term borrowings	160,703	160,703
Other borrowings	143,789	156,930

Cash and Cash Equivalents and Time Deposits in Other Financial Institutions – The carrying amount is a reasonable estimate of fair value.

Securities – For securities either available for sale or trading, fair value equals quoted market price if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans and Leases – The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The fair value of loans held for sale is estimated using quoted market prices.

Deposits – The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

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

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

Twenty-One

Parent Company Only Financial Information

Condensed financial information for Heartland Financial USA, Inc. is as follows:

(Dollars in thousands)

Balance Sheets December 31,	2002	2001
Assets:		
Cash and interest bearing deposits	**$ 1,985**	$ 323
Trading securities	**915**	1,528
Securities available for sale	**3,003**	3,666
Investment in subsidiaries	**166,061**	148,966
Other assets	**5,480**	4,375
Due from subsidiaries	**17,250**	15,500
TOTAL	**$ 194,694**	**$ 174,358**
Liabilities and stockholders' equity:		
Liabilities:		
Short-term borrowings	**$ 25,000**	$ 29,225
Other borrowings	**40,438**	36,138
Accrued expenses and other liabilities	**5,215**	1,905
Total liabilities	**70,653**	67,268
Stockholders' equity:		
Common stock	**9,906**	9,906
Capital surplus	**16,725**	18,116
Retained earnings	**94,048**	79,107
Accumulated other comprehensive income	**4,230**	3,565
Treasury stock	**(868)**	(3,604)
Total stockholders' equity	124,041	107,090
TOTAL	**$ 194,694**	**$ 174,358**

Income Statements for the Years Ended December 31,	2002	2001	2000
Operating revenues:			
Dividends from subsidiaries	**$ 9,890**	$ 15,452	$ 21,768
Security losses, (net)	**95**	(246)	–
Loss on trading account securities	**(598)**	(192)	–
Impairment loss on equity securities	**(267)**	(773)	–
Other	**1,016**	1,047	769
Total operating revenues	**10,136**	15,288	22,537
Operating expenses:			
Interest	**4,592**	4,807	4,934
Salaries and benefits	**1,973**	1,039	958
Outside services	**572**	456	198
Other operating expenses	**367**	262	246
Minority interest expense	**403**	207	237
Total operating expenses	**7,907**	6,771	6,573
Equity in undistributed earnings	**14,509**	659	(8,322)
Income before income tax benefit	**16,738**	9,176	7,642
Income tax benefit	**2,129**	2,238	1,944
NET INCOME	**$ 18,867**	**$ 11,414**	**$ 9,586**

Statements of Cash Flows for the Years Ended December 31,	2002	2001	2000
Cash flows from operating activities:			
Net income	**$ 18,867**	$ 11,414	$ 9,586
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed earnings of subsidiaries	**(14,509)**	(659)	8,322
(Increase) decrease in due from subsidiaries	**(1,750)**	1,250	(9,200)
Increase in other liabilities	**3,310**	601	1,183
Increase in other assets	**(1,105)**	(1,531)	(410)
(Increase) decrease in trading account securities	**613**	(657)	–
Noncash dividend from subsidiary	**–**	(5,149)	–
Other	**(33)**	1,282	88
Net cash provided by operating activities	**5,393**	6,551	9,569
Cash flows from investing activities:			
Capital injections for subsidiaries	**(600)**	(1,248)	(4,150)
Receipts for sale of minority interest	**–**	–	780
Payments for purchase of subsidiaries	**–**	–	(13,509)
Purchases of available for sale securities	**(1,774)**	(1,377)	–
Sales of available for sale securities	**1,766**	1,917	–
Net cash used by investing activities	**(608)**	(708)	(16,879)
Cash flows from financing activities:			
Net increase (decrease) in short-term borrowings	**(4,225)**	(10,075)	14,300
Proceeds from other borrowings	**5,155**	8,248	–
Payments on other borrowings	**(855)**	(1,438)	(1,449)
Cash dividends paid	**(3,926)**	(3,560)	(3,465)
Purchase of treasury stock	**(1,348)**	(1,026)	(5,197)
Sale of treasury stock	**2,076**	1,689	19
Net cash provided (used) by financing activities	**(3,123)**	(6,162)	4,208
Net increase (decrease) in cash and cash equivalents	**1,662**	(319)	(3,102)
Cash and cash equivalents at beginning of year	**323**	642	3,744
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$ 1,985**	**$ 323**	**$ 642**

Twenty-Two

Summary of Quarterly Financial Information (Unaudited)

(Dollars in thousands, except per share data)

2002	Dec. 31	Sept. 30	June 30	March 31
Net interest income	$ 15,517	$ 14,906	$ 13,989	$ 13,268
Provision for loan and lease losses	1,775	167	630	981
Net interest income after provision for loan and lease losses	13,742	14,739	13,359	12,287
Noninterest income	9,553	7,489	7,274	8,441
Noninterest expense	17,015	15,500	15,155	15,101
Income taxes	2,070	2,087	1,560	1,806
Income from continuing operations	4,210	4,641	3,918	3,821
Gain from operations of discontinued operations (including gain on disposal of $2,602)	3,124	224	202	201
Income tax expense	1,228	88	79	79
Gain on discontinued operation	1,896	136	123	122
Net income	$ 6,106	$ 4,777	$ 4,041	$ 3,943
Per share:				
Earnings per share – basic	$ 0.62	$ 0.49	$ 0.41	$ 0.41
Earnings per share – diluted	0.62	0.48	0.41	0.40
Earnings per common share from continuing operations – basic[1]	0.43	0.47	0.40	0.39
Earnings per common share from continuing operations – diluted[1]	0.43	0.47	0.40	0.39
Adjusted earnings per common share – basic[2]	0.62	0.49	0.41	0.41
Adjusted earnings per common share – diluted[2]	0.62	0.48	0.41	0.40
Adjusted earnings per common share from continuing operations – basic[3]	0.43	0.47	0.40	0.39
Adjusted earnings per common share from continuing operations – diluted[3]	0.43	0.47	0.40	0.39
Cash dividends declared on common stock	0.10	0.10	0.10	0.10
Book value per common share	12.60	12.19	11.68	11.24
Market price – high	17.70	15.30	15.00	14.00
– low	15.00	14.40	13.60	12.80
Weighted average common shares outstanding	9,811,168	9,819,148	9,808,922	9,729,332
Weighted average diluted common shares outstanding	9,890,267	9,894,883	9,872,842	9,793,766
Ratios:				
Return on average assets	1.39%	1.13%	0.96%	0.95%
Return on average equity	20.06	16.20	13.98	14.19
Net interest margin	4.06	4.12	4.02	3.86
Efficiency ratio	66.78	69.08	70.43	69.04

2001	Dec. 31	Sept. 30	June 30	March 31
Net interest income	$ 13,433	$ 12,635	$ 11,877	$ 11,044
Provision for loan and lease losses	1,196	1,230	1,131	701
Net interest income after provision for loan and lease losses	12,237	11,405	10,746	10,343
Noninterest income	8,156	7,150	7,546	7,409
Noninterest expense	15,134	14,652	14,395	14,152
Income taxes	1,798	1,351	1,180	1,201
Income from continuing operations	3,461	2,552	2,717	2,399
Gain from operations of discontinued operations	34	181	160	94
Income tax expense	13	71	63	37
Gain on discontinued operation	21	110	97	57
Net income	$ 3,482	$ 2,662	$ 2,814	$ 2,456
Per share:				
Earnings per share – basic	$ 0.36	$ 0.28	$ 0.29	$ 0.26
Earnings per share – diluted	0.36	0.27	0.29	0.25
Earnings per common share from continuing operations – basic[1]	0.36	0.27	0.28	0.25
Earnings per common share from continuing operations – diluted[1]	0.36	0.26	0.28	0.25
Adjusted earnings per common share – basic[2]	0.39	0.31	0.32	0.28
Adjusted earnings per common share – diluted[2]	0.38	0.30	0.32	0.28
Adjusted earnings per common share from continuing operations – basic[3]	0.39	0.29	0.31	0.28
Adjusted earnings per common share from continuing operations – diluted[3]	0.38	0.29	0.31	0.27
Cash dividends declared on common stock	0.10	0.09	0.09	0.09
Book value per common share	11.06	10.82	10.56	10.33
Market price – high	13.50	13.80	14.00	14.25
– low	12.78	13.15	10.25	12.50
Weighted average common shares outstanding	9,581,389	9,584,400	9,600,801	9,618,210
Weighted average diluted common shares outstanding	9,689,376	9,692,878	9,695,351	9,724,761
Ratios:				
Return on average assets	0.85%	0.67%	0.73%	0.67%
Return on average equity	13.20	10.38	11.32	10.24
Net interest margin	3.79	3.67	3.60	3.54
Efficiency ratio	69.28	74.69	73.95	77.58

[1] Excludes the discontinued operations for the sale of our Eau Claire branch in the fourth quarter of 2002 and the related gain on sale.

[2] Excludes goodwill amortization discontinued with the adoption of FAS 142 on January 1, 2002, and the adoption of FAS 147 on September 30, 2002.

[3] Excludes the goodwill amortization discontinued with the adoption of FAS 142 on January 2, 2002, and the adoption of FAS 147 on September 30, 2002, and the discontinued operations for the sale of our Eau Claire branch in the fourth quarter of 2002 and the related gain on sale.

REPRESENTATIONS OF MANAGEMENT

Management is responsible for the contents of the consolidated financial statements and other information contained in other sections of this annual report. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate to reflect, in all material respects, the substance of events and transactions that should be included. The consolidated financial statements reflect management's judgments and estimates as to the effects of events and transactions that are accounted for or disclosed. The company maintains accounting and reporting systems, supported by an internal accounting control system, which are adequate to provide reasonable assurance that transactions are authorized, assets are safeguarded and reliable consolidated financial statements are prepared, recognizing the cost and expected benefits of internal accounting controls. A staff of internal auditors conducts ongoing reviews of accounting practices and internal accounting controls.

The consolidated financial statements as of December 31, 2002, 2001 and 2000, of Heartland Financial USA, Inc. and its subsidiaries: Dubuque Bank and Trust Company; Galena State Bank and Trust Company; Riverside Community Bank; Wisconsin Community Bank; New Mexico Bank & Trust; First Community Bank; DB&T Insurance, Inc.; DB&T Community Development Corp.; Citizens Finance Co.; ULTEA, Inc.; DBT Investment Corporation; Heartland Capital Trust I; Heartland Statutory Trust II; and Heartland Capital Trust II were audited by independent certified public accountants. Their role is to render independent professional opinions of the fairness of the consolidated financial statements based upon performance of procedures they deem appropriate under generally accepted auditing standards.

The Audit Committees of the Boards of Directors of member banks meet periodically with the internal auditors to review matters relating to internal accounting controls and the nature, extent and results of audit efforts. The internal auditors and independent certified public accountants have free access to the Audit Committees.

Lynn B. Fuller
President and CEO, Heartland Financial USA, Inc.

John K. Schmidt
Executive Vice President and CFO, Heartland Financial USA, Inc.

KPMG

2500 Ruan Center
666 Grand Avenue
Des Moines, IA 50309

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Heartland Financial USA, Inc.:

We have audited the accompanying consolidated balance sheets of Heartland Financial USA, Inc. and subsidiaries (the Company) as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heartland Financial USA, Inc. and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. As discussed in note one to the consolidated financial statements, the Company changed its method of accounting for goodwill in 2002.

KPMG LLP

Des Moines, Iowa
January 17, 2003

SELECTED FINANCIAL DATA

For the years ended December 31, 2002, 2001, 2000, 1999 and 1998 (Dollars in thousands, except per share data)

	2002	2001	2000	1999	1998
Statement of Income Data:					
Interest income	$ 100,012	$ 107,609	$ 102,535	$ 74,119	$ 64,517
Interest expense	42,332	58,620	58,678	40,830	36,304
Net interest income	57,680	48,989	43,857	33,289	28,213
Provision for loan and lease losses	3,553	4,258	2,976	2,550	951
Net interest income after provision for loan and lease losses	54,127	44,731	40,881	30,739	27,262
Noninterest income	32,757	30,261	26,979	25,423	17,297
Noninterest expense	62,771	58,333	54,070	44,571	31,781
Income taxes	7,523	5,530	4,211	3,239	3,757
Income from continuing operations	$ 16,590	$ 11,129	$ 9,579	$ 8,352	$ 9,021
Discontinued operations:					
Income (loss) from operations of discontinued branch (including gain on sale of $2,602)	3,751	469	12	(210)	–
Income taxes	1,474	184	5	(83)	–
Income (loss) on discontinued operations	$ 2,277	285	7	(127)	–
Net income	$ 18,867	$ 11,414	$ 9,586	$ 8,225	$ 9,021
Per Common Share Data:					
Net income – diluted	$ 1.91	$ 1.18	$ 0.98	$ 0.84	$ 0.94
Income from continuing operations – diluted[(1)]	1.68	1.15	0.98	0.86	0.94
Adjusted net income – diluted[(2)]	1.91	1.28	1.09	0.89	0.96
Adjusted income from continuing operations – diluted[(3)]	1.68	1.26	1.09	0.91	0.96
Cash dividends	0.40	0.37	0.36	0.34	0.31
Dividend payout ratio	20.81%	31.19%	36.15%	39.47%	32.48%
Book value	$ 12.60	$ 11.06	$ 10.00	$ 9.03	$ 8.84
Weighted average shares outstanding	9,791,549	9,602,520	9,628,038	9,555,194	9,463,313
Balance Sheet Data:					
Investments and federal funds sold	$ 424,514	$ 349,417	$ 274,365	$ 213,452	$ 259,964
Total loans and leases, net of unearned	1,175,236	1,105,205	1,042,096	835,146	590,133
Allowance for loan and lease losses	16,091	14,660	13,592	10,844	7,945
Total assets	1,785,979	1,644,064	1,466,387	1,184,147	953,785
Total deposits	1,337,985	1,205,159	1,101,313	869,659	717,877
Long-term obligations	161,379	143,789	102,856	105,737	80,016
Stockholders' equity	124,041	107,090	96,146	86,573	84,270
Earnings Performance Data:					
Return on average total assets	1.13%	0.72%	0.70%	0.78%	1.01%
Return on average stockholders' equity	16.44	11.32	10.69	9.61	11.26
Net interest margin ratio[(1)(4)]	4.04	3.67	3.74	3.64	3.58
Earnings to fixed charges:					
Excluding interest on deposits	3.28x	2.27x	1.87x	2.18x	2.65x
Including interest on deposits	1.57	1.28	1.23	1.28	1.35
Asset Quality Ratios:					
Nonperforming assets to total assets	0.29%	0.52%	0.51%	0.19%	0.28%
Nonperforming loans and leases to total loans and leases	0.38	0.73	0.65	0.20	0.30
Net loan and lease charge-offs to average loans and leases	0.16	0.30	0.17	0.06	0.07
Allowance for loan and lease losses to total loans and leases	1.37	1.33	1.30	1.30	1.35
Allowance for loan and lease losses to nonperforming loans and leases	358.77	180.47	201.60	657.49	453.74
Capital Ratios:					
Average equity to average assets	6.86%	6.47%	6.54%	8.12%	9.01%
Total capital to risk-adjusted assets	11.86	10.89	9.90	11.68	12.13
Tier 1 leverage	8.24	7.53	7.25	8.85	8.58

(1) Excludes the discontinued operations of our Eau Claire branch and the related gain on sale in the fourth quarter of 2002.

(2) Excludes goodwill amortization discontinued with the adoption of FAS 142 on January 1, 2002, and the adoption of FAS 147 on September 30, 2002.

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

(4) Tax equivalent using a 34% tax rate.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following presents management's discussion and analysis of the consolidated financial condition and results of operations of Heartland Financial USA, Inc. ("Heartland") as of the dates and for the periods indicated. This discussion should be read in conjunction with the Selected Financial Data, Heartland's Consolidated Financial Statements and the Notes thereto and other financial data appearing elsewhere in this report. The consolidated financial statements include the accounts of Heartland and its subsidiaries. All of Heartland's subsidiaries are wholly-owned except for New Mexico Bank & Trust, of which Heartland was an 86% owner on December 31, 2002.

Overview

Heartland is a diversified financial services holding company providing full-service community banking through six banking subsidiaries with a total of 33 banking locations in Iowa, Illinois, Wisconsin and New Mexico. In addition, Heartland has separate subsidiaries in the consumer finance, vehicle leasing/fleet management, insurance agency and investment management businesses. Heartland's primary strategy is to balance its focus on increasing profitability with asset growth and diversification through acquisitions, *de novo* bank formations, branch openings and expansion into non-bank subsidiary activities.

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

The year 2002 was the third consecutive year Heartland was able to record double-digit growth in earnings. Net income increased $7.5 million or 65% when compared to 2001. Return on common equity was 16.44% and return on assets was 1.13%. The Eau Claire branch of Wisconsin Community Bank, a bank subsidiary of Heartland, was sold effective December 15, 2002. This discontinued operation contributed net income of $2.3 million, or $.23 on a diluted earnings per common share basis, during 2002, which includes a $1.6 million gain on disposal, net of taxes. Exclusive of the Eau Claire branch, income from continuing operations totaled $16.6 million, or $1.68 on a diluted per common share basis, compared to $11.1 million, or $1.15 on a diluted per common share basis, during 2001, an increase of $5.5 million or 49%. The 2002 results reinforce and encourage our community banking approach.

The largest contributor to the improved earnings during 2002 was net interest income, which grew $8.7 million or 18%. Average earning assets from continuing operations rose from $1.363 billion during 2001 to $1.467 billion during 2002, a change of $103.2 million or 8%. The $705 thousand or 17% decrease in provision for loan and lease losses also contributed to the improved earnings for 2002. Additionally, noninterest income experienced a $3.3 million or 11% increase, exclusive of securities gains and losses, including impairment losses on equity securities and trading account securities gains and losses, and valuation adjustments on mortgage servicing rights. In addition to gains on sale of loans, the other noninterest income category to reflect significant improvement was service charges and fees. Noninterest expense was held to a $4.4 million or 8% increase.

Heartland's adoption of the provisions of Statement of Financial Accounting Standards ("FAS") 142, "Goodwill and Other Intangible Assets," on January 1, 2002, discontinued the amortization of $9.5 million in unamortized goodwill. Heartland's adoption of the provisions of FAS 147, "Acquisitions of Certain Financial Institutions," on September 30, 2002, discontinued the amortization of $6.6 million in unamortized other intangibles retroactively to January 1, 2002. The amount of amortization expense recorded during 2001 on this goodwill and other intangibles was $1.1 million, or $.11 on a diluted per common share basis.

A majority of the $142 million or 9% growth in total assets since year-end 2001 occurred during the last half of the year. Loans and leases were $1.175 billion and deposits were $1.338 billion at the end of 2002, an increase of 6% and 11%, respectively, since year-end 2001. Commercial and agricultural loan growth was $92 million or 14% and $10 million or 7%, respectively, during 2002. A portion of this growth was offset by the $23 million or 14% decrease in the mortgage loan portfolio due to paydowns experienced as customers continued to refinance their mortgage loans into fifteen- and thirty-year fixed rate loans, which Heartland usually sells into the secondary market.

For the year ended December 31, 2001, income from continuing operations totaled $11.1 million, an increase of $1.6 million or 16% when compared to the net income of $9.6 million recorded in 2000. Diluted earnings per common share grew to $1.15 from the $.98 recorded during 2000. Return on common equity was 11.32% and return on assets was .72% for 2001, compared to 10.69% and .70%, respectively, for 2000. Contributing to the increased earnings during 2001 was the $5.1 million or 12% increase in net interest income from continuing operations, due in large part to growth in average earning assets. Noninterest income experienced a $3.3 million or 12% increase, primarily due to additional gains on sale of loans and service charges and fees. As interest rates moved downward throughout 2001, customers frequently elected to refinance into fifteen- and thirty-year, fixed-rate mortgage loans, which Heartland usually elects to sell into the secondary market while retaining servicing.

Total assets reached $1.644 billion at year-end 2001, an increase of $178 million or 12% over year-end 2000. Even though the economy weakened throughout 2001, Heartland was able to grow its loan portfolio by $63 million or 6% and its deposit account balances by $104 million or 9% in 2001.

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 practice for Heartland. The allowance for loan and lease losses represents management's estimate of identified and unidentified losses in the existing loan portfolio. Thus, the accuracy of this estimate could have a material impact on Heartland's earnings. The adequacy of the allowance for loan and lease losses is determined using factors that include the overall composition of the loan portfolio, general economic conditions, types of loans, past loss experience, loan delinquencies, and potential substandard and doubtful credits. 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 board of directors. Factors considered by the loan review committee included the following:

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

There can be no assurances that the allowance for loan and lease losses will be adequate to cover all losses, but management believes that the allowance for loan and lease losses was adequate at December 31, 2002. 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. Along with other financial institutions, management shares a concern for the outlook of the economy during 2003. Even though there have been various signs of emerging strength, it is not certain that this strength will be sustainable. Consumer confidence plunged to a nine-year low during 2002. Should the economic climate continue to deteriorate, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs, and delinquencies could rise and require further increases in the provision for loan and lease losses. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan and lease losses carried by the Heartland subsidiaries. Such agencies may require Heartland to make additional provisions to the allowance based upon their judgment about information available to them at the time of their examinations.

The table below estimates the theoretical range of the 2002 allowance outcomes and related changes in provision expense assuming either a reasonably possible deterioration in loan credit quality or a reasonably possible improvement in loan credit quality.

Theoretical Range of Allowance for Loan and Lease Losses

(Dollars in thousands)

Allowance for loan and lease losses at December 31, 2002	$ 16,091
Assuming deterioration in credit quality:	
Addition to provision	1,649
Resultant allowance for loan and lease losses	$ 17,740
Assuming improvement in credit quality:	
Reduction in provision	(1,154)
Resultant allowance for loan and lease losses	$ 14,937

The assumptions underlying this sensitivity analysis represent an attempt to quantify theoretical changes that could occur in the total allowance for loan and lease losses given various economic assumptions that could impact inherent loss in the loan and lease portfolio as currently configured. It further assumes that the general composition of the allowance for loans and lease losses determined through Heartland's existing process and methodology remains relatively unchanged. It does not attempt to encompass extreme and/or prolonged economic downturns, systemic contractions to specific industries, or systemic shocks to the financial services sector. A downward/upward migration of the balances from the current loan grade to the next lower/higher loan grade was assumed based upon Heartland's experiences during previous periods of economic movement.

Results of Operations
Net Interest Income

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

Net interest margin from continuing operations, expressed as a percentage of average earning assets, was 4.04% for the year 2002 compared to 3.67% for the year 2001. Heartland has been successful in the utilization of floors on its commercial loan portfolio to minimize the effect downward rates have on its interest income. If rates begin to edge upward, Heartland will not see a corresponding increase in its interest income until rates have moved above the floors in place on these loans. Interest income as a percentage of average earning assets went from 7.97% during 2001 to 6.93% during 2002, a decline of 104 basis points. Additionally, on the liability side of the balance sheet, Heartland has locked in some funding in the three- to five-year maturities as rates were at historical low levels. Interest expense as a percentage of average earning assets went from 4.30% during 2001 to 2.89% for 2002, a decline of 141 basis points.

Net interest margin from continuing operations, expressed as a percentage of average earning assets, decreased from 3.74% during 2000 to 3.67% during 2001. During 2000, the national prime rate increased from 8.50% at the beginning of the year to 9.50% at the end of the year. Conversely, during 2001, the national prime rate decreased from 9.50% to 4.75%. Management elected to remain competitive in the market areas it serves and not reprice its deposit products as quickly. In addition to the delay in repricing of deposit products, also negatively impacting the net interest margin was the change in the composition of the balance sheet, as the percentage of average loans to total average earning assets decreased from 80% in 2000 to 75% in 2001. Loan growth slowed due to paydowns experienced in the mortgage loan portfolio and reduced demand in the commercial loan portfolio.

Net interest income from continuing operations, on a fully tax equivalent basis, was $59.3 million, $50.1 million and $45.0 million for 2002, 2001 and 2000, respectively, an increase of 18% for 2002 and 11% for 2001. These increases were the largest contributors to the double-digit growth in earnings experienced during both years and were primarily attributable to the growth in earning assets and the ability to keep the increase in interest expense below the growth in interest income. Average earning assets from continuing operations grew $103 million or 8% and $162 million or 13% during 2002 and 2001, respectively.

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

ANALYSIS OF AVERAGE BALANCES, TAX EQUIVALENT YIELDS AND RATES[1]

For the years ended December 31, 2002, 2001 and 2000 (Dollars in thousands)

	2002			2001			2000		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
Earning Assets:									
Securities:									
Taxable	$ 305,315	$ 13,132	4.30%	$ 253,290	$ 14,143	5.58%	$ 189,610	$ 11,824	6.24%
Nontaxable[1]	52,756	4,177	7.92	30,909	2,712	8.77	31,026	2,748	8.86
Total securities	358,071	17,309	4.83	284,199	16,855	5.93	220,636	14,572	6.60
Interest bearing deposits	10,535	248	2.35	7,320	243	3.32	5,796	333	5.75
Federal funds sold	20,835	322	1.55	49,126	1,981	4.03	16,874	911	5.40
Loans and leases:									
Commercial and commercial real estate[1]	665,431	45,480	6.83	564,261	44,773	7.93	502,040	43,531	8.67
Residential mortgage	142,469	10,518	7.38	191,081	15,364	8.04	202,429	16,376	8.09
Agricultural and agricultural real estate[1]	150,485	10,941	7.27	139,421	11,767	8.44	133,043	11,848	8.91
Consumer	120,561	12,036	9.98	126,027	13,278	10.54	118,455	12,625	10.66
Direct financing leases, net	13,626	1,037	7.61	16,574	1,242	7.49	15,027	1,056	7.03
Fees on loans	–	3,694	–	–	3,197	–	–	2,400	–
Less: allowance for loan and lease losses	(15,309)	–	–	(14,528)	–	–	(12,984)	–	–
Net loans and leases	1,077,263	83,706	7.77	1,022,836	89,621	8.76	958,010	87,836	9.17
Total earning assets	1,466,704	101,585	6.93	1,363,481	108,700	7.97	1,201,316	103,652	8.63
Nonearning Assets:									
Assets of discontinued operation	31,525	–	–	31,951	–	–	18,777	–	–
Total nonearning assets	173,385	–	–	162,900	–	–	150,305	–	–
TOTAL ASSETS	**$ 1,671,614**	**$ 101,585**	**6.08%**	**$ 1,558,332**	**$ 108,700**	**6.98%**	**$ 1,370,398**	**$ 103,652**	**7.56%**
Interest Bearing Liabilities:									
Interest bearing deposits:									
Savings accounts	$ 477,484	$ 6,530	1.37%	$ 425,258	$ 11,858	2.79%	$ 382,365	$ 13,866	3.63%
Time, $100,000 and over	124,063	4,505	3.63	143,315	8,220	5.74	99,272	6,001	6.05
Other time deposits	459,638	20,360	4.43	441,325	25,705	5.82	399,952	23,274	5.82
Short-term borrowings	134,949	2,643	1.96	141,532	5,598	3.96	120,561	6,986	5.79
Other borrowings	135,365	8,294	6.13	106,267	7,239	6.81	113,706	8,551	7.52
Total interest bearing liabilities	1,331,499	42,332	3.18	1,257,697	58,620	4.66	1,115,856	58,678	5.26
Noninterest Bearing Liabilities:									
Noninterest bearing deposits	162,638	–	–	138,694	–	–	123,411	–	–
Liabilities of discontinued operation	31,525	–	–	31,951	–	–	18,777	–	–
Accrued interest and other liabilities	31,212	–	–	29,154	–	–	22,681	–	–
Total noninterest bearing liabilities	225,375	–	–	199,799	–	–	164,869	–	–
Stockholders' equity	114,740	–	–	100,836	–	–	89,673	–	–
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 1,671,614**	**$ 42,332**	**2.53%**	**$ 1,558,332**	**$ 58,620**	**3.76%**	**$ 1,370,398**	**$ 58,678**	**4.28%**
Net interest income[1]		**$ 59,253**			**$ 50,080**			**$ 44,974**	
Net interest income to total earning assets[1]			**4.04%**			**3.67%**			**3.74%**
Interest bearing liabilities to earning assets	**90.78%**			**92.24%**			**92.89%**		

[1] *Tax equivalent basis is calculated using an effective tax rate of 34%.*

Provision for Loan and Lease Losses

The allowance for loan and lease losses is established through a provision charged to expense to provide, in Heartland's opinion, an adequate allowance for loan and lease losses. The $3.6-million provision for loan losses made during 2002, a decrease of $705 thousand or 17% when compared to 2001, resulted primarily from a large recovery on a prior-year charge-off and a decrease in nonperforming loans. The provision for loan losses made during 2001 was $4.3 million, an increase of $1.3 million or 43% when compared to the $3.0 million provision made during 2000. Much of this increase was recorded in response to loan growth experienced and an increase in nonperforming loans. 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, past loss experience, loan delinquencies, and probable substandard and doubtful credits. A weak economy will inevitably result in increased problem loans, but Heartland expects the problems to be manageable and of a lesser scope for Heartland than for the industry as a whole. For additional details on the specific factors considered, refer to the critical accounting policies and allowance for loan and lease losses sections of this report.

Noninterest Income

For the years ended December 31, 2002, 2001 and 2000
(Dollars in thousands)

	2002	2001	2000
Service charges and fees	**$ 8,089**	$ 6,308	$ 5,357
Trust fees	**3,407**	3,148	3,088
Brokerage commissions	**658**	615	846
Insurance commissions	**765**	807	862
Securities gains, net	**790**	1,489	501
Loss on trading account securities	**(598)**	(417)	–
Impairment loss on equity securities	**(267)**	(773)	(244)
Rental income on operating leases	**14,602**	15,446	14,918
Gains on sale of loans	**4,656**	2,738	521
Valuation adjustment on mortgage servicing rights	**(469)**	–	–
Other noninterest income	**1,124**	900	1,130
TOTAL NONINTEREST INCOME	**$ 32,757**	**$ 30,261**	**$ 26,979**

The table above shows Heartland's noninterest income for the years indicated. Total noninterest income from continuing operations increased $2.5 million or 8% during 2002 and $3.3 million or 12% during 2001. Exclusive of valuation adjustments on mortgage servicing rights and securities gains and losses, including trading account securities losses and impairment losses on equity securities, noninterest income experienced a $3.3 million or 11% increase in 2002 and a $3.2 million or 12% increase in 2001. During both periods, the noninterest income categories reflecting significant improvement were gains on sale of loans and service charges and fees.

Emphasis during the past several years on enhancing revenues from services provided to customers has resulted in significant growth in service charges and fees. These fees increased $1.8 million or 28% during 2002 and $951 thousand or 18% during 2001. Average noninterest bearing checking account balances increased $23.9 million or 17% during 2002 and $15.8 million or 12% during 2001. The addition of an overdraft privilege feature to our checking account product line during the fall of 2001, along with growth in these noninterest bearing checking account balances, resulted in the generation of additional service charge revenue related to activity fees charged to these accounts. Service fees are also collected on the mortgage loans Heartland has sold into the secondary market while retaining servicing. Heartland's servicing portfolio grew from $183.9 million at year-end 2000 and $268.6 million at year-end 2001 to $395.1 million at December 31, 2002. Also contributing to the increase in service charges and fees was the growth in fees collected for the processing of merchant credit card activity.

Gains on sale of loans totaled $4.7 million during 2002, $2.7 million during 2001 and $521 thousand during 2000. During low-rate environments, customers frequently elect to take fifteen- and thirty-year, fixed-rate mortgage loans, which Heartland usually elects to sell into the secondary market. The lower volume of mortgage loans sold into the secondary market during 2000 was reflective of a higher rate environment in which customers elected to take three- and five-year adjustable rate mortgage loans, which Heartland elected to retain in its loan portfolio.

Securities gains were $790 thousand, $1.5 million and $501 thousand during 2002, 2001 and 2000, respectively. The continual decline of interest rates during 2001 provided an opportunity for Heartland to realize securities gains in its bond portfolio. As rates declined in 2001, Heartland's interest rate forecast changed to an upward bias and therefore, longer-term agency securities were sold at a gain to shorten the portfolio. In order to reduce the interest rate risk of rising interest rates, the proceeds were invested in well-seasoned premium mortgage-backed securities that were projected to outperform the agency securities in a rising interest rate environment.

Heartland elected to begin classifying some of its new equity securities purchases as trading during the first quarter of 2001. Losses on this portfolio totaled $598 thousand during 2002 compared to losses of $417 thousand during 2001. The losses primarily resulted from the decline in the stock market.

Impairment losses on equity securities totaled $267 thousand during 2002. These losses were related to the decline in market value on the common stock of three companies held in Heartland's available for sale equity securities portfolio. The carrying value of these stocks on Heartland's balance sheet at December 31, 2002, was $206 thousand. During 2001, impairment losses on equity securities totaled $773 thousand. Heartland was a limited partner in an investment partnership that had a portion of its funds invested in a company that filed bankruptcy under Chapter 11 in 2001. The impairment loss recorded on this investment totaled $700 thousand and reflected Heartland's 30% ownership. During 2002, Heartland began the process of divesting its interest in this partnership. The fair value of the remaining portion of Heartland's investment in this partnership at December 31, 2002, was $10 thousand. The remaining $73 thousand of impairment losses recorded during 2001 related to common stock held in the available for sale equity securities portfolio, all of which stock was sold during 2002. Similarly, during 2000, an impairment loss on equity securities of $244 thousand was recorded. This loss resulted from the announcement that Safety Kleen Corp. had filed bankruptcy under Chapter 11. Heartland held 20,000 shares of Safety Kleen's common stock in its equity portfolio, which stock was sold during 2002.

Valuation adjustments on mortgage servicing rights totaled a $469 thousand loss during 2002. The valuation of Heartland's mortgage servicing rights declined since year-end 2001 as a result of the further drop in mortgage loan interest rates. Heartland utilizes the services of an independent third-party to perform a valuation analysis of its servicing portfolio each quarter.

Noninterest Expense

For the years ended December 31, 2002, 2001 and 2000 (Dollars in thousands)

	2002	2001	2000
Salaries and employee benefits	**$ 28,571**	$ 25,182	$ 23,645
Occupancy	**3,178**	3,014	2,876
Furniture and equipment	**3,273**	3,144	2,989
Depreciation on equipment under operating leases	**11,555**	11,805	11,199
Outside services	**4,318**	3,433	2,634
FDIC deposit insurance assessment	**209**	208	228
Advertising	**1,917**	1,588	1,482
Goodwill amortization	**–**	1,057	1,057
Core deposit premium amortization	**495**	615	757
Other noninterest expense	**9,255**	8,287	7,203
TOTAL NONINTEREST EXPENSE	**$ 62,771**	**$ 58,333**	**$ 54,070**
Efficiency ratio[1]	68.81%	73.98%	75.67%

[1]Noninterest expense divided by the sum of net interest income and noninterest income less security gains.

The table above shows Heartland's noninterest expense for the years indicated. Noninterest expense from continuing operations increased $4.4 million or 8% in 2002 and $4.3 million or 8% in 2001. Growth in some of these expenses began to taper off in 2001 as Heartland began to realize the full utilization of the resources it expended during the early stages of its 1999 and 2000 growth initiatives.

Salaries and employee benefits expense, the largest component of noninterest expense, experienced increases of $3.4 million or 13% and $1.5 million or 7% during 2002 and 2001, respectively. In addition to normal merit increases, these increases were also attributable to expansion efforts, primarily at New Mexico Bank & Trust. The number of full-time equivalent employees increased from 544 at December 31, 2000, to 581 at December 31, 2001, and 606 at December 31, 2002.

Fees for outside services increased $885 thousand or 26% during 2002 and $799 thousand or 30% during 2001. Contributing to these increases were the following:

- A consultant was engaged to assist in the implementation of an overdraft privilege feature on Heartland's checking account products during 2001. The fee associated with these services was accrued and payable monthly during the last quarter of 2001 and throughout all of 2002 based upon the additional fees generated.
- Beginning in 2002, Heartland elected to engage Darling Consulting Group to provide balance sheet management advisory services. Included in these services are quarterly asset/liability management position assessments and strategy formulation.
- As on-line banking has grown in popularity, Heartland has incurred additional costs to provide this service to its customers.
- During 2002, legal fees were paid related to actions brought by Heartland to recover losses realized in an investment fund partnership, in which Heartland was a limited partner, and to resolve a dispute on the enforceability of a guarantee on a nonperforming commercial loan. Legal and professional fees related to Heartland's continuing exploration of potential acquisitions also were paid during 2001.
- Beginning in 2001, Heartland elected to outsource its internal audit function instead of fully staffing an internal audit department.
- As a result of enhancing the fleet card program at ULTEA, additional conversion costs were incurred during 2001.

During 2002, advertising/public relations expense increased $329 thousand or 21%. Dubuque Bank and Trust deposited $200 thousand into its charitable trust fund during 2002. This fund provides a source for future charitable giving.

Other noninterest expenses increased $968 thousand or 12% during 2002 and $1.1 million or 15% during 2001. A large portion of the 2002 increase was the result of additional processing fees related to increased activity in the merchant credit card processing area and additional minority interest related to the improved earnings at New Mexico Bank & Trust. During 2001, a large portion of the increase was also the result of additional processing fees related to increased activity in the merchant credit card processing area and growth in amortization and maintenance expense on software.

Heartland's adoption of the provisions of FAS 142 on January 1, 2002, and FAS 147 on September 30, 2002, discontinued the amortization of $16.1 million in unamortized goodwill. The amount of amortization expense recorded during both 2001 and 2000 on this goodwill was $1.1 million.

Income Taxes

Income tax expense increased $3.3 million or 57% for 2002 and $1.5 million or 36% for 2001, primarily as a result of increased pre-tax earnings. The discontinued operations and related gain on sale of our Eau Claire branch was responsible for $1.5 million or 45% of the 2002 increase in income taxes. Heartland's effective tax rate was 32.3% for 2002, 33.4% for 2001 and 30.5% for 2000. The effective tax rate grew in 2001, in part, as a result of the amount of additional merger-related goodwill and other intangibles amortization expense recorded that was not deductible for federal income tax purposes. These expenses grew as a percentage of pre-tax income from 4.26% in 2000 to 5.71% in 2001. Tax-exempt interest income on securities and loans as a percentage of pre-tax income has varied over the past several years. Tax-exempt interest income was 10% of pre-tax income during 2002 and 2001 compared to 13% for 2000. In April of 2002, Dubuque Bank and Trust acquired a 99.9% ownership in a limited liability company that owns a certified historic structure for which historic rehabilitation tax credits apply to the 2002 tax year.

Financial Condition
Lending Activities

Heartland's major source of income is interest on loans and leases. The following table presents the composition of Heartland's loan portfolio at the end of the years indicated.

Heartland experienced growth in net loans and leases during both 2002 and 2001. This growth was $68.6 million or 6% in 2002 and $62.0 million or 6% in 2001. Exclusive of the $30.0

LOAN PORTFOLIO

For the years ended December 31, 2002, 2001, 2000, 1999 and 1998 (Dollars in thousands)

	2002		2001		2000		1999		1998	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Commercial and commercial real estate	**$ 743,520**	**63.10%**	$ 651,479	58.73%	$ 550,366	52.62%	$ 448,991	53.53%	$ 277,765	46.88%
Residential mortgage	**145,931**	**12.39**	168,912	15.23	215,638	20.62	180,347	21.50	156,415	26.40
Agricultural and agricultural real estate	**155,596**	**13.21**	145,460	13.11	133,614	12.78	92,936	11.08	77,211	13.03
Consumer	**120,853**	**10.26**	127,874	11.53	128,685	12.30	103,608	12.35	72,642	12.26
Lease financing, net	**12,308**	**1.04**	15,570	1.40	17,590	1.68	12,886	1.54	8,508	1.43
Gross loans and leases	**1,178,208**	**100.00%**	1,109,295	100.00%	1,045,893	100.00%	838,768	100.00%	592,541	100.00%
Unearned discount	**(2,161)**		(3,457)		(3,397)		(3,169)		(2,136)	
Deferred loan fees	**(811)**		(633)		(400)		(453)		(272)	
Total loans and leases	**1,175,236**		1,105,205		1,042,096		835,146		590,133	
Allowance for loan and lease losses	**(16,091)**		(14,660)		(13,592)		(10,844)		(7,945)	
LOANS AND LEASES, NET	**$ 1,159,145**		**$ 1,090,545**		**$1,028,504**		**$ 824,302**		**$ 582,188**	

million loans included in the sale of the Eau Claire branch, net loans and leases grew by $98.6 million or 9% during 2002. This increase was attributable to growth in the commercial and agricultural loan portfolios and would have been more significant had the mortgage and consumer loan portfolios not experienced declines. Loan growth during 2001 was slower than during 2000 due to paydowns experienced in the mortgage loan portfolio and reduced demand in the commercial loan portfolio, particularly during the first half of the year. Growth in the commercial loan portfolio increased during the remaining half of 2001 and continued into 2002.

The largest growth occurred in commercial and commercial real estate loans, which increased $92.0 million or 14% during 2002 and $101.1 million or 18% during 2001. All the loans included in the Eau Claire branch sale were classified as commercial and commercial real estate. Exclusive of those loans, this category of the loan portfolio grew $122.0 million or 20%. All the bank subsidiaries, except for First Community Bank, experienced growth in this loan category, principally as a result of continued calling efforts.

Agricultural and agricultural real estate loans outstanding experienced an increase of $10.1 million or 7% during 2002. Over 75% of this growth occurred at Dubuque Bank and Trust Company, Heartland's flagship bank in Dubuque, Iowa. During 2001, agricultural and agricultural real estate loans outstanding grew $11.8 million or 9%, the majority of which occurred at New Mexico Bank & Trust's office in Clovis and at Dubuque Bank and Trust Company.

The residential mortgage loan portfolio experienced a decline of $23.0 million or 14% during 2002 and $46.7 million or 22% during 2001, as customers refinanced their mortgage loans into fifteen- and thirty-year fixed rate loans, which Heartland usually sells into the secondary market. Servicing is retained on a majority of these loans so that the Heartland bank subsidiaries have an opportunity to continue providing their customers the excellent service they expect. Heartland's servicing portfolio was $268.6 million at year-end 2001 and $395.1 million at December 31, 2002. During both years, long-term rates were at all-time lows and many customers were anxious to lock in these low rates for a longer period of time on their mortgage loans.

Consumer loan outstandings declined $7.0 million or 5% during 2002, as the economy continued to weaken and consumers were provided other sources of financing, e.g., zero percent automobile financing through dealerships. During 2001, consumer loan outstandings remained relatively flat, as the economy began to weaken and consumers were provided other sources of financing.

Although the risk of nonpayment for any reason exists with respect to all loans, specific risks are associated with each type of loan. The primary risks associated with commercial and agricultural loans are the quality of the borrower's management and the impact of national and regional economic factors. Additionally, risks associated with commercial and agricultural real estate loans include fluctuating property values and concentrations of loans in a specific type of real estate. Repayment on loans to individuals, including those on residential real estate, are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances and deteriorating economic conditions. Heartland monitors its loan concentrations and does not believe it has concentrations in any specific industry.

Heartland's strategy with respect to the management of these types of risks, whether loan demand is weak or strong, is to encourage the Heartland banks to follow tested and prudent loan policies and underwriting practices which include: (i) granting loans on a sound and collectible basis; (ii) ensuring that primary and secondary sources of repayment are adequate in relation to the amount of the loan; (iii) administering loan policies through a board of directors and an officers' loan committee; (iv) developing and maintaining adequate diversification of the loan portfolio as a whole and of the loans within each loan category; and (v) ensuring that each loan is properly documented and, if appropriate, guaranteed by government agencies and that insurance coverage is adequate.

NONPERFORMING ASSETS

For the years ended December 31, 2002, 2001, 2000, 1999 and 1998 (Dollars in thousands)

	2002	2001	2000	1999	1998
Nonaccrual loans and leases	**$ 3,944**	$ 7,269	$ 5,860	$ 1,414	$ 1,324
Loan and leases contractually past due 90 days or more	**541**	500	523	236	426
Restructured loans and leases	–	354	357	–	–
Total nonperforming loans and leases	**4,485**	8,123	6,740	1,650	1,750
Other real estate	**452**	130	489	514	832
Other repossessed assets	**279**	343	219	138	102
TOTAL NONPERFORMING ASSETS	**$ 5,216**	**$ 8,596**	**$ 7,448**	**$ 2,302**	**$ 2,684**
Nonperforming loans and leases to total loans and leases	**0.38%**	0.73%	0.65%	0.20%	0.30%
Nonperforming assets to total loans and leases plus repossessed property	**0.44%**	0.78%	0.71%	0.28%	0.45%
Nonperforming assets to total assets	**0.29%**	0.52%	0.51%	0.19%	0.28%

Nonperforming Loans and Leases and Other Nonperforming Assets

The table above sets forth the amounts of nonperforming loans and leases and other nonperforming assets on the dates indicated.

Under Heartland's internal loan review program, a loan review officer is responsible for reviewing existing loans and leases, identifying potential problem loans and leases and monitoring the adequacy of the allowance for loan and lease losses at the Heartland banks.

Heartland constantly monitors and continues to develop systems to oversee the quality of its loan portfolio. One integral part is a loan rating system, which assigns a rating on each loan and lease within the portfolio based on the borrower's financial position, repayment ability, collateral position and repayment history. This emphasis on quality is reflected in Heartland's credit quality figures, which compare favorably to peer data in the Bank Holding Company Performance Reports published by the Federal Reserve Board for bank holding companies with total assets of $1 to $3 billion. In this report, the peer group reported nonperforming assets to total assets of 0.63% and 0.59% for September 30, 2002, and December 31, 2001, respectively. Heartland's ratios at December 31, 2002 and 2001, were 0.29% and 0.52%, respectively.

Nonperforming loans, defined as nonaccrual loans, restructured loans and loans past due ninety days or more, decreased to .38% of total loans and leases at December 31, 2002, compared to .73% of total loans and leases at December 31, 2001. A portion of this decrease was the result of one large credit that was partially paid off. Nonperforming loans increased to 0.73% of total loans and leases at December 31, 2001, compared to 0.65% of total loans and leases at December 31, 2000. Contributing to this increase in nonperforming loans at year-end 2001 were a $1.4 million and $1.5 million increase at Wisconsin Community Bank and New Mexico Bank & Trust, respectively. These increases were attributable to a few large credits and not felt to be an indication of a trend in either of these newer markets for Heartland. These increases were offset by a $2.3 million reduction in nonperforming loans at Dubuque Bank and Trust Company, as payments totaling $1.5 million were received during the first quarter of 2001 and a $900 thousand charge-off was recorded during the last quarter of 2001 on the same credit. Workout plans are in process on a majority of Heartland's nonperforming loans and, because of the net realizable value of collateral, guarantees and other factors, anticipated losses on these credits are expected to be minimal. A weak economy will inevitably result in increased problem loans, but Heartland expects the problems to be manageable and of a lesser scope for Heartland than for the industry as a whole.

Allowance for Loan and Lease Losses

The process utilized by Heartland to estimate 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 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 increased by $1.4 million or 10% during 2002 and $1.1 million or 8% during 2001. The allowance for loan and lease losses at December 31, 2002, was 1.37% of loans and 359% of nonperforming loans, compared to 1.33% of loans and 180% of nonperforming loans, at year-end 2001. A portion of the growth in the allowance for loan and lease losses occurred as a result of the expansion of the loan portfolio during both years.

During 2002, Heartland recorded net charge-offs of $1.8 million compared to $3.2 million in 2001. The decrease in net charge-offs during 2002 was primarily the result of a large recovery on a prior year charge-off. Citizens Finance Co., Heartland's consumer finance subsidiary, experienced net charge-offs of $1.2 million or 66% of total net charge-offs during 2002 compared to $1.0 million or 32% during 2001. Increased losses at Citizens relate directly to the rapid growth it experienced during the previous two years with expansion into the Rockford, Illinois, market. Identification of problem loans in a portfolio begin to occur as the portfolio matures. Additionally, the weakened economy has affected the ability of borrowers to repay their consumer loans. Net losses as a percentage of average gross loans at Citizens were 5.17% for 2002 compared to 4.37% for 2001. Loans with payments past due for more than thirty days at Citizens remained constant at 5.30% of gross loans at December 31, 2001 and 5.27% at December 31, 2002.

The table at the top of the next page summarizes activity in the allowance for loan and lease losses for the years indicated, including amounts of loans and leases charged off, amounts of recoveries, additions to the allowance charged to income and the ratio of net charge-offs to average loans and leases outstanding.

ANALYSIS OF ALLOWANCE FOR LOAN AND LEASE LOSSES

For the years ended December 31, 2002, 2001, 2000, 1999 and 1998 (Dollars in thousands)

	2002	2001	2000	1999	1998
Allowance at beginning of year	**$ 14,660**	$ 13,592	$ 10,844	$ 7,945	$ 7,362
Charge-offs:					
Commercial and commercial real estate	**795**	1,477	407	81	289
Residential mortgage	**38**	32	54	–	20
Agricultural and agricultural real estate	**279**	463	580	8	41
Consumer	**2,085**	1,785	1,239	546	473
Lease financing	**6**	–	–	–	–
Total charge-offs	**3,203**	3,757	2,280	635	823
Recoveries:					
Commercial and commercial real estate	**836**	79	97	74	372
Residential mortgage	**8**	–	4	12	–
Agricultural and agricultural real estate	**177**	108	176	6	1
Consumer	**389**	355	308	151	82
Lease financing	–	–	–	–	–
Total recoveries	**1,410**	542	585	243	455
Net charge-offs[1]	**1,793**	3,215	1,695	392	368
Provision for loan and lease losses from continuing operations	**3,553**	4,258	2,976	2,550	951
Provision for loan and lease losses from discontinued operations	**(329)**	25	325	76	–
Additions related to acquisitions	–	–	1,142	665	–
ALLOWANCE AT END OF PERIOD	**$ 16,091**	**$ 14,660**	**$ 13,592**	**$ 10,844**	**$ 7,945**
NET CHARGE-OFFS TO AVERAGE LOANS AND LEASES	**0.16%**	**0.30%**	**0.17%**	**0.06%**	**0.07%**

[1]Includes net charge-offs at Citizens Finance, Heartland's consumer finance company, of $1,182 for 2002, $1,043 for 2001, $614 for 2000, $256 for 1999 and $278 for 1998.

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 22% of total assets at December 31, 2002, as compared to 20% at December 31, 2001. As loan growth lagged deposit growth during the first half of 2002, the amount of securities held in Heartland's portfolio was increased. Additionally, Heartland increased its securities portfolio as opposed to holding excess liquidity in lower-yielding federal funds sold.

During 2002, management changed the composition of the securities portfolio. Additional paydowns received on mortgage-backed securities were replaced with short-term U.S. government agency securities and municipal securities. Management purchased some longer-term municipal securities to take advantage of the unusually steep slope in the yield curve and the spread of the tax-equivalent yield on municipal securities over the yield on agency securities with the same maturities. Also to improve net interest margin, management elected to reduce its fed funds and money market instruments position and invest in short-term U.S. treasury and government agency securities.

During 2001, as Heartland's interest rate forecast changed to one of rising rates, except for the short end of the yield curve, management elected to shift a portion of its securities portfolio into mortgage-backed securities from U.S. government agencies. Tightly structured tranches in well-seasoned mortgage-backed securities were purchased to enhance the performance of the portfolio given a rise in interest rates.

Heartland implemented Statement of Financial Accounting Standards 133, "Accounting for Derivative Instruments and Hedging Activities," on January 1, 2001. At that date, all investments previously included in Heartland's held to maturity investment portfolio were reclassified to the available for sale investment portfolio. The table below presents the composition of the securities portfolio by major category.

SECURITIES PORTFOLIO COMPOSITION

For the years ended December 31, 2002, 2001 and 2000 (Dollars in thousands)

	2002		2001		2000	
	Amount	% of Portfolio	Amount	% of Portfolio	Amount	% of Portfolio
U. S. government corporations, agencies and treasuries	**$ 101,339**	**25.99%**	$ 79,234	24.48%	$ 118,897	52.13%
Mortgage-backed securities	**187,318**	**48.04**	183,661	56.74	53,407	23.42
States and political subdivisions	**71,391**	**18.31**	30,948	9.56	34,044	14.93
Other securities	**29,852**	**7.66**	29,846	9.22	21,717	9.52
TOTAL	**$ 389,900**	**100.00%**	**$ 323,689**	**100.00%**	**$ 228,065**	**100.00%**

Deposits and Borrowed Funds

Total average deposits experienced an increase of $99.4 million or 9% during 2002 compared to an increase of $144.2 million or 14% during 2001. Total average deposits were $1.252 billion during 2002, $1.153 billion during 2001 and $1.009 billion during 2000. The Eau Claire branch sale included deposits of $6.7 million. Exclusive of those deposits, growth in average deposits was $106.1 million or 9% during 2002. Increases in total deposits occurred at all of the bank subsidiaries except for First Community Bank.

All deposit categories, except for time deposits over $100,000, experienced growth during 2002. Average demand deposit account balances increased $24.4 million or 17%. All the Heartland bank subsidiaries experienced double-digit growth in these balances except for First Community Bank. Average savings deposit account balances increased by $60.8 million or 14% and average time deposits under $100,000 grew by $33.3 million or 8% during 2002. With the continued instability in the equity markets, many customers have elected to keep funds on deposit in financial institutions. Additionally, as long-term rates have continued at all-time lows, efforts were focused at attracting customers into certificates of deposit with a maturity exceeding two years. A portion of the growth in certificate of deposit account balances was also attributable to the implementation of a balance sheet management strategy that included the acquisition of brokered deposits. Average balances in time deposits over $100,000 decreased during 2002 by $19.1 million or 13%. These accounts are typically obtained via a bidding process and Heartland management elected to not aggressively pursue these deposits.

During 2001, the demand and savings deposit categories experienced growth in excess of 10% and most of this growth was reflective of increased marketing efforts and customers' election to keep funds on deposit in a financial institution as the volatility in the stock market continued. Half of the $15.8 million or 13% growth in average demand deposits occurred at New Mexico Bank & Trust in Albuquerque, New Mexico. The $42.9 million or 11% growth in average savings deposits resulted from growth in all of the markets served by the Heartland banks. The money market product line was enhanced during 2000 and much of the growth in savings was attributable to marketing efforts focused on attracting new customers into this product line, as well as, customers' election to keep funds on deposit in a financial institution as the volatility in the stock market continued. Average time deposits grew by $85.5 million or 17%. Again, all the Heartland banks experienced growth in this deposit category. As long-term rates moved downward during 2001, efforts were initiated to attract customers into certificates of deposit with a maturity exceeding two years.

The table below sets forth the distribution of Heartland's average deposit account balances and the average interest rates paid on each category of deposits for the years indicated.

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 year-end 2002, the $161.4 million of short-term borrowings was consistent with the $160.7 million outstanding at year-end 2001.

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 repurchase agreements is subject to variation, the account relationships represented by these balances are principally local. These balances declined $9.6 million since year-end 2001 as interest rates continued at all-time low levels and some of these repurchase agreement customers elected to invest a portion of their excess funds in higher-yielding products. From year-end 2000 to year-end 2001, these balances grew from $93.0 million to $108.6 million, principally as a result of the entry into new markets.

Also included in short-term borrowings are the credit lines Heartland entered into with two unaffiliated banks. Under the unsecured credit lines, Heartland may borrow up to $50.0 million. At December 31, 2002, $25.0 million was outstanding as compared to $29.2 million at December 31, 2001.

Other borrowings include all debt arrangements Heartland and its subsidiaries have entered into with original maturities that extend beyond one year. These borrowings were $126.3 million on December 31, 2002, compared to $143.8 million on December 31, 2001. The change in these account balances primarily resulted from activity in the bank subsidiaries' borrowings from the FHLB. All of the Heartland banks own stock in the FHLB of Des Moines, Chicago or Dallas, enabling them to borrow funds from their respective FHLB for short- or long-term purposes under a variety of programs. Total FHLB borrowings at December 31, 2002, and December 31, 2001, were $72.5 million and $86.5 million, respectively. Substantially all of these borrowings are fixed-rate advances for original terms between three and five years. As advance rates moved downward during 2001 to historically low levels, Heartland elected to obtain additional advances to lock in funding for anticipated fixed-rate commercial loan growth and replace the maturity of advances during the first half of 2002.

AVERAGE DEPOSITS

For the years ended December 31, 2002, 2001 and 2000 (Dollars in thousands)

	2002			2001			2000		
	Average Balance	% of Deposits	Rate	Average Balance	% of Deposits	Rate	Average Balance	% of Deposits	Rate
Demand deposits	$ 164,280	13.12%	–%	$ 139,870	12.13%	–%	$ 124,117	12.30%	–%
Savings accounts	488,756	39.03	1.37	427,953	37.13	2.80	385,047	38.18	3.61
Time deposits less than $100	474,817	37.92	4.41	441,505	38.30	5.82	400,096	39.67	5.82
Time deposits of $100 or more	124,321	9.93	3.62	143,429	12.44	5.74	99,322	9.85	6.04
TOTAL DEPOSITS	$ 1,252,174	100.00%		$ 1,152,757	100.00%		$ 1,008,582	100.00%	

Additionally, balances outstanding on capital securities issued by Heartland are included in total other borrowings. The issuance in October of 1999 for $25.0 million bears an annual rate of 9.60% and matures on September 30, 2029. A private placement offering for $8.0 million was completed in December of 2001. This variable rate issuance matures on December 18, 2031, and bears interest at the rate of 3.60% per annum over the three-month LIBOR rate, as calculated each quarter. An additional private placement offering for $5.0 million was completed in June of 2002. This additional variable rate issuance matures on June 30, 2032, and bears interest at the rate of 3.65% per annum over the three-month LIBOR rate, as calculated each quarter.

The following table summarizes significant contractual obligations and other commitments as of December 31, 2002:

(Dollars in thousands)

		Payments Due By Period			
	Total	**Less Than One Year**	**One–Three Years**	**Three–Five Years**	**More Than Five Years**
Contractual obligations:					
Long-term debt obligations	**$ 126,299**	$ 10,157	$ 46,824	$ 20,578	$ 48,740
Operating lease obligations	**3,277**	536	1,258	772	711
Purchase obligations	**4,469**	3,845	624	–	–
Other long-term liabilities	**4,359**	–	3,610	–	749
Total contractual obligations	**$ 138,404**	**$ 14,538**	**$ 52,316**	**$ 21,350**	**$ 50,200**
Other commitments:					
Lines of credit	**$ 391,144**	$ 237,849	$ 57,398	$ 17,433	$ 78,464
Standby letters of credit	**11,803**	9,543	307	55	1,898
Other commitments	**21,418**	21,418	–	–	–
Total other commitments	**$ 424,365**	**$ 268,810**	**$ 57,705**	**$ 17,488**	**$ 80,362**

Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Capital Resources

Heartland's risk-based capital ratios, which take into account the different credit risks among banks' assets, met all capital adequacy requirements over the past three years. Tier 1 and total risk-based capital ratios were 10.65% and 11.86%, respectively, on December 31, 2002, compared with 9.71% and 10.89%, respectively, on December 31, 2001, and 8.74% and 9.90%, respectively, on December 31, 2000. At December 31, 2002, Heartland's leverage ratio, the ratio of Tier 1 capital to total average assets, was 8.24% compared to 7.53% and 7.25% at December 31, 2001 and 2000, respectively. 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.

Commitments for capital expenditures are an important factor in evaluating capital adequacy. In February of 2003, Heartland entered into an agreement with a group of Arizona business leaders to establish a new bank in Mesa. Pending regulatory approval, the new bank is expected to begin operations in the summer of 2003. Heartland's portion of the $15.0 million initial capital investment is $12.0 million, of which $500 thousand has already been advanced. Heartland intends to fund this transaction through its revolving credit line.

As a result of the acquisition of National Bancshares, Inc., the one-bank holding company of First National Bank of Clovis, remaining requisite cash payments under the notes payable total $637 thousand in 2003 and 2004, plus interest at 7.00%. Immediately following the closing of the acquisition, the bank was merged into New Mexico Bank & Trust. As a result of this affiliate bank merger, Heartland's ownership in New Mexico Bank & Trust increased to approximately 88%.

In June of 2000, Heartland offered a portion of its shares of New Mexico Bank & Trust's common stock to interested investors. In no case would Heartland's interest be allowed to fall below 80%. All minority stockholders, including the initial investors, entered into a stock transfer agreement before shares were issued to them. This stock transfer agreement imposes certain restrictions on the investor's sale, transfer or other disposition of their shares and requires Heartland to repurchase the shares from the investor on April 9, 2003. As of December 31, 2002, Heartland's ownership in New Mexico Bank & Trust was 86%.

Heartland has an incentive compensation agreement with certain employees of one of the bank subsidiaries, none of whom is an executive officer of Heartland, that requires a total payment of $3.6 million to be made no later than February 29, 2004, to those who remain employed with the subsidiary on December 31, 2003. Additionally, each employee is bound by a confidentiality and non-competition agreement. One-third of the payment will be made in cash and the remaining two-thirds in shares of Heartland's common stock. The obligation is being accrued over the performance period.

On June 27, 2002, Heartland completed a private placement offering of $5.0 million of variable rate cumulative capital securities representing undivided beneficial interests in Heartland Financial Capital Trust II, a special purpose trust subsidiary formed for the sole purpose of this offering. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. The proceeds were used by Heartland for general corporate purposes. The debentures will mature and the capital securities must be redeemed on June 30, 2032. Heartland has the option to shorten the maturity date to a date not earlier than June 30, 2007. All of these securities qualified as Tier 1 capital for regulatory purposes as of December 31, 2002.

On December 18, 2001, Heartland completed a private placement offering of $8.0 million of variable rate cumulative capital securities representing undivided beneficial interests in Heartland Financial Statutory Trust II, a special purpose trust subsidiary formed for the sole purpose of this offering. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. The proceeds were used by Heartland for general corporate purposes. The debentures will mature and the capital securities must be redeemed on December 18, 2031. Heartland has the option to shorten the maturity date to a date not earlier than December 18, 2006. All of these securities qualified as Tier 1 capital for regulatory purposes as of December 31, 2002.

In October of 1999, Heartland completed an offering of $25.0 million of 9.60% cumulative capital securities representing undivided beneficial interests in Heartland Capital Trust I, a special purpose trust subsidiary formed for the sole purpose of this offering. The proceeds from the offering were used by the trust to purchase junior subordinated debentures from Heartland. The proceeds were used by Heartland for general corporate purposes. The debentures will mature and the capital securities must be redeemed on September 30, 2029. Heartland has the option to shorten the maturity date to a date not earlier than September 30, 2004. All of these securities continued to qualify as Tier 1 capital for regulatory purposes as of December 31, 2002.

Expansion efforts are underway at Wisconsin Community Bank, as it committed to the construction of a three-story, 20,000-square-foot building in Fitchburg, a suburb southwest of Madison. The bank will occupy the first floor and financially related companies or law offices will occupy the top two floors. Wisconsin Community Bank's share of the construction costs on this project is estimated at $2.5 million. This project is well underway with completion targeted for March of 2003.

Plans for the renovation and construction of a 50,000-square-foot facility to accommodate the operations and support functions of Heartland are underway. Property in downtown Dubuque, Iowa, across the street from Dubuque Bank and Trust's main facility, has been purchased. The $4.5 million project has begun with completion anticipated next winter. A reduction in overall costs on this project will result from tax credits and other incentives made available on the project as it includes the rehabilitation of two historical structures and the creation of new jobs.

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. Representative of this was the entrance into a new market at the beginning of 2003 by our bank subsidiary in New Mexico with the opening of a branch in Santa Fe. Future expenditures relating to these efforts are not estimable at this time.

Other Developments

At its regular board meeting held on January 21, 2003, Heartland appointed John W. Cox Jr. as a director. Mr. Cox is a partner with the law firm of Cox and Ward, P.C. in Galena, Illinois, and a former Member of the U.S. House of Representatives from Illinois' 16th District. He serves on the board of directors of Galena State Bank and Trust, a Heartland bank subsidiary. Mr. Cox's appointment fills the vacancy created last January by the resignation of Gregory R. Miller. At Heartland's annual stockholders meeting in May, Mr. Cox will stand for election to a full term.

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.

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.

Heartland's revolving credit agreements provide a maximum borrowing capacity of $50.0 million. As of December 31, 2002, these credit agreements provided an additional borrowing capacity of $25.0 million. These agreements contain specific covenants which, among other things, limit dividend payments and restrict the sale of assets by Heartland under certain circumstances. Also contained within the agreements 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 December 31, 2002, Heartland was in compliance with the covenants contained in these credit agreements.

Market Risk Management

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.

Heartland 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 management team and board of directors. Darling Consulting Group, Inc. has been engaged to provide asset/liability management position assessment and strategy formulation services to Heartland and its bank subsidiaries. At least quarterly, a detailed

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
TABLE OF MARKET RISK SENSITIVE INSTRUMENTS

The following table presents the expected maturity of market risk sensitive instruments at December 31, 2002 (Dollars in thousands)

Maturing in:	2003	2004	2005	2006	2007	Thereafter	Total	Average Interest Rate	Estimated Fair Value
Assets:									
Federal funds sold and other short-term investments	$ 39,886	$ –	$ –	$ –	$ –	$ –	$ 39,886	1.09%	$ 39,886
Time deposits in other financial institutions	587	–	1,090	–	–	–	1,677	6.14	1,677
Trading securities	–	–	–	–	–	915	915	1.22	915
Securities available for sale	98,432	76,167	64,109	27,059	7,261	116,872	389,900	5.39	389,900
Loans and leases:									
Fixed rate loans	198,504	128,673	120,320	60,390	51,090	54,614	613,591	7.58	656,755
Variable rate loans	232,712	71,125	59,118	34,711	49,366	114,613	561,645	5.99	568,657
Loans and leases, net	431,216	199,798	179,438	95,101	100,456	169,227	1,175,236		1,225,412
TOTAL MARKET RISK SENSITIVE ASSETS	**$ 570,121**	**$ 275,965**	**$ 244,637**	**$122,160**	**$ 107,717**	**$ 287,014**	**$ 1,607,614**		**$ 1,657,790**
Liabilities:									
Savings	$ 511,979	$ –	$ –	$ –	$ –	$ –	$ 511,979	1.04%	$ 511,979
Time deposits									
Fixed rate time certificates less than $100,000	208,531	86,806	76,889	25,343	91,636	434	489,639	3.93	521,024
Variable rate time certificates less than $100,000	8,389	4,227	5	2	–	–	12,623	3.62	12,623
Time deposits less than $100,000	216,920	91,033	76,894	25,345	91,636	434	502,262		533,647
Time deposits of $100,000 or more	96,310	12,741	6,656	1,936	8,585	–	126,228	3.10	129,603
Federal funds purchased, securities sold under repurchase agreements and other short-term borrowings	161,379	–	–	–	–	–	161,379	1.39	161,379
Other borrowings:									
Fixed rate borrowings	10,157	22,659	24,165	20,538	40	35,740	113,299	6.10	152,133
Variable rate borrowings	–	–	–	–	–	13,000	13,000	5.02	13,000
Other borrowings	10,157	22,659	24,165	20,538	40	48,740	126,299		165,133
TOTAL MARKET RISK SENSITIVE LIABILITIES	**$ 996,745**	**$ 126,433**	**$ 107,715**	**$ 47,819**	**$ 100,261**	**$ 49,174**	**$ 1,428,147**		**$ 1,501,741**

review of Heartland's and each of the 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. Through the use of these tools, Heartland has determined that the balance sheet is structured such that changes in net interest margin in response to changes in interest rates would be minimal, all other factors being held constant. Management does not believe that Heartland's primary market risk exposures and how those exposures were managed in 2002 have materially changed when compared to 2001.

Derivative financial instruments include futures, forwards, interest rate swaps, option contracts and other financial instruments with similar characteristics. Heartland's use of derivative financial instruments relates to the management of the risk that changes in interest rates will affect its future interest payments. Heartland utilizes an interest rate swap contract to effectively convert a portion of its variable rate interest rate debt to fixed interest rate debt. Under the interest rate swap contract, Heartland agrees to pay an amount equal to a fixed rate of interest times a notional principal amount, and to receive in return an amount equal to a specified variable rate of interest times the same notional principal amount. The notional amounts are not exchanged and payments under the interest rate swap contract are made monthly. Heartland is exposed to credit-related losses in the event of nonperformance by the counterparty to the swap contract, which has been minimized by entering into the contract with a large, stable financial institution. As of December 31, 2002, Heartland had an interest rate swap contract to pay a fixed rate of interest and receive a variable rate of interest on $25.0 million of indebtedness. This contract expires on November 1, 2006. The fair market value of the interest rate swap contract was recorded as a liability in the amount of $1.7 million as of December 31, 2002.

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

Effects of Inflation

Consolidated financial data included in this report has been prepared in accordance with generally accepted accounting principles. Presently, these principles require reporting of financial position and operating results in terms of historical dollars, except for available for sale securities, trading securities and derivative instruments, which require reporting at fair value. Changes in the relative value of money due to inflation or recession are generally not considered.

In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not change at the same rate or in the same magnitude as the inflation rate. Rather, interest rate volatility is based on changes in the expected rate of inflation, as well as on changes in monetary and fiscal policies. A financial institution's ability to be relatively unaffected by changes in interest rates is a good indicator of its capability to perform in today's volatile economic environment. Heartland seeks to insulate itself from interest rate volatility by ensuring that rate-sensitive assets and rate-sensitive liabilities respond to changes in interest rates in a similar time frame and to a similar degree.

Controls and Procedures

Based upon an evaluation within the 90 days prior to the filing date of this report, Heartland's Chief Executive Officer and Chief Financial Officer concluded that Heartland's disclosure controls and procedures are effective. There have been no significant changes in Heartland's internal controls or in other factors that could significantly affect Heartland's internal controls subsequent to the date of the evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Safe Harbor Statement

This report (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. Factors which could have a material adverse effect on the operations and future prospects of Heartland and its subsidiaries include, but are not limited to, the following:

- The strength of the United States economy in general and the strength of the local economies in which Heartland conducts its operations which may be less favorable than expected and may result in, among other things, a deterioration in the credit quality and value of Heartland's assets.
- The economic impact of past and any future terrorist threats and attacks, acts of war or threats thereof, and the response of the United States to any such threats and attacks.
- The effects of, and changes in, federal, state and local laws, regulations and policies affecting banking, securities, insurance and monetary and financial matters.
- The effects of changes in interest rates (including the effects of changes in the rate of prepayments of Heartland's assets) and the policies of the Board of Governors of the Federal Reserve System.
- The ability of Heartland to compete with other financial institutions as effectively as Heartland currently intends due to increases in competitive pressures in the financial services sector.
- The inability of Heartland to obtain new customers and to retain existing customers.
- The timely development and acceptance of products and services, including products and services offered through alternative delivery channels such as the Internet.
- Technological changes implemented by Heartland and by other parties, including third party vendors, which may be more difficult or more expensive than anticipated or which may have unforeseen consequences to Heartland and its customers.
- The ability of Heartland to develop and maintain secure and reliable electronic systems.
- The ability of Heartland to retain key executives and employees and the difficulty that Heartland may experience in replacing key executives and employees in an effective manner.
- Consumer spending and saving habits which may change in a manner that affects Heartland's business adversely.
- Business combinations and the integration of acquired businesses may be more difficult or expensive than expected.
- 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 and the Financial Accounting Standards 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. Additional information concerning Heartland and its business, including other factors that could materially affect Heartland's financial results, is included in Heartland's filings with the Securities and Exchange Commission.

Corporate Profile

Mailing Address:
Heartland Financial USA, Inc.
1398 Central Avenue
P.O. Box 778
Dubuque, Iowa 52004-0778
Telephone: (563) 589-2100

Independent Auditors

KPMG LLP
Des Moines, Iowa

Corporate Counsel

Barack Ferrazzano Kirschbaum Perlman & Nagelberg
Chicago, Illinois

Annual Meeting

The Board of Directors of Heartland Financial USA, Inc. has established Wednesday, May 21, 2003, at 1:30 p.m. as the date of the Annual Meeting of Stockholders. We invite all stockholders to attend the meeting which will be held at the main office of Dubuque Bank and Trust Company, 1398 Central Avenue, Dubuque, Iowa.

Transfer Agent/Stockholder Services

Inquiries related to stockholder records, stock transfers, changes of ownership, change of address and dividend payments should be sent to the transfer agent at the following address:

Heartland Financial USA, Inc.
c/o Lois K. Pearce, Vice President and Corporate Secretary
1398 Central Avenue
P.O. Box 778
Dubuque, Iowa 52004-0778

Stock Listing

Heartland's common stock is traded in the over-the-counter market under the symbol "HTLF". Primary market makers provide a primary market in the stock as listed below:

Howe Barnes Investments, Inc.
135 South LaSalle St.
Chicago, Illinois 60603-4398
(800) 800-4693

FTN Financial Securities Corp.
2525 West End Ave., Suite 330
Nashville, Tennessee 37203
(888) 801-3477

Trust Preferred Securities

Heartland's trust preferred securities under Heartland Capital Trust I are traded on the American Stock Exchange under the symbol "HFT.Pr."

Form 10-K and Other Information

The company submits an annual report to the Securities and Exchange Commission on Form 10-K. Stockholders may obtain copies of our Form 10-K without charge by writing to Ms. Lois K. Pearce, Corporate Secretary, Heartland Financial USA, Inc., 1398 Central Avenue, P.O. Box 778, Dubuque, Iowa 52004-0778. Securities analysts and other investors seeking additional information about Heartland should contact John K. Schmidt, Executive Vice President and Chief Financial Officer, at the above address or call him at (563) 589-1994. Additional information is also available through our web site at *www.htlf.com*.

Heartland
FINANCIAL USA, INC.

1398 Central Avenue
P.O. Box 778
Dubuque, Iowa 52004-0778
Phone: (563) 589-2100
FAX: (563) 589-2011