

Heartland BancCorp | Parent Company of Heartland Bank

2017 FINANCIAL STATEMENTS



Heartland BancCorp

Independent Auditor's Report and Consolidated Financial Statements

December 31, 2017 and 2016



Heartland BancCorp
December 31, 2017 and 2016

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Independent Auditor's Report

Board of Directors
Heartland BancCorp
Gahanna, Ohio

We have audited the accompanying consolidated financial statements of Heartland BancCorp and its subsidiary, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heartland BancCorp and its subsidiary as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Indianapolis, Indiana
March 9, 2017

Heartland BancCorp

Consolidated Balance Sheets

December 31, 2017 and 2016

Assets	2017	2016
Cash and cash equivalents	\$ 27,933,990	\$ 21,360,328
Interest bearing time deposits	250,000	-
Available-for-sale securities	117,226,637	103,040,574
Held-to-maturity securities, fair value of \$4,739,626 and \$5,771,601 at December 31, 2017 and 2016, respectively	4,672,941	5,570,879
Loans, net of allowance for loan losses of \$6,224,947 and \$5,698,631 at December 31, 2017 and 2016, respectively	703,542,094	617,861,089
Premises and equipment	24,686,510	14,055,450
Nonmarketable equity securities	2,830,339	2,825,439
Foreclosed assets held for sale	40,000	400,000
Interest receivable	3,113,862	2,240,709
Goodwill	417,353	417,353
Deferred income taxes	804,622	2,557,509
Life insurance assets	12,970,166	9,531,991
Other	2,446,388	1,441,033
Total assets	<u>\$ 900,934,902</u>	<u>\$ 781,302,354</u>
 Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Demand	\$ 195,365,474	\$ 162,690,185
Savings, NOW and money market	293,381,666	223,817,354
Time	288,058,814	278,166,617
Total deposits	<u>776,805,954</u>	<u>664,674,156</u>
Short-term borrowings	24,664,767	24,456,241
Long-term debt	15,460,000	15,460,000
Interest payable and other liabilities	5,447,731	5,311,789
Total liabilities	<u>822,378,452</u>	<u>709,902,186</u>
Shareholders' Equity		
Common stock, without par value; authorized 5,000,000 shares; issued 2017 - 1,610,628 shares, 2016 - 1,583,228 shares	25,107,771	24,595,195
Retained earnings	53,667,333	47,545,465
Accumulated other comprehensive loss	(218,654)	(740,492)
Total shareholders' equity	<u>78,556,450</u>	<u>71,400,168</u>
Total liabilities and shareholders' equity	<u>\$ 900,934,902</u>	<u>\$ 781,302,354</u>

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Consolidated Statements of Income

Years Ended December 31, 2017 and 2016

	2017	2016
Interest Income		
Loans	\$ 32,497,823	\$ 28,478,204
Securities		
Taxable	1,622,856	1,604,436
Tax-exempt	1,615,048	1,635,314
Other	244,582	137,738
Total interest income	35,980,309	31,855,692
Interest Expense		
Deposits	4,439,839	3,702,300
Borrowings	508,751	394,985
Total interest expense	4,948,590	4,097,285
Net Interest Income	31,031,719	27,758,407
Provision for Loan Losses	1,095,000	645,000
Net Interest Income After Provision for Loan Losses	29,936,719	27,113,407
Noninterest Income		
Service charges	2,022,264	1,944,229
Net gains and commissions on loan sales and servicing	996,373	603,849
Net realized gain on sales of available-for-sale securities	6,128	197,711
Net realized gain on sales of foreclosed assets	139,497	-
Gain on redemption of life insurance proceeds	301,278	-
Increase in cash value of life insurance	440,003	272,863
Other	757,316	541,140
Total noninterest income	4,662,859	3,559,792
Noninterest Expense		
Salaries and employee benefits	12,876,116	11,413,273
Net occupancy and equipment expense	2,413,454	2,125,591
Data processing fees	1,271,395	1,120,524
Professional fees	696,566	681,553
Marketing expense	675,767	563,381
Printing and office supplies	250,175	255,321
State financial institution tax	565,828	531,002
FDIC Insurance premiums	355,000	368,000
Other	2,544,547	2,479,506
Total noninterest expense	21,648,848	19,538,151
Income Before Income Tax	12,950,730	11,135,048
Provision for Income Taxes	4,077,765	3,146,789
Net Income	\$ 8,872,965	\$ 7,988,259
Basic Earnings Per Share	\$ 5.56	\$ 5.08
Diluted Earnings Per Share	\$ 5.40	\$ 4.97

Heartland BancCorp
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Net Income	\$ 8,872,965	\$ 7,988,259
Other Comprehensive Income (Loss):		
Unrealized gain (loss) on available-for-sale securities, net of taxes of \$270,909 and (\$724,958) for 2017 and 2016, respectively	525,882	(1,407,272)
Reclassification adjustment for realized gains included in net income, net of taxes of \$2,084 and \$67,222 for 2017 and 2016, respectively	<u>(4,044)</u>	<u>(130,489)</u>
Other comprehensive income (loss)	<u>521,838</u>	<u>(1,537,761)</u>
Comprehensive Income	<u><u>\$ 9,394,803</u></u>	<u><u>\$ 6,450,498</u></u>

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Consolidated Statements of Shareholders' Equity

Years Ended December 31, 2017 and 2016

	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2016	1,564,581	\$ 23,872,599	\$ 41,991,488	\$ 797,269	\$ 66,661,356
Net income			7,988,259		7,988,259
Other comprehensive loss				(1,537,761)	(1,537,761)
Dividends on common stock, \$1.55 per share			(2,434,282)		(2,434,282)
Stock option expense		163,662			163,662
Stock options exercised	24,190	770,391			770,391
Tax benefit related to stock options exercised		92,212			92,212
Purchase of common stock	(5,543)	(303,669)			(303,669)
Balance, December 31, 2016	1,583,228	24,595,195	47,545,465	(740,492)	71,400,168
Net income			8,872,965		8,872,965
Other comprehensive income				521,838	521,838
Dividends on common stock, \$1.72 per share			(2,751,097)		(2,751,097)
Stock option expense		185,691			185,691
Stock options exercised	27,400	326,885			326,885
Balance, December 31, 2017	<u>1,610,628</u>	<u>\$ 25,107,771</u>	<u>\$ 53,667,333</u>	<u>\$ (218,654)</u>	<u>\$ 78,556,450</u>

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Consolidated Statements of Cash Flows

Years Ended December 31, 2017 and 2016

	2017	2016
Operating Activities		
Net income	\$ 8,872,965	\$ 7,988,259
Items not requiring (providing) cash		
Depreciation and amortization	884,224	760,650
Provision for loan losses	1,095,000	645,000
Amortization of premiums and discounts on securities	638,051	588,835
Amortization of loan fees, net	94,107	(25,859)
Deferred income taxes	1,414,479	6,957
Net realized gains on sale of available-for-sale securities	(6,128)	(197,711)
Net gains on sales of foreclosed assets	(139,497)	-
Benefits in excess of life insurance cash value	(301,278)	-
Stock option expense	185,691	163,662
Tax benefit related to stock options exercised	52,226	92,212
Gain on sale of loans	(333,343)	(395,767)
Increase in cash surrender value	(440,003)	(272,863)
Changes in		
Interest receivable	(873,153)	(282,627)
Other assets	(935,772)	(5,192)
Interest payable and other liabilities	10,028	4,549
Net cash provided by operating activities	<u>10,217,597</u>	<u>9,070,105</u>
Investing Activities		
Net change in interest bearing time	(250,000)	-
Purchase of available-for-sale securities	(27,970,288)	(60,189,518)
Proceeds from maturities of available-for-sale securities	12,899,690	64,465,916
Proceeds from sales of available-for-sale securities	1,039,973	4,464,286
Proceeds from maturities of held-to-maturity securities	901,240	463,557
Purchase of nonmarketable equity securities	(4,900)	(167,200)
Net change in loans	(86,576,770)	(77,376,863)
Purchase of premises and equipment	(11,906,480)	(1,309,750)
Proceeds from sale of premises and equipment	391,196	-
Purchase of foreclosed assets	-	(149,228)
Proceeds from sale of foreclosed assets	539,497	-
Purchase of life insurance	(3,200,000)	-
Proceeds from life insurance cash value and excess benefits	503,106	-
Net cash used in investing activities	<u>(113,633,736)</u>	<u>(69,798,800)</u>

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Consolidated Statements of Cash Flows (Continued)

Years Ended December 31, 2017 and 2016

	2017	2016
Financing Activities		
Net increase in demand deposits, money market, NOW and savings accounts	\$ 102,239,601	\$ 28,204,484
Net increase in certificates of deposit	9,892,197	13,515,414
Net increase (decrease) in short-term borrowings	208,526	(4,693,877)
Proceeds from Federal Home Loan Bank Advances	-	10,000,000
Proceeds from stock options exercised	326,885	770,391
Purchase of common stock	-	(303,669)
Dividends paid	(2,677,408)	(2,397,891)
Net cash provided by financing activities	109,989,801	45,094,852
Increase (Decrease) in Cash and Cash Equivalents	6,573,662	(15,633,843)
Cash and Cash Equivalents, Beginning of Year	21,360,328	36,994,171
Cash and Cash Equivalents, End of Year	<u>\$ 27,933,990</u>	<u>\$ 21,360,328</u>
Supplemental Cash Flows Information		
Interest paid	\$ 4,897,523	\$ 3,985,174
Income taxes paid (net of refunds)	\$ 3,534,999	\$ 3,244,285
Supplemental disclosure of noncash investing and financing activities		
Transfers from loans to foreclosed assets held for sale	\$ 40,000	\$ 250,772

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Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Heartland BancCorp (“Company”) is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Heartland Bank (the “Bank”) and the Bank’s wholly-owned subsidiaries, Heartland Mortgage Corporation (inactive), Heartland Investments, Inc. (inactive) and Heartland Financial, LLC. The Bank is primarily engaged in providing a full range of banking and financial services to individual and corporate customers in Franklin, Fairfield, and Licking counties of central Ohio. The Bank is subject to competition from other financial institutions. The Bank is subject to the regulation of certain federal and state agencies and undergoes examinations by those regulatory authorities on an 18 month cycle.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank and Heartland Financial, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan losses, valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, valuation of deferred tax assets, and other-than-temporary impairments (OTTI) and fair values of financial instruments.

Cash Equivalents

At December 31, 2017, the Company’s cash accounts exceeded federally insured limits by approximately \$1,128,000.

Additionally, approximately \$17,099,000 of cash is held by the Federal Home Loan Bank of Cincinnati and Federal Reserve Bank of Cleveland as of December 31, 2017, which is not federally insured.

Interest-bearing Deposits in Banks

Interest-bearing deposits in banks mature within one year and are carried at cost.

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Securities

Available-for-sale securities, which include any security for which the Company has no immediate plan to sell but which may be sold in the future, are carried at fair value. Unrealized gains and losses are recorded, net of related income tax effects, in other comprehensive income.

Held-to-maturity securities, which include any security for which the Company has the positive intent and ability to hold until maturity, are carried at historical cost adjusted for amortization of premiums and accretion of discounts.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

For debt securities with fair value below carrying value when the Company does not intend to sell a debt security, and it is more likely than not the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

For available-for-sale and held-to-maturity debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections. The Company recognized no other-than temporary impairment in 2017 and 2016.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

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For all loan classes, the accrual of interest is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. For all loan classes, past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

For all loan classes, all interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

Discounts and premiums on purchased commercial real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the un-collectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established if the discounted cash flows, underlying collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical charge-off experience. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment

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delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Interest income on impaired loans is recognized on a cash basis after all past due and current principal payments have been made.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

In the course of working with borrowers, the Company may choose to restructure the contractual terms of certain loans. In this scenario, the Company attempts to work-out an alternative payment schedule with the borrower in order to optimize collectability of the loan. Any loans that are modified are reviewed by the Company to identify if a troubled debt restructuring ("TDR") has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the borrower's ability to repay in line with the borrower's current financial status, and the restructuring of the loan may include a transfer of assets from the borrower to satisfy the debt, a modification of loan terms or a combination of the two. If such efforts by the Company do not result in a satisfactory arrangement, the loan is referred to legal counsel, at which time foreclosure proceedings are initiated. At any time prior to a sale of the property at foreclosure, the Company may terminate foreclosure proceedings if the borrower is able to work-out a satisfactory payment plan.

It is the Company's policy that any restructured loans on nonaccrual status prior to being restructured remain on nonaccrual status until six months of satisfactory borrower performance, at which time management would consider its return to accrual status. If a loan is accruing at the time of restructuring, the Company reviews the loan to determine if it is appropriate to continue the accrual of interest on the restructured loan.

With regard to determination of the amount of the allowance for credit losses, troubled debt restructured loans are considered to be impaired. As a result, the method for determining the amount of impaired loans for each portfolio segment of troubled debt restructurings is the same as detailed previously.

Premises and Equipment

Depreciable assets are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets.

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Nonmarketable Equity Securities

Nonmarketable equity securities consist of common stock in the Federal Reserve Bank (FRB), Federal Home Loan Bank (FHLB), and Farmer Mac. The FRB and FHLB stocks are required investments for institutions that are members of the FRB and FHLB systems. The required investment in the common stock is based on a predetermined formula, carried at cost and evaluated for impairment. The common stock in Farmer Mac was purchased to participate in correspondent services offered by Farmer Mac to its shareholders.

Foreclosed Assets Held for Sale

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net income or expense from foreclosed assets. At December 31, 2017 there are no recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process.

Goodwill

Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements. There were no changes in the carrying amount of goodwill.

Company-owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Company-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Stock Options

At December 31, 2017, the Company has a share-based employee compensation plan, which is described more fully in Note 13.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have

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been isolated from the Company—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment.

If necessary, the Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Company files consolidated income tax returns with its subsidiaries in the U.S. federal jurisdiction. With a few exceptions, the Company is no longer subject to tax authorities for years before 2014. As of December 31, 2017, the Company had no uncertain income tax positions.

Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during each period. Diluted earnings per share reflects additional potential common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result

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from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income, net of applicable income taxes. Other comprehensive income includes unrealized gain (loss) on available-for-sale securities.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of unrealized gain (loss) on available-for-sale securities, net of applicable income taxes.

Marketing Costs

Marketing costs are expensed as incurred.

Reclassifications

Certain reclassifications have been made to the 2016 financial statements to conform to the 2017 financial statement presentation. These reclassifications had no effect on net income.

Note 2: Restriction on Cash and Due From Banks

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve required at December 31, 2017 was \$18,578,000.

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Notes to Consolidated Financial Statements
December 31, 2017 and 2016
(Table Dollar Amounts in Thousands)

Note 3: Securities

The amortized cost and approximate fair values, together with gross unrealized gains and losses, of securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Available-for-sale Securities:				
December 31, 2017:				
U.S. government agencies	\$ 40,538	\$ 11	\$ (874)	\$ 39,675
SBA Loan Pools	4,699	22	(26)	4,695
Mortgage-backed securities of U.S. Government sponsored enterprises	15,522	53	(276)	15,299
State and political subdivisions	55,800	902	(144)	56,558
Corporate bonds	1,000	-	-	1,000
Totals	<u>\$ 117,559</u>	<u>\$ 988</u>	<u>\$ (1,320)</u>	<u>\$ 117,227</u>
December 31, 2016:				
U.S. government agencies	\$ 27,048	\$ 9	\$ (1,016)	\$ 26,041
SBA Loan Pools	5,517	35	(9)	5,543
Mortgage-backed securities of U.S. Government sponsored enterprises	19,572	106	(440)	19,238
State and political subdivisions	51,025	691	(497)	51,219
Corporate bonds	1,000	-	-	1,000
Totals	<u>\$ 104,162</u>	<u>\$ 841</u>	<u>\$ (1,962)</u>	<u>\$ 103,041</u>
Held-to-maturity Securities:				
December 31, 2017:				
State and political subdivisions	<u>\$ 4,673</u>	<u>\$ 67</u>	<u>\$ -</u>	<u>\$ 4,740</u>
December 31, 2016:				
State and political subdivisions	<u>\$ 5,571</u>	<u>\$ 201</u>	<u>\$ -</u>	<u>\$ 5,772</u>

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Notes to Consolidated Financial Statements
December 31, 2017 and 2016
(Table Dollar Amounts in Thousands)

The amortized cost and fair value of available-for-sale securities and held-to-maturity securities at December 31, 2017, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ 517	\$ 523	\$ -	\$ -
One to five years	6,772	6,796	2,794	2,826
Five to ten years	39,438	39,097	1,879	1,914
After ten years	50,611	50,817	-	-
	97,338	97,233	4,673	4,740
SBA Loan Pools	4,699	4,695	-	-
Mortgage-backed securities of U.S. Government sponsored entities	15,522	15,299	-	-
Totals	\$ 117,559	\$ 117,227	\$ 4,673	\$ 4,740

The carrying value, which equals fair value, of securities pledged as collateral, to secure public deposits and for other purposes, was \$81,300,000 at December 31, 2017 and \$62,871,000 at December 31, 2016.

Gross gains of approximately \$6,000 and \$212,000 resulting from sales of available-for-sale securities were realized for 2017 and 2016, respectively. There were no losses resulting from the sale of available-for-sale securities in 2017, the losses in 2016 were \$14,000. The \$6,000 and \$198,000 net gains from the sales of available-for-sale securities were a reclassification from accumulated other comprehensive income (loss) and are included in the net gains on available-for-sale securities in the income statement for 2017 and 2016, respectively. The related tax expense of approximately \$2,000 and \$67,000 were a reclassification from accumulated other comprehensive income and included in the provision for income tax in the income statement for 2017 and 2016, respectively.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2017 and 2016 was \$65,085,000 and \$64,267,000, which is approximately 53% and 60%, respectively, of the Company's available-for-sale and held-to-maturity investment portfolio. These declines resulted from changes in market interest rates.

Management believes the declines in fair value for these securities are temporary.

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(Table Dollar Amounts in Thousands)

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2017 and 2016:

December 31, 2017						
Description of Securities	Less than 12 Months Unrealized		12 Months or More Unrealized		Total	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Unrealized Losses
U.S. Government agencies	\$ 13,369	\$ (108)	\$ 22,158	\$ (766)	\$ 35,527	\$ (874)
SBA Loan Pools	1,725	(9)	797	(17)	2,522	(26)
Mortgage-backed securities of U.S. Government sponsored enterprises	2,405	(29)	10,743	(247)	13,148	(276)
State and political subdivisions	8,445	(49)	5,443	(95)	13,888	(144)
Total temporarily impaired securities	<u>\$ 25,944</u>	<u>\$ (195)</u>	<u>\$ 39,141</u>	<u>\$ (1,125)</u>	<u>\$ 65,085</u>	<u>\$ (1,320)</u>

December 31, 2016						
Description of Securities	Less than 12 Months Unrealized		12 Months or More Unrealized		Total	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Unrealized Losses
U.S. Government agencies	\$ 23,907	\$ (1,016)	\$ -	\$ -	\$ 23,907	\$ (1,016)
SBA Loan Pools	-	-	1,039	(9)	1,039	(9)
Mortgage-backed securities of U.S. Government sponsored enterprises	11,327	(310)	4,890	(130)	16,217	(440)
State and political subdivisions	23,104	(497)	-	-	23,104	(497)
Total temporarily impaired securities	<u>\$ 58,338</u>	<u>\$ (1,823)</u>	<u>\$ 5,929</u>	<u>\$ (139)</u>	<u>\$ 64,267</u>	<u>\$ (1,962)</u>

U.S. Government Agencies

The unrealized losses on the Company's investments in direct obligations of U.S. government agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2017.

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Mortgage-backed Securities of U.S. Government Sponsored Enterprises

The unrealized losses on the Company's investment in mortgage-backed securities of U.S. Government sponsored enterprises were caused by changes in interest rates and illiquidity. The Company expects to recover the amortized cost bases over the term of the securities. Because the decline in market value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investment to be other-than-temporarily impaired at December 31, 2017.

Note 4: Loans and Allowance for Loan Losses

Classes of loans at December 31, include:

	<u>2017</u>	<u>2016</u>
Commercial	\$ 86,235	\$ 80,365
Commercial Real Estate:		
Owner occupied	195,662	181,748
NonOwner occupied	218,867	184,320
Residential Real Estate:		
1-4 Family	170,531	142,096
Home Equity	28,481	24,085
Consumer	<u>9,822</u>	<u>10,693</u>
Total loans	709,598	623,307
Less		
Net deferred loan costs, premiums and discounts	169	253
Allowance for loan losses	<u>(6,225)</u>	<u>(5,699)</u>
Net loans	<u>\$ 703,542</u>	<u>\$ 617,861</u>

The risk characteristics of each loan portfolio segment are as follows:

Commercial (Non-Real Estate)

Commercial loans are based on the identified cash flows of the borrower and on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

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Commercial Real Estate

These loans are viewed as cash flow loans with a significant emphasis on the value of real estate securing the loan. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type within the Company's market area. Management monitors and evaluates commercial real estate loans based on collateral, market area, risk grade criteria, and concentrations. As a general rule, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus higher risk non-owner occupied loans.

Residential Real Estate and Consumer

With respect to residential loans that are secured by one- to-four family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio of 80% and requires private mortgage insurance of 35% coverage if that ratio exceeds 90%. Home equity loans are typically secured by a subordinate interest in one- to-four family residences, and other consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. The security value can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

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(Table Dollar Amounts in Thousands)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of December 31, 2017 and 2016.

				2017			
				Commercial Real Estate		Residential Real Estate	
	Commercial	Owner Occupied	NonOwner Occupied	1-4 family	Home Equity	Consumer	Total
December 31, 2017:							
Allowance for loan losses:							
Balance, beginning of year	\$ 855	\$ 2,225	\$ 1,147	\$ 1,041	\$ 249	\$ 182	\$ 5,699
Provision charged to expense (credit)	201	560	254	172	(159)	67	1,095
Losses charged off	(99)	(401)	-	(68)	(5)	(138)	(711)
Recoveries	29	23	-	25	28	37	142
Balance, end of year	<u>\$ 986</u>	<u>\$ 2,407</u>	<u>\$ 1,401</u>	<u>\$ 1,170</u>	<u>\$ 113</u>	<u>\$ 148</u>	<u>\$ 6,225</u>
Ending balance: individually evaluated for impairment	<u>\$ 73</u>	<u>\$ 1,001</u>	<u>\$ 59</u>	<u>\$ 202</u>	<u>\$ 9</u>	<u>\$ -</u>	<u>\$ 1,344</u>
Ending balance: collectively evaluated for impairment	<u>\$ 913</u>	<u>\$ 1,406</u>	<u>\$ 1,342</u>	<u>\$ 968</u>	<u>\$ 104</u>	<u>\$ 148</u>	<u>\$ 4,881</u>
Loans:							
Ending balance	<u>\$ 86,235</u>	<u>\$ 195,662</u>	<u>\$ 218,867</u>	<u>\$ 170,531</u>	<u>\$ 28,481</u>	<u>\$ 9,822</u>	<u>\$ 709,598</u>
Ending balance: individually evaluated for impairment	<u>\$ 917</u>	<u>\$ 5,555</u>	<u>\$ 1,415</u>	<u>\$ 1,337</u>	<u>\$ 255</u>	<u>\$ 26</u>	<u>\$ 9,505</u>
Ending balance: collectively evaluated for impairment	<u>\$ 85,318</u>	<u>\$ 190,107</u>	<u>\$ 217,452</u>	<u>\$ 169,194</u>	<u>\$ 28,226</u>	<u>\$ 9,796</u>	<u>\$ 700,093</u>
2016							
				Commercial Real Estate		Residential Real Estate	
	Commercial	Owner Occupied	NonOwner Occupied	1-4 family	Home Equity	Consumer	Total
December 31, 2016:							
Allowance for loan losses:							
Balance, beginning of year	\$ 868	\$ 1,605	\$ 1,854	\$ 849	\$ 407	\$ 133	\$ 5,716
Provision charged to expense (credit)	4	897	(482)	224	(147)	149	645
Losses charged off	(29)	(287)	(225)	(32)	(27)	(126)	(726)
Recoveries	12	10	-	-	16	26	64
Balance, end of year	<u>\$ 855</u>	<u>\$ 2,225</u>	<u>\$ 1,147</u>	<u>\$ 1,041</u>	<u>\$ 249</u>	<u>\$ 182</u>	<u>\$ 5,699</u>
Ending balance: individually evaluated for impairment	<u>\$ 207</u>	<u>\$ 1,064</u>	<u>\$ 64</u>	<u>\$ 276</u>	<u>\$ 112</u>	<u>\$ -</u>	<u>\$ 1,723</u>
Ending balance: collectively evaluated for impairment	<u>\$ 648</u>	<u>\$ 1,161</u>	<u>\$ 1,083</u>	<u>\$ 764</u>	<u>\$ 137</u>	<u>\$ 182</u>	<u>\$ 3,975</u>
Loans:							
Ending balance	<u>\$ 80,365</u>	<u>\$ 181,748</u>	<u>\$ 184,320</u>	<u>\$ 142,096</u>	<u>\$ 24,085</u>	<u>\$ 10,693</u>	<u>\$ 623,307</u>
Ending balance: individually evaluated for impairment	<u>\$ 788</u>	<u>\$ 7,871</u>	<u>\$ 2,154</u>	<u>\$ 1,483</u>	<u>\$ 516</u>	<u>\$ 18</u>	<u>\$ 12,830</u>
Ending balance: collectively evaluated for impairment	<u>\$ 79,693</u>	<u>\$ 173,877</u>	<u>\$ 182,166</u>	<u>\$ 140,613</u>	<u>\$ 23,959</u>	<u>\$ 10,675</u>	<u>\$ 610,983</u>

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Internal Risk Categories

Loan grades are numbered 1 through 8. Grades 1 through 4 are considered satisfactory grades. The grade of 5, or Special Mention, represents loans of lower quality and signs of potential weakness. The grades of 6, or Substandard, and 7, or Doubtful, refer to assets that are classified. The use and application of these grades by the Company will be uniform and shall conform to the Company's policy.

Excellent (1) loans are of superior quality with excellent credit strength and repayment ability proving a nominal credit risk.

Good (2) loans are of above average credit strength and repayment ability proving only a minimal credit risk.

Satisfactory (3) loans are of reasonable credit strength and repayment ability proving an average credit risk due to one or more underlying weaknesses.

Watch (4) borrowers in this grade are still considered acceptable from quality standpoint but have risk factors more substantial than for the typical satisfactory graded loan. Although identified weaknesses are present, performance on loans is acceptable with only moderate delinquency.

Special Mention (5) assets have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard (6) loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful (7) loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

Loss (8) loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off even though partial recovery may be affected in the future.

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The following tables present the credit risk profile of the Company's loan portfolio based on the Company's internal rating categories as of December 31, 2017 and 2016:

		2017					
		Commercial Real Estate		Residential Real Estate			
		Owner	NonOwner				
Commercial		Occupied	Occupied	1-4 Family	Home Equity	Consumer	Total
Pass	\$ 76,358	\$ 181,048	\$ 212,280	\$ 167,299	\$ 27,923	\$ 9,811	\$ 674,719
Special mention	6,972	2,290	774	556	172	-	10,764
Substandard	2,905	12,324	5,813	2,676	386	11	24,115
Doubtful	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-
Total	\$ 86,235	\$ 195,662	\$ 218,867	\$ 170,531	\$ 28,481	\$ 9,822	\$ 709,598

		2016					
		Commercial Real Estate		Residential Real Estate			
		Owner	NonOwner				
Commercial		Occupied	Occupied	1-4 Family	Home Equity	Consumer	Total
Pass	\$ 69,343	\$ 162,788	\$ 169,465	\$ 138,405	\$ 22,885	\$ 10,622	\$ 573,508
Special mention	7,808	5,649	4,321	1,261	171	-	19,210
Substandard	3,214	13,172	10,534	2,430	1,029	71	30,450
Doubtful	-	139	-	-	-	-	139
Loss	-	-	-	-	-	-	-
Total	\$ 80,365	\$ 181,748	\$ 184,320	\$ 142,096	\$ 24,085	\$ 10,693	\$ 623,307

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis. No significant changes were made to either during the past year.

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The following tables present the Company's loan portfolio aging analysis of the recorded investment in loans as of December 31, 2017 and 2016:

	2017				Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due			
Commercial	\$ 2	\$ 57	\$ 283	\$ 342	\$ 85,893	\$ 86,235	\$ -
Commercial Real Estate:							
Owner occupied	12	-	998	1,010	194,652	195,662	-
NonOwner occupied	-	270	205	475	218,392	218,867	-
Residential Real Estate:							
1-4 family	312	-	259	571	169,960	170,531	-
Home equity	25	-	73	98	28,383	28,481	-
Consumer	16	-	2	18	9,804	9,822	-
Total	<u>\$ 367</u>	<u>\$ 327</u>	<u>\$ 1,820</u>	<u>\$ 2,514</u>	<u>\$ 707,084</u>	<u>\$ 709,598</u>	<u>\$ -</u>

	2016				Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due			
Commercial	\$ 153	\$ 2,146	\$ 437	\$ 2,736	\$ 77,629	\$ 80,365	\$ -
Commercial Real Estate:							
Owner occupied	3,408	-	2,798	6,206	175,542	181,748	-
NonOwner occupied	379	367	586	1,332	182,988	184,320	-
Residential Real Estate:							
1-4 family	288	-	171	459	141,637	142,096	-
Home equity	-	-	193	193	23,892	24,085	-
Consumer	91	2	-	93	10,600	10,693	-
Total	<u>\$ 4,319</u>	<u>\$ 2,515</u>	<u>\$ 4,185</u>	<u>\$ 11,019</u>	<u>\$ 612,288</u>	<u>\$ 623,307</u>	<u>\$ -</u>

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings.

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The following tables present impaired loans for the years ended December 31, 2017 and 2016:

	2017				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Balance of Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Commercial	\$ 720	\$ 986	\$ -	\$ 1,091	\$ 40
Commercial real estate:					
Owner occupied	2,922	2,922	-	3,709	156
NonOwner occupied	799	799	-	1,023	52
Residential real estate:					
1-4 family	1,007	1,007	-	1,022	48
Home equity	246	246	-	259	7
Consumer	26	26	-	29	1
Loans with a specific valuation allowance:					
Commercial	197	197	73	212	13
Commercial real estate:					
Owner occupied	2,633	3,268	1,001	3,333	103
NonOwner occupied	616	616	59	627	37
Residential real estate:					
1-4 family	330	330	202	384	17
Home equity	9	9	9	10	5
Consumer	-	-	-	-	-
Total:					
Commercial	917	1,183	73	1,303	53
Commercial real estate:					
Owner occupied	5,555	6,190	1,001	7,042	259
NonOwner occupied	1,415	1,415	59	1,650	89
Residential real estate:					
1-4 family	1,337	1,337	202	1,406	65
Home equity	255	255	9	269	12
Consumer	26	26	-	29	1
Totals	<u>\$ 9,505</u>	<u>\$ 10,406</u>	<u>\$ 1,344</u>	<u>\$ 11,699</u>	<u>\$ 479</u>

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	2016				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Balance of Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Commercial	\$ 243	\$ 243	\$ -	\$ 247	\$ 9
Commercial real estate:					
Owner occupied	4,194	4,194	-	4,468	221
NonOwner occupied	1,518	1,518	-	1,600	82
Residential real estate:					
1-4 family	745	745	-	752	36
Home equity	211	211	-	213	3
Consumer	18	18	-	20	-
Loans with a specific valuation allowance:					
Commercial	546	546	207	574	12
Commercial real estate:					
Owner occupied	3,676	3,985	1,064	4,000	63
NonOwner occupied	636	636	64	636	38
Residential real estate:					
1-4 family	738	738	277	751	26
Home equity	305	305	112	309	10
Consumer	-	-	-	-	-
Total:					
Commercial	788	788	207	821	21
Commercial real estate:					
Owner occupied	7,871	8,179	1,064	8,468	284
NonOwner occupied	2,154	2,154	64	2,236	120
Residential real estate:					
1-4 family	1,483	1,483	276	1,503	62
Home equity	516	516	112	522	13
Consumer	18	18	-	20	-
Totals	<u><u>\$ 12,830</u></u>	<u><u>\$ 13,138</u></u>	<u><u>\$ 1,723</u></u>	<u><u>\$ 13,570</u></u>	<u><u>\$ 500</u></u>

Interest income recognized is not materially different than interest income that would have been recognized on a cash basis.

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The following table presents the Company's nonaccrual loans at December 31, 2017 and 2016. This table excludes performing troubled debt restructurings.

	2017	2016
Commercial	\$ 283	\$ 437
Commercial Real Estate:		
Owner occupied	998	2,798
NonOwner occupied	205	586
Residential Real Estate:		
1-4 family	259	171
Home equity	74	206
Consumer	13	18
	<u>1,832</u>	<u>4,216</u>
Total nonaccrual	<u>\$ 1,832</u>	<u>\$ 4,216</u>

The following table presents information regarding troubled debt restructurings by class for the year ended December 31, 2017:

	2017		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial	1	\$ 167	\$ 167
Commercial Real Estate:			
Owner occupied	-	-	-
NonOwner occupied	-	-	-
Residential Real Estate:			
1-4 family	-	-	-
Home equity	-	-	-
Consumer	1	15	15
	<u>1</u>	<u>15</u>	<u>15</u>
Total	<u>2</u>	<u>\$ 182</u>	<u>\$ 182</u>

There were no new troubled debt restructurings for the year ended December 31, 2016

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The troubled debt restructurings described above did not increase the allowance for loan losses and did not result in charge offs during the years ended December 31, 2017 and 2016.

The following table presents information regarding troubled debt restructurings by type of modification for the year ended December 31, 2017:

2017

	Interest Only Terms	Extension of Maturity	Combination	Advance Funds	Total Modification
Commercial	\$ -	\$ -	\$ 167	\$ -	\$ 167
Commercial Real Estate:					
Owner occupied	-	-	-	-	-
NonOwner occupied	-	-	-	-	-
Residential Real Estate:					
1-4 family	-	-	-	-	-
Home equity	-	-	-	-	-
Consumer	-	-	-	15	15
	<u>-</u>	<u>-</u>	<u>-</u>	<u>15</u>	<u>15</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 167</u>	<u>\$ 15</u>	<u>\$ 182</u>

There were no troubled debt restructurings modified in 2017 that subsequently defaulted.

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Note 5: Premises and Equipment

Major classifications of premises and equipment, stated at cost, are as follows:

	2017	2016
Land and improvements	\$ 3,772	\$ 3,849
Building and improvements	22,914	11,923
Equipment	9,676	9,178
Total	36,362	24,950
Less accumulated depreciation	(11,675)	(10,895)
Net premises and equipment	<u>\$ 24,687</u>	<u>\$ 14,055</u>

Note 6: Interest-bearing Time Deposits

Interest-bearing time deposits in denominations of \$250,000 or more were \$47,952,000 on December 31, 2017 and \$46,138,000 on December 31, 2016.

At December 31, 2017, the scheduled maturities of time deposits are as follows:

2018	\$ 120,410
2019	77,716
2020	41,002
2021	26,704
2022 and thereafter	22,227
Total time deposits	<u>\$ 288,059</u>

Note 7: Short-term Borrowings

Short-term borrowings consisted of the following at December 31:

	2017	2016
Securities sold under repurchase agreements	\$ 14,665	\$ 18,312
Federal Home Loan Bank borrowings - fixed at 1.52%, maturing on March 21, 2018 and March 22, 2018	10,000	6,144
Total	<u>\$ 24,665</u>	<u>\$ 24,456</u>

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Securities sold under agreements to repurchase consist of obligations of the Bank to other parties. The obligations are secured by U. S. Government Agency, FHLB, FHLMC, and FNMA securities and such collateral is held in safekeeping with a third party. The maximum amount of outstanding agreements at any month end during 2017 and 2016 totaled \$27,105,000 and \$32,297,000, respectively, and the daily average of such agreements totaled \$20,037,000 and \$26,921,000 for 2017 and 2016, respectively. These agreements mature daily. The following table represents the remaining contractual maturity of repurchase agreements disaggregated by the class of securities pledged as of December 31.

	2017 Overnight & Continuous
December 31, 2017:	
U.S. government agencies	\$ 9,553
Mortgage-backed securities of U.S. Government sponsored enterprises	<u>\$ 5,112</u>
Totals	<u><u>\$ 14,665</u></u>

The Company has Federal Funds Borrowing Line Agreements with US Bank and PNC Bank that allows the Company to borrow up to \$20,000,000 and \$5,000,000 in Federal Funds, respectively.

The Company has a cash management advance (CMA) line of credit with the Federal Home Loan Bank (FHLB) of Cincinnati. FHLB borrowings are collateralized by all shares of FHLB stock owned by the Bank and by the Bank's residential mortgage loans.

At December 31, 2017 and 2016, the Company had \$56,636,000 and \$63,573,000, respectively, available on its CMA line of credit. The CMA application expires on August 28, 2018. The Company has the option of selecting a variable interest rate set daily for 90 days or a fixed interest rate for a maximum of thirty days. Variable interest rates are set daily based upon the FHLB's published interest rates. Variable interest rate advances are prepayable with no fee. The fixed rate is not prepayable prior to maturity.

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Note 8: Long-term Debt

At December 31, 2017, advances from the Federal Home Loan Bank were \$10,000,000 at fixed rates from 1.26% to 1.63%, averaging 1.45%.

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by approximately \$222,259,000 of first mortgage loans under a blanket lien arrangement at year-end 2017. Based on this collateral and the Company's holdings of FHLB stock, the Company has additional borrowing capacity of \$56,636,000 at December 31, 2017.

Payments over the next five years are as follows:

2018	\$ -
2019	5,000
2020	-
2021	5,000
2022	<u>-</u>
Total FHLB Advances	<u>\$ 10,000</u>

On November 12, 2015, the Company completed a private issuance and sale, of subordinated notes, to 14 accredited investors for an aggregate of \$5,460,000, comprised of: \$3,000,000 at 5.50% fixed, \$750,000 at 5.00% fixed, \$1,410,000 at 4.50% fixed, and \$300,000 at a floating rate equal to the 1-Year Treasury Rate plus 1.63%, reset quarterly. Interest is payable in January, April, July, and October of each year. The weighted average interest rate at December 31, 2017 was 5.06%. The subordinated notes will mature on November 12, 2025, and the Company cannot redeem the notes prior to November 12, 2020, subject to approval of the Board of Governors of the Federal Reserve System, as required by law or regulation.

Note 9: Income Taxes

The provision for income taxes includes these components:

	<u>2017</u>	<u>2016</u>
Taxes currently payable	\$ 2,664	\$ 3,140
Deferred income taxes	<u>1,414</u>	<u>7</u>
Income tax expense	<u>\$ 4,078</u>	<u>\$ 3,147</u>

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A reconciliation of income tax expense at the statutory rate to the Company's actual income tax expense is shown below:

	2017	2016
Computed at the statutory rate (34%)	\$ 4,403	\$ 3,786
Increase (decrease) resulting from		
Tax exempt interest	(658)	(636)
Cash surrender value, net of premiums	(224)	(60)
Change in enacted rules	541	-
Other	16	57
	<u>4,078</u>	<u>3,147</u>
Actual tax expense	<u>\$ 4,078</u>	<u>\$ 3,147</u>

The tax effects of temporary differences related to deferred taxes shown on the balance sheets were:

	2017	2016
Deferred tax assets		
Allowance for loan losses	\$ 1,307	\$ 1,938
Deferred compensation	516	793
Nonaccrual of loan interest	24	37
Stock option expense	45	55
Unrealized losses on available-for-sale securities	70	381
Other	38	8
	<u>2,000</u>	<u>3,212</u>
Total Deferred Tax Assets	2,000	3,212
Deferred tax liabilities		
Depreciation	(928)	(410)
Purchase accounting adjustments	(6)	(14)
FHLB stock dividends	(94)	(152)
Prepaid expenses	(66)	(70)
Other	(32)	(8)
	<u>(1,126)</u>	<u>(654)</u>
Total Deferred Tax Liabilities	(1,126)	(654)
Net deferred tax asset	<u>\$ 874</u>	<u>\$ 2,558</u>

On December 22, 2017, the United States enacted tax reform legislation through the Tax Cuts and Jobs Act, which significantly changes the existing U.S. tax laws, including a reduction in the corporate tax rate from 34% to 21%, as well as other changes. As a result of the enactment of the legislation, the Company incurred additional one-time income tax expenses of \$541,000 during the

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fourth quarter of 2017, primarily related to the remeasurement of certain deferred tax assets and liabilities. Included in this additional one-time income tax expense of \$541,000 is \$43,000 related to the adjustment of deferred tax assets for net unrealized losses on available-for-sale securities included in accumulated other comprehensive loss.

Note 10: Regulatory Matters

The Company and the Bank 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 Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting guidelines. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Furthermore, the Company's regulators could require adjustments to regulatory capital not reflected in these financial statements.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined) to risk-weighted assets (as defined), common equity Tier 1 capital (as defined) to total risk-weighted assets (as defined) and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2017, the most recent notification from the Federal Reserve categorized the Company and Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Company and Bank must maintain capital ratios as set forth in the table that follows. There are no conditions or events since that notification that management believes have changed the Company or Bank's category.

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The Company's and Bank's actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017						
Total Capital						
(to Risk-Weighted Assets)						
Consolidated	\$ 90,039	12.4%	\$ 58,020	8.0%	N/A	N/A
Bank	88,256	12.2%	57,998	8.0%	\$ 72,498	10.0%
Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	78,354	10.8%	43,515	6.0%	N/A	N/A
Bank	82,031	11.3%	43,499	6.0%	57,998	8.0%
Common Equity Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	78,354	10.8%	32,636	4.5%	N/A	N/A
Bank	82,031	11.3%	32,624	4.5%	47,124	6.5%
Tier I Capital						
(to Average Assets)						
Consolidated	78,354	8.7%	35,990	4.0%	N/A	N/A
Bank	82,031	9.1%	35,954	4.0%	44,943	5.0%
As of December 31, 2016						
Total Capital						
(to Risk-Weighted Assets)						
Consolidated	\$ 82,882	13.2%	\$ 50,376	8.0%	N/A	N/A
Bank	81,412	12.9%	50,358	8.0%	\$ 62,947	10.0%
Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	71,723	11.3%	37,782	6.0%	N/A	N/A
Bank	75,713	12.0%	37,768	6.0%	50,358	8.0%
Common Equity Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	71,723	11.4%	28,336	4.5%	N/A	N/A
Bank	75,713	12.0%	28,326	4.5%	40,916	6.5%
Tier I Capital						
(to Average Assets)						
Consolidated	71,723	9.1%	31,380	4.0%	N/A	N/A
Bank	75,713	9.7%	31,347	4.0%	39,184	5.0%

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. Generally, the Bank's payment of dividends is limited to net income for the current year plus the two preceding calendar years, less capital distributions paid over the comparable time period.

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The above minimum capital requirements exclude the capital conservation buffer required to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The capital conservation buffer is being phased in from 0.625% for 2016 to 2.50% by 2019. The capital conservation buffer was 1.25% at December 31, 2017. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital.

Basel III Capital Rules

In July 2013, the three federal bank regulatory agencies jointly published final rules (the Basel III Capital Rules) establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. These rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, compared to the current U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. These rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules were effective for the Company on January 1, 2015 (subject to a four-year phase-in period).

Note 11: Related Party Transactions

At December 31, 2017 and 2016, the Bank had loans outstanding and lines of credit available to executive officers, directors, significant shareholders and their affiliates (related parties), in the amount of approximately \$31,230,000 and \$24,650,000, respectively.

In management's opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons.

Further, in management's opinion, these loans did not involve more than normal risk of collectability or present other unfavorable features.

Deposits from related parties held by the Bank at December 31, 2017 and 2016, totaled \$6,915,000 and \$6,407,000, respectively.

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Note 12: Employee Benefits

The Company has a retirement savings 401(k) plan covering substantially all employees. Employees may contribute up to the maximum amount allowable by the Internal Revenue Service with the Company matching 50% of the employee's contribution not to exceed 3% of the employee's compensation. In addition, the Company may make additional discretionary contributions allocated to all eligible participants based on compensation. Employee contributions are always 100% vested. Employer contributions vest annually until the employee becomes fully vested after six years of participation in the plan. Employer contributions charged to expense for 2017 and 2016, were approximately \$238,000 and \$166,000, respectively.

The Company has supplemental retirement plans for certain former and current Senior Officers. Officers in the plans, upon retirement, will receive annually for ten or fifteen years a percentage of their final annual payroll amount exclusive of incentive and bonus amounts and may be partially offset by 401(k) or 401(k) and social security retirement benefits. The plans are uniquely designed for each participant. The charge to expense for 2017 and 2016 were \$390,000 and \$259,000, respectively. Such charges reflect the straight-line accrual over the period until full eligibility of the present value of benefits due each participant on the full eligibility date. For plans executed before 2016, a 6% discount factor is used. For plans executed after January 1, 2016, the accumulation period crediting rate is 50% of the prior year Return on Equity of The Company; and the distribution period crediting rate is equal to the 10-Year U.S. Treasury note on the first day of each year plus 1%. The resulting liability at December 31, 2017 and 2016 was \$2,457,000 and \$2,334,000, respectively. The Company purchased life insurance on the participants.

The Bank has employment agreements with certain officers of the Bank. Under these agreements, the officers are employed for rolling one to three-year periods. Unless the Bank serves a termination notice to the officers before December 31 of each year, the agreements are automatically extended for one additional year. The Bank's Board of Directors approve the officers' base salaries annually. The agreements prohibit the officers from soliciting banking business from customers of the Bank for a period of one to three years following the termination of the employment agreements.

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Note 13: Stock Option Plan

The Company has a fixed option plan under which the Company may grant options to selected directors, Advisory Board Members and employees for up to 249,738 shares of common stock that vest over two years or immediately if the recipient is 65 years old or older. The Company believes that such awards align the interests of its employees with those of its shareholders. The exercise price of each option is intended to equal the fair value of the Company's stock on the date of grant. An option's maximum term is ten years. The compensation cost for the stock option expense recognized in 2017 totaled \$186,000 with a related tax benefit in 2017 of \$52,000. The compensation cost for the stock option expense recognized in 2016 totaled \$164,000 with a related tax benefit in 2016 of \$55,000. As of December 31, 2017, there was \$488,000 of total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan.

A summary of the status of the plan at December 31, 2017 and changes during the year then ended is presented below:

			2017 Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
	Shares	Weighted- Average Exercise Price		
Outstanding, beginning of year	131,050	\$ 38.38		
Granted	68,200	76.50		
Exercised	(27,150)	39.20		
Forfeited or expired	(26,500)	36.65		
Outstanding, end of year	<u>145,600</u>	<u>\$ 56.40</u>	<u>7.71</u>	<u>\$ 3,819,660</u>
Exercisable, end of year	<u>77,400</u>	<u>\$ 38.68</u>	<u>6.09</u>	<u>\$ 3,399,240</u>

The weighted-average grant-date fair value of options granted during 2017 was \$8.95. There were no stock options granted in 2016. The total intrinsic value of options exercised during the year ended December 31, 2017 and 2016 was \$1,178,000 and \$778,000, respectively.

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The fair value of each option award granted is estimated on the date of the grant using a Black-Scholes valuation model that uses the assumptions noted in the following table. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses the simplified method to estimate option exercise and employee termination within the valuation model due to lack of historical data. The expected term of options granted represents the period of time that options are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	<u>2017</u>	<u>2016</u>
Dividend yield	2.85%	N/A
Volatility factors of expected market price of common stock	15.17%	N/A
Risk-free interest rate	2.27%	N/A
Expected life (in years)	7.34	N/A
Weighted-average fair value of options granted during the year	\$8.95	N/A

Note 14: Earnings Per Share

Earnings per share (EPS) were computed as follows:

	Year Ended December 31, 2017		
	Income	Weighted-Average Shares	Per Share Amount
Basic earnings per share			
Income available to common stockholders	\$ 8,873	1,594,823	<u>\$ 5.56</u>
Effect of dilutive securities			
Stock options		<u>46,731</u>	
Diluted earnings per share			
assumed conversions			
stockholders and assumed conversions	<u>\$ 8,873</u>	<u>1,641,554</u>	<u>\$ 5.40</u>

As of December 31, 2017, all options to purchase shares of common stock were included in the computation of diluted EPS because the options' exercise price was not greater than the average market price of the common shares.

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	Year Ended December 31, 2016		
	Income	Weighted-Average Shares	Per Share Amount
Basic earnings per share			
Income available to common stockholders	\$ 7,988	1,572,992	<u>\$ 5.08</u>
Effect of dilutive securities			
Stock options		<u>35,226</u>	
Diluted earnings per share assumed conversions			
stockholders and assumed conversions	<u>\$ 7,988</u>	<u>1,608,218</u>	<u>\$ 4.97</u>

As of December 31, 2016, all options to purchase shares of common stock were included in the computation of EPS because the options exercise price was not greater than the average market price of common shares.

Note 15: Disclosures about Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

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Recurring Measurements

The following tables present the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2017 and 2016:

	Fair Value Measurements Using							
	Fair Value		Quoted Prices		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
			in Active Markets for Identical Assets (Level 1)					
December 31, 2017:								
U.S. government agencies	\$	39,675	\$	-	\$	39,675	\$	-
SBA Loan Pools		4,695		-		4,695		-
Mortgage-backed securities of U.S. government sponsored enterprises		15,299		-		15,299		-
State and political subdivisions		56,558		-		56,558		-
Corporate Bonds		1,000		-		1,000		-
December 31, 2016:								
U.S. government agencies	\$	26,041	\$	-	\$	26,041	\$	-
SBA Loan Pools		5,543		-		5,543		-
Mortgage-backed securities of U.S. government sponsored enterprises		19,238		-		19,238		-
State and political subdivisions		51,219		-		51,219		-
Corporate Bonds		1,000		-		1,000		-

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets. There have been no significant changes in the valuation techniques during the year-ended December 31, 2017.

Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Level 2 securities include U.S. government agencies, Mortgage-backed securities of U.S. government sponsored enterprises, State and political subdivisions and corporate bonds. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

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Nonrecurring Measurements

The following tables present the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2017 and 2016:

		Fair Value Measurements Using			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	Fair Value				
December 31, 2017:					
Collateral-dependent impaired loans	\$ 133	\$ -	\$ -	\$ 133	
December 31, 2016:					
Collateral-dependent impaired loans	\$ 4,177	\$ -	\$ -	\$ 4,177	

Following is a description of the valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Collateral-dependent Impaired Loans, Net of ALLL

The estimated fair value of collateral-dependent impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

The Company considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by management. Appraisals are reviewed for accuracy and consistency. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by comparison to historical results.

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Unobservable (Level 3) Inputs

The following table presents quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements at December 31, 2017 and 2016.

		Fair Value at 12/31/2017	Valuation Technique	Unobservable Inputs	Weighted Average
Collateral-dependent impaired loans	\$	133	Market comparable properties	Marketability discounts	10%
		Fair Value at 12/31/2016	Valuation Technique	Unobservable Inputs	Weighted Average
Collateral-dependent impaired loans	\$	4,177	Market comparable properties	Marketability discounts	10%

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Collateral-dependent impaired loans

The significant unobservable input used in the fair value measurement of the Company's collateral-dependent impaired loans is the marketability discount. Significant increases in this input in isolation would result in a significantly lower fair value measurement.

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Fair Value of Financial Instruments

The following table presents estimated fair values of the Company's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2017 and 2016.

		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Carrying Amount				
December 31, 2017				
Financial assets				
Cash and cash equivalents	\$ 27,934	\$ 27,934	\$ -	\$ -
Interest-bearing time deposits	250	250	-	-
Held-to-maturity securities	4,673	-	4,740	-
Loans, net of allowance for loan losses	703,542	-	-	707,337
Nonmarketable equity securities	2,830	-	2,830	-
Interest receivable	3,114	3,114	-	-
Financial liabilities				
Deposits	776,806	-	776,329	-
Short-term borrowings	24,665	-	24,661	-
Long-term borrowings	15,460	-	15,247	-
Interest payable	272	272	-	-
December 31, 2016				
Financial assets				
Cash and cash equivalents	\$ 21,360	\$ 21,360	\$ -	\$ -
Held-to-maturity securities	5,571	-	5,772	-
Loans, net of allowance for loan losses	617,861	-	-	625,643
Nonmarketable equity securities	2,825	-	2,825	-
Interest receivable	2,241	2,241	-	-
Financial liabilities				
Deposits	664,674	-	664,707	-
Short-term borrowings	24,456	-	24,456	-
Long-term borrowings	15,460	-	15,254	-
Interest payable	221	221	-	-

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The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheet at amounts other than fair value.

Cash and Cash Equivalents, Interest-bearing Time Deposits, and Nonmarketable Equity Securities and Interest Receivable

The carrying amount approximates fair value.

Held-to-maturity Securities

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

Fair value is estimated by discounting the future cash flows using the market rates at which similar notes would be made to borrowers with similar credit ratings and for the same remaining maturities. The market rates used are based on current rates the Bank would impose for similar loans and reflect a market participant assumption about risks associated with nonperformance, illiquidity, and the structure and term of the loans along with local economic and market conditions.

Deposits

Fair value of term deposits is estimated by discounting the future cash flows using rates of similar deposits with similar maturities. The market rates used were obtained from a knowledgeable independent third party and reviewed by the Company. The rates were the average of current rates offered by local competitors of the bank.

The estimated fair value of demand, NOW, savings and money market deposits is the book value since rates are regularly adjusted to market rates and amounts are payable on demand at the reporting date.

Short-term Borrowings and Interest Payable

The carrying amount approximates fair value.

Federal Home Loan Bank Advances

Fair value is estimated by discounting the future cash flows using rates of similar advances with similar maturities. These rates were obtained from current rates offered by FHLB.

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Subordinated Debentures

Fair value of the subordinated debt is estimated by discounting the estimated future cash flows using current estimated market rates. The market rates used were based on the 10-Year treasury constant maturity as of December 31, 2017 adjusted for spreads over the 10-Year treasury at the issuance date of the subordinated notes.

Commitments to Originate Loans, Forward Sale Commitments, Letters of Credit and Lines of Credit

The fair value of commitments to originate loans is estimated using 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. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The fair value of forward sale commitments is estimated based on current market prices for loans of similar terms and credit quality. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date. The fair values of commitments were not material at December 31, 2017 and 2016.

Note 16: Commitments and Credit Risk

As of December 31, 2017, the Bank had \$59,904,000 in outstanding loan balances to churches within the Bank's lending area with an additional \$3,538,000 available to be drawn, representing the largest concentration of the Company.

Letters of Credit

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

The Bank had total outstanding letters of credit amounting to \$596,000 and \$478,000 at December 31, 2017 and 2016, respectively, with maturities within the next 12 months.

Lines of Credit

Lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Lines of credit generally have fixed expiration dates. Since a portion of the line may expire without being drawn upon, the total unused lines do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-

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(Table Dollar Amounts in Thousands)

case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate. Management uses the same credit policies in granting lines of credit as it does for on-balance-sheet instruments.

At December 31, 2017, the Bank had granted unused lines of credit to borrowers aggregating approximately \$37,858,000 and \$32,182,000 for commercial lines and open-end consumer lines, respectively. At December 31, 2016, the Bank had granted unused lines of credit to borrowers aggregating approximately \$35,947,000 and \$30,095,000 for commercial lines and open-end consumer lines, respectively.

Commitments to Originate Loans

Commitments to originate loans 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 a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate.

At December 31, 2017, and 2016, the Bank had outstanding commitments to originate variable rate loans aggregating approximately \$26,407,000 and \$46,079,000, respectively. The commitments extended over varying periods of time with the majority being disbursed within a one-year period.

Heartland BancCorp
Notes to Consolidated Financial Statements
December 31, 2017 and 2016
(Table Dollar Amounts in Thousands)

Note 17: Condensed Financial Information (Parent Company Only)

Presented below is condensed financial information as to the financial position, results of operations and cash flows of the Company:

Condensed Balance Sheets

	December 31,	
	2017	2016
Assets		
Cash and cash equivalents	\$ 2,331	\$ 1,991
Investment in common stock of the Bank	81,812	74,973
Other assets	655	591
	<u>655</u>	<u>591</u>
Total assets	<u>\$ 84,798</u>	<u>\$ 77,555</u>
Liabilities		
Long Term Debt	5,460	5,460
Other liabilities	782	695
	<u>782</u>	<u>695</u>
Total liabilities	6,242	6,155
Shareholders' Equity	<u>78,556</u>	<u>71,400</u>
Total liabilities and shareholders' equity	<u>\$ 84,798</u>	<u>\$ 77,555</u>

Heartland BancCorp
Notes to Consolidated Financial Statements
December 31, 2017 and 2016
(Table Dollar Amounts in Thousands)

Condensed Statements of Income and Comprehensive Income

	Year Ending December 31,	
	2017	2016
Income		
Dividends from the Bank	\$ 3,025	\$ 2,706
Total income	3,025	2,706
Expenses		
Interest expense	275	273
Other expenses	233	195
Total expenses	508	468
Income Before Income Tax and Equity in Undistributed Income of the Bank	2,517	2,238
Income Tax Benefit	(225)	(159)
Income Before Equity in Undistributed Income of the Bank	2,742	2,397
Equity in Undistributed Income of the Bank	6,131	5,591
Net Income	\$ 8,873	\$ 7,988
Comprehensive Income	\$ 9,395	\$ 6,450

Heartland BancCorp
Notes to Consolidated Financial Statements
December 31, 2017 and 2016
(Table Dollar Amounts in Thousands)

Condensed Statements of Cash Flows

	Year Ending December 31,	
	2017	2016
Operating Activities		
Net income	\$ 8,873	\$ 7,988
Stock option expense	186	164
Tax benefit related to stock options exercised	52	92
Items not providing cash	(6,421)	(5,772)
	<u>2,690</u>	<u>2,472</u>
Net cash provided by operating activities		
Investing Activities		
Investment in Common Stock of the Bank	-	-
Financing Activities		
Cash dividends paid	(2,677)	(2,398)
Proceeds from stock options exercised	327	770
Purchase of common stock	-	(304)
	<u>(2,350)</u>	<u>(1,932)</u>
Net cash used in financing activities		
Net Change in Cash and Cash Equivalents	340	540
Cash and Cash Equivalents at Beginning of Year	<u>1,991</u>	<u>1,451</u>
Cash and Cash Equivalents at End of Year	<u><u>\$ 2,331</u></u>	<u><u>\$ 1,991</u></u>

Note 18: Subsequent Events

Subsequent events have been evaluated through March 9, 2018 which is the date the financial statements were available to be issued.



CENTRAL OHIO FOOTPRINT

1. Croton	740-893-2191	9. Capitol Square	614-416-0244	17. Friendship Village of Dublin	614-923-0575
2. Johnstown	740-967-6500	10. Grove City	614-875-1884	18. Worthington Christian Village	614-846-6076
3. Westerville	614-839-2265	11. Wilson Road	614-351-2100	19. Friendship Village of Columbus	614-394-8686
4. Newark	740-349-7888	12. Hilliard	614-710-1640		
5. Gahanna	614-337-4605	13. Dublin	614-798-8818		
6. Stygler Road	614-475-7024	14. Clintonville	614-745-0070		
7. Reynoldsburg	614-416-0400	15. Whitehall	614-416-4601		
8. Pickerington	614-321-4919	16. Upper Arlington	Coming Soon!		

General Info

Heartland BancCorp is a registered Ohio bank holding company and the parent of Heartland Bank, which operates fifteen full-service banking offices. Heartland Bank, founded in 1911, provides full service commercial, small business, and consumer banking services; alternative investment services and other financial products and services. Heartland Bank is a member of the Federal Reserve, a member of the FDIC and an Equal Housing Lender. Heartland BancCorp is currently quoted on the OTC markets (OTCQB) under the symbol HLAN.

430 North Hamilton Road
Whitehall, OH 43213

Member FDIC NMLS# 440231  Equal Housing Lender

Heartland.Bank
1(800) 697-0049