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HEARTLAND PARTNERS L P
Form 10-Q
May 24, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2005

OR

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

For the transition period from _____ to _____

Commission File Number: 1-10520

HEARTLAND PARTNERS, L.P.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE

36-3606475

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

53 WEST JACKSON BLVD., SUITE 1150, CHICAGO, ILLINOIS

60604

(Address of Principal Executive Offices)

(Zip Code)

312/834-0592

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to such
filing requirements for the past 90 days.

Yes X No
 --- ---

Indicate by check mark whether the registrant is an accelerated filer (as
defined in Rule 12b-2 of the Exchange Act).

Yes No X

HEARTLAND PARTNERS, L.P.
MARCH 31, 2005

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HEARTLAND PARTNERS, L.P.

CONSOLIDATED BALANCE SHEETS
(dollars in thousands)
(Unaudited)

March 31,
2005

December 31,
2004

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Assets:				
Cash and cash equivalents	\$	4,396	\$	1,450
Accounts receivable (net of allowance of \$354 at March 31, 2005 and December 31, 2004)		638		905
Due from affiliate (net of allowance of \$7,334 and \$7,234 at March 31, 2005 and December 31, 2004, respectively)		2,400		2,500
Prepaid and other assets		252		402
-----			-----	
Total		7,686		5,257
-----			-----	
Property:				
Land		383		383
Buildings and Improvements		141		141
Less accumulated depreciation		(21)		(20)
-----			-----	
Net land, buildings and improvement		503		504
Land held for sale		2,343		5,912
-----			-----	
Net properties		2,846		6,416
-----			-----	
Total assets	\$	10,532	\$	11,673
=====			=====	
Liabilities:				
Accounts payable and accrued expenses	\$	1,840	\$	1,234
Accrued real estate taxes		108		186
Allowance for claims and liabilities		3,665		4,228
Unearned rents and deferred income		869		888
Other liabilities		1		1
-----			-----	
Total liabilities		6,483		6,537
-----			-----	
Partners' capital:				
General Partner		--		--
Class A Limited Partners - 2,142 units authorized and issued and 2,092 outstanding at March 31, 2005 and December 31, 2004		--		--
Class B Limited Partner		4,049		5,136
-----			-----	
Total partners' capital		4,049		5,136
-----			-----	
Total liabilities and partners' capital	\$	10,532	\$	11,673
=====			=====	

The accompanying notes are an integral part of these financial statements.

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	For the Three Months Ended March 31,	
	2005	2004

INCOME:		
Property sales	\$ 4,203	\$ 3,115
Less: Cost of property sales	3,952	744

GROSS PROFIT ON PROPERTY SALES	251	2,371

OPERATING EXPENSES:		
Selling expenses	287	341
General and administrative expenses	617	826
Interest expense	--	17
Bad debt expense	100	--
Real estate taxes	42	71
Environmental expenses and other charges	300	486

TOTAL OPERATING EXPENSES	1,346	1,741

OPERATING (LOSS) INCOME	(1,095)	630
OTHER INCOME AND (EXPENSES):		
Interest income	6	5
Rental income	49	397
Other income	57	20
Depreciation	(1)	(12)
Management fee	(103)	(103)

TOTAL OTHER INCOME	8	307

NET (LOSS) INCOME	\$ (1,087)	\$ 937
	=====	
Net income allocated to General Partner	\$ --	\$ 9
	=====	
Net (loss) income allocated to Class B Limited Partner	\$ (1,087)	\$ 48
	=====	
Net income allocated to Class A Limited Partners	\$ --	\$ 880
	=====	
Net income per Class A Limited Partnership Unit	\$ --	\$ 0.42
	=====	
Weighted average number of Class A Limited Partnership Units outstanding	2,092	2,092
	=====	

The accompanying notes are an integral part of these financial statements.

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HEARTLAND PARTNERS, L. P.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

	For the Three Months Ended March 31,	
	2005	2004
CASH FLOW FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ (1,087)	\$ 937
Adjustments reconciling net (loss) income to net cash provided by operating activities:		
Land write off to cost of sales	--	108
Depreciation	1	12
Bad debt expense	100	--
Net change in allowance for claims and liabilities	(563)	57
Net change in assets and liabilities:		
Decrease in accounts receivable	267	188
Decrease in land held for sale	3,569	548
Increase (decrease) in accounts payable and accrued liabilities	606	(968)
Net change in other assets and liabilities	53	(699)
Net cash provided by operating activities	2,946	183
Net increase in cash	2,946	183
Cash at beginning of period	1,450	3,926
Cash at end of period	\$ 4,396	\$ 4,109
NON-CASH ACTIVITIES:		
Write off of furniture, fixtures and equipment and the related accumulated depreciation	\$ --	\$ 52

The accompanying notes are an integral part of these financial statements.

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Heartland Partners, L.P.
Notes to Consolidated Financial Statements
(Unaudited)

These unaudited consolidated financial statements of Heartland Partners, L.P., a Delaware limited partnership, and its subsidiaries (collectively, "Heartland" or

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the "Company"), have been prepared pursuant to the Securities and Exchange Commission ("SEC") rules and regulations and should be read in conjunction with the financial statements and notes thereto included in the Company's 2004 Annual Report on Form 10-K (the "2004 Form 10-K"). The following Notes to Consolidated Financial Statements highlight significant changes to the notes included in the 2004 Form 10-K and present interim disclosures as required by the SEC. The accompanying unaudited consolidated financial statements reflect, in the opinion of management, all adjustments necessary for a fair presentation of the interim financial statements. All such adjustments are of a normal and recurring nature.

1. Organization

Organization and Purpose

Heartland was formed on October 6, 1988. Heartland's existence will continue until December 31, 2065, unless extended or dissolved pursuant to the provisions of Heartland's partnership agreement. Heartland was originally organized to engage in the ownership, purchasing, development, leasing, marketing, construction and sale of real estate properties.

Heartland is now attempting to sell its remaining real estate holdings, pursuing recovery on claims it has against local government units in Wisconsin and foreclosing on the Company's Class B Interest held by a wholly owned subsidiary of Heartland Technology, Inc., a Delaware corporation formerly known as Milwaukee Land Company ("HTI"), that secures outstanding loans from the Company to HTI that HTI has indicated it will be unable to repay.

The Company is additionally undertaking to resolve and pay or make provisions for its remaining liabilities, most of which are actual or contingent environmental liabilities. Heartland is also a party to litigation involving its former chief executive officer. The amount and timing of future cash distributions will depend on generation of cash from sales and claims, resolution of liabilities and associated costs.

HTI Interests, LLC, a Delaware limited liability company and sole general partner of Heartland (the "General Partner" or "HTII"), is owned 99.9% by HTI, and 0.1% by HTI Principals, Inc., a Delaware corporation owned by four current members and one former member of HTII's board of managers. CMC Heartland Partners, a Delaware general partnership ("CMC"), is an operating general partnership owned 99.99% by Heartland and 0.01% by HTII.

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Heartland Partners, L.P. Notes to Consolidated Financial Statements (Unaudited)

The following table sets forth certain entities formed by Heartland since its inception that currently hold real estate and other assets, the date and purpose of formation, development location and ownership:

COMPANY -----	YEAR FORMED -----	BUSINESS PURPOSE -----
Heartland Development Corporation (1) ("HDC")	1993	General Partner of CMC Heartland Limited Partnership

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CMC Heartland Partners III, LLC (2) ("CMCIII") 1997 Owned Kinzie Station Phases I an

(1) Wholly owned by Heartland Partners, L.P.

(2) Wholly owned by CMC.

Except as otherwise noted herein, references in this report to "Heartland" or the "Company" include CMC, HDC and CMCIII.

2. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of Heartland Partners, L.P.; CMC, its 99.99% owned operating partnership; HDC, 100% owned by Heartland Partners, L.P. and CMCIII, 100% owned by CMC. All intercompany transactions have been eliminated in consolidation.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reasonable estimates of their fair values because of the short maturity of these financial instruments. The amounts due from affiliate have been written down to reflect its fair value.

Revenue Recognition

Land sales are recognized when the Company has received an adequate cash down payment and all other conditions necessary for profit recognition have been satisfied.

Property

Properties and improvements are carried at their historical cost. Depreciation is provided for financial statement purposes over the estimated useful life of the respective assets ranging from thirty one and one-half (31 1/2) to forty (40) years for building and improvements using the straight-line method.

For properties held for sale, an impairment loss is recognized when the fair value of the property, less the estimated cost to sell, is less than the carrying amount of the property. No event occurred during the first three months of 2005 that resulted in an impairment loss being recognized.

Reclassification

Certain reclassifications have been made to the prior periods' financial statements in order to conform with the current period presentation.

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Heartland Partners, L.P.
Notes to Consolidated Financial Statements
(Unaudited)

3. Real Estate Sale Activities

Property sales during the three months ended March 31, 2005 totaled \$4,203,000 which consisted of the sale of 1.25 acres of land in Chicago, IL (Kinzie Station

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Phase II) for \$4,200,000 and various minor land held for sale parcels for \$3,000.

Property sales during the three months ended March 31, 2004 totaled \$3,115,000 which consisted of approximately 2 acres of land in the Kinzie Station development in Chicago, Illinois for \$1,597,000, 6 acres of land at Petit Point located near Milwaukee, Wisconsin for \$1,155,000, and various land held for sale parcels for approximately \$363,000.

At March 31, 2005 the Company had remaining property and air rights at Kinzie Station in Chicago, Illinois, of approximately 2.85 acres, a 20 acre property in Glendale, Wisconsin, 28 acres in Rockford, Illinois, a five acre site in Minneapolis, Minnesota and approximately 157 acres of land scattered over 9 states.

In addition, although the Company conveyed its property in Menomonee Valley located in Milwaukee, Wisconsin to the Redevelopment Authority of the City of Milwaukee ("RACM") and received \$3,550,000 in connection with a July 2003 condemnation proceeding, it retained the right to appeal the purchase price and to seek additional consideration. In April 2004 the Company filed suit against RACM in the Milwaukee County Circuit Court appealing the compensation paid by RACM. Heartland's appraiser has valued the property at \$15,000,000. However, there can be no certainty that the Company will be successful in obtaining additional compensation in its suit against RACM.

4. Related Party Transactions

Management Agreement

Heartland has a management agreement with HTII pursuant to which Heartland is required to pay HTII an annual management fee in the amount of \$413,000. The management agreement terminates on June 27, 2005. The management fee of \$103,000 for the three months ended March 31, 2005 has been accrued but not paid.

Notes Receivable from HTI

As of March 31, 2005 and December 31, 2004, HTI owed Heartland an aggregate of \$9,734,000 of which \$8,464,000 relates to promissory notes issued in 2000 and 2001 (the "2000 Notes") and \$1,270,000 relates to the Company's purchase of certain notes from PG Oldco, Inc., a creditor of HTI ("PG Oldco Notes"). The 2000 Notes and the PG Oldco Notes are collateralized by a security interest in the Class B Interest (the "Collateral"). Heartland has recorded an allowance for doubtful accounts of approximately \$7,334,000 and \$7,234,000 on the 2000 Notes and PG Oldco Notes receivable balance of \$9,734,000 at March 31, 2005 and December 31, 2004, respectively. An additional allowance for doubtful accounts

of \$100,000 was recorded for the three months ended March 31, 2005 due to continued operating costs above amounts estimated in prior periods. Because Heartland intends to acquire the Class B Interest from HTI either pursuant to a proposed settlement agreement between HTI and certain of its creditors or upon a foreclosure of the Class B Interest, as discussed below, Heartland has determined that the amount due from affiliate should reflect the value of the Class B Interest based on the estimated amount of potential future cash distributions distributable in respect of the Class B Interest upon a

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liquidation of Heartland (assuming that the Class B Interest is not cancelled and remains outstanding). In the event that the proposed settlement agreement is not approved by HTI's other creditors, Heartland anticipates that it will exercise its rights under the 2000 Notes, the PG Oldco Notes, the related security agreements and applicable law to foreclose on the Class B Interest. Upon either the acquisition of the Class B Interest pursuant to the proposed settlement agreement or the foreclosure on the Class B Interest, the receivable amount in respect of the 2000 Notes and the PG Oldco Notes reflected in the "Due from Affiliate" account will be reduced to zero, and the Class B Interest and the Class B Interest's capital account balance will be cancelled. If cancelled, the Class B Interest will no longer be entitled to receive any distributions of cash or other property from Heartland. Although Heartland's management believes it is unlikely, there can be no assurance that either the settlement agreement will be approved by HTI's creditors or that Heartland will be able to foreclose on the Class B Interest. If the Class B Interest is not foreclosed upon and cancelled, it will be entitled to receive distributions in accordance with the terms of the partnership agreement.

Conflicts of Interest of General Partner and its Officers and Directors

The officers and directors of HTI, the officers of Heartland and the managers of HTII; including Lawrence S. Adelson, Chairman of the Board, President and Chief Executive Officer of HTI and Chief Executive Officer of Heartland, will not devote their entire business time to the affairs of Heartland. The Heartland Partnership Agreement provides that (i) whenever a conflict of interest exists or arises between the General Partner or any of its affiliates, on the one hand, and Heartland, or any Unitholder on the other hand, or (ii) whenever the Heartland Partnership Agreement or any other agreement contemplated therein provides that the General Partner shall act in a manner which is, or provide terms which are, fair and reasonable to Heartland, or any Unitholder, the General Partner shall resolve such conflict of interest, take such action or provide such terms, considering in each case the relative interests of each party (including its own interest) to such conflict, agreement, transaction or situation and the benefits and burdens relating to such interests, any customary or accepted industry practices, and any applicable generally accepted accounting practices or principles. Thus, unlike the strict duty of a fiduciary who must act solely in the best interests of his beneficiary, the Heartland Partnership Agreement permits the General Partner to consider the interests of all parties to a conflict of interest, including the General Partner. The Heartland Partnership Agreement also provides that, in certain circumstances, the General Partner will act in its sole discretion, in good faith or pursuant to other appropriate standards. The General Partner has sole authority over the timing and amount of distributions as well as dissolution of the partnership.

Other

A senior partner of a law firm who provides services to the Company owns approximately 7.5% of the stock of HTI. Lawrence S. Adelson also owns 119,500 shares of HTI. Furthermore, Lawrence S. Adelson, C.E.O. of the Company, and Richard P. Brandstatter, an outside consultant to the Company and a Manager of HTII, are employees and directors of HTI.

5. Legal Proceedings and Contingencies

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At March 31, 2005 and December 31, 2004, Heartland's allowance for claims and liabilities was approximately \$3,665,000 and \$4,228,000, respectively. The decrease in the allowance resulted from payments made by Heartland and Borax for remediation of contamination at the Lite Yard site in Minneapolis, Minnesota.

Krachte Litigation

On September 21, 2004, the surviving spouse of an employee of a contractor demolishing buildings on what was then Company owned property filed suit against the Company, the contractor and the contractor's insurer in Milwaukee County, Wisconsin Circuit Court alleging wrongful death of the employee and other damages. The matter has been referred to the Company's insurer which has accepted the defense of this litigation.

Maples

Under the terms of a lot agreement with the Longleaf Associates Limited Partnership ("LALP"), one of Heartland's subsidiaries was required to pay \$135,000, \$250,000, \$135,000 and \$250,000 on April 1, 2002, November 1, 2002, April 1, 2003, and November 1, 2003, respectively, to Maples, the owner and operator of the golf course and club house located at the Longleaf Country Club in Southern Pines, North Carolina. The four payments totaling \$770,000 were not made, which constituted an event of default under the lot agreement. The Company believes Maples is in default of its obligations under the golf membership agreements. In addition, LALP, the seller of the Longleaf lots, did not notify the Company's subsidiary that it was in default. LALP would have been entitled to seek specific performance and/or other remedies as provided for in the membership agreement. However, due to its belief that Maples had breached the membership agreement, the Company's subsidiary did not make these payments. On June 19, 2003, Maples joined the Company's subsidiary as a defendant in a lawsuit Maples filed against LALP in the North Carolina General Court of Justice Superior Court Division of Moore County for breach of contract. Maples is seeking \$3,515,000 in compensatory damages from the defendants. The Company's subsidiary is vigorously defending itself against this action, and, at this time, the Company has not recorded a loss contingency because the Company cannot determine (a) if it is probable that a liability will be incurred and (b) the amount of any possible liability. The Company's management is not able to express an opinion on whether this action will adversely affect the Company's future financial condition or results of operations. At this time, due to the sale of all of the assets of the Company's subsidiary on December 31, 2003, and due to the release of the Company's subsidiary from any liability related to the lot agreement by LALP, the Company is attempting to have the Company's subsidiary removed as a defendant in the lawsuit.

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Heartland Partners, L.P.
Notes to Consolidated Financial Statements
(Unaudited)

Edwin Jacobson Lawsuit

On August 19, 2002, the former President and Chief Executive Officer of CMC, Edwin Jacobson, filed two lawsuits against the Company, CMC and certain officers and/or managers of the General Partner. One of the lawsuits alleges CMC breached the terms of his employment contract and that the officers and/or board members wrongfully interfered with his contract. Jacobson is seeking compensatory and

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punitive damages (\$1,000,000 in salary and \$11,000,000 in incentive compensation). Jacobson asked the court to enforce his contract and enjoin the Company from selling property or making distributions to the Unitholders until the Company has appraised its properties and paid him according to the terms of his employment contract. Jacobson's second lawsuit was for defamation. On January 31, 2003, the Company filed motions to dismiss the amended lawsuits. On May 29, 2003, the court dismissed, with prejudice, the defamation lawsuit against the Company, CMC and certain officers and/or managers of the General Partner. At the same time, the court dismissed, with prejudice, Jacobson's motion to enjoin the Company from selling its real estate properties. Jacobson also filed a motion for summary judgment on his contract claims which the court denied. Jacobson filed a motion for reconsideration which was denied on April 8, 2005. CMC has filed a counterclaim alleging breach of fiduciary duty and a motion to dismiss the claim for tortious interference with a contract. Jacobson filed a motion for summary judgment on CMC's counterclaim alleging breach of fiduciary duty which was denied on April 8, 2005.

On February 28, 2003, the Company filed suit against Jacobson in Delaware state court to collect a note from Jacobson to the Company in the amount of \$332,000, which includes \$16,000 of interest that has not been recorded in the Company's consolidated financial statements. On July 8, 2003, the Delaware Court stayed that action pending resolution of Jacobson's action against the Company.

CMC is vigorously defending itself against Jacobson's lawsuit and, in the opinion of management, has valid defenses against the remaining lawsuit relating to the Company's alleged breach of Jacobson's employment contract. At this time, the probability that a liability will be incurred and the amount of any potential liability cannot be determined. However, this litigation may not be resolved in the Company's favor, and the Company may incur significant costs associated therewith. If the Company is required to pay substantial amounts with respect to the Jacobson litigation, the Company may not be left with any cash or other property to distribute to the Unitholders. The parties have agreed to voluntary, non-binding mediation.

RACM

On July 30, 2003, the Company conveyed 142 acres of property in Milwaukee, Wisconsin to the RACM in consideration of \$3.55 million in lieu of condemnation. The Company reserved the right to appeal the fair market value of the property and filed that appeal on April 6, 2004, in Milwaukee County, Wisconsin Circuit court. The most recent appraisal performed on behalf of the Company opines that the property had a fair market value of \$15 million. There is no assurance that a court will award that amount at trial or that RACM would offer that amount to settle the litigation. A court could find that the property was worth less than \$3.55 million and order the Company to return money to RACM. Any determination of fair market value and award to the Company will be net of the \$3.55 million which the Company has already received. In the event of a court decision that determines the value of the property to be more than 115% of \$3.55 million, the Company will be entitled to recover certain costs of the appeal.

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CMC owns a 5 acre site in Minneapolis, Minnesota that is impacted with arsenic and lead ("Lite Yard"). On April 29, 2004, a Response Action Plan for the site was approved by the Minnesota Department of Agriculture. The Company filed suit against US Borax Inc. ("Borax") on July 23, 2003, in the United States District Court for the District of Minnesota for contribution. Borax, which discontinued operations in 1968, is a former operator of a pesticide/herbicide facility on the property. This matter was settled pursuant to a Confidential Settlement Agreement and Release dated September 27, 2004, between the Company and Borax. Pursuant to the settlement agreement, Borax has agreed to pay a portion of the Company's past and future response costs at the site. At March 31, 2005 and December 31, 2004, the Company's aggregate allowance for claims and liabilities for this site was \$1,044,000 and \$1,588,000, respectively. Of this amount, \$19,000 was billed, but not yet paid, in respect of work related to the site through March 31, 2005.

At March 31, 2005, the Company has recorded a \$638,000 receivable for the portion of these amounts due from Borax under the settlement agreement.

On September 3, 2004, the United States Environmental Protection Agency ("USEPA") issued an order ("Order") requiring the Company and Borax to remediate arsenic in the soils of a nearby residential neighborhood on an emergency basis. On January 24, 2005, the USEPA issued a general notice letter ("Letter") to the Company and Borax requesting that the Company and Borax perform a remedial investigation and feasibility study on the soils of the same nearby residential neighborhood on a non-emergency basis for matters not covered by the Order. Neither the Order nor the Letter are covered by the Confidential Settlement Agreement and Release between the Company and Borax.

The Company offered the USEPA \$300,000 to settle the Company's obligations under the Order and Letter. The USEPA has not yet responded to the Company's offer. The Company believes, based on USEPA publications, that the USEPA has provided \$1,500,000 for past and future remediation activities in the residential neighborhood. This amount does not necessarily represent the entire cost of the cleanup being undertaken by the USEPA. The entire cost could be higher or lower. The USEPA could seek substantial penalties against the Company in addition to remediation costs. The Company engaged an environmental engineering consultant to review information available regarding the possible scope and cost of USEPA activities. The consultant projected a range of possible costs of \$2,841,000 to \$3,833,000. However, this estimate was based on limited data available to the consultant. The Company has reserved \$1,196,000 in connection with the Order and Letter. This reserve amount takes into consideration the estimated range of possible costs and the allocation of costs among PRPs for the on-site remediation at the Lite Yard.

A former consultant for the Company at the Lite Yard, Exponent, Inc., filed suit against the Company in Minnesota state court on January 27, 2005. The complaint alleges that the Company owes Exponent \$361,000 in unpaid consultant fees. CMC has disputed the reasonableness of Exponent's invoices.

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Heartland Partners, L.P.
Notes to Consolidated Financial Statements
(Unaudited)

Miles City Yard

By letter dated June 10, 2004, the Montana Department of Environmental Quality

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(the "DEQ") demanded that the Company perform a remedial investigation of a railyard in Miles City, Montana previously owned and operated by the Milwaukee Road. The Company has, for many years, been conducting a clean-up of a substantial diesel fuel release at this site. On September 7, 2004, Trinity Railcar Repair, Inc. ("Trinity") filed suit against the Company and CMC in Custer County, Montana state court, for contribution under state environmental law, for indemnification under sale agreements between the Company's predecessors-in-interest and Trinity's alleged predecessors and for injunctive relief prohibiting the Company from dissolving or making any distributions to its Unitholders. On September 14, 2004, Trinity filed a motion for a preliminary injunction to prohibit the Company from liquidating or making distributions to its Unitholders. On January 10, 2005, the court held a hearing at which the Company's engineering witness testified that the maximum cost of investigation and remediation could be as much as \$1,250,000. However, this estimate was not based on any direct investigation of conditions at the site. On March 24, 2005, the court ordered the Company to escrow cash, post a bond, or provide another guarantee, of \$2,500,000 to cover possible remediation and clean-up costs for the site. The court did not make a determination as to the requirement for any remediation, the costs of remediation or liability for any costs. The Company is considering an appeal of this order and is negotiating a letter of credit to comply with the terms of such order. The Company, based on current review of the site believes that the range of costs of investigation and remediation, including the ongoing diesel fuel clean-up could be between \$618,000 and \$1,740,000. At March 31, 2005, the Company's aggregate allowance for claims and liabilities for this site (including costs of investigation, remediation and legal fees relating to the litigation) is \$618,000.

Bozeman

In 2001 the Company sold a 14 acre property to the City of Bozeman, Montana that was known to be contaminated with asbestos ore. As part of the sale, the City of Bozeman released the Company from all environmental liability. The City of Bozeman performed a clean-up of the north half of the property. In September 2003, the Company received a letter from the DEQ requesting an investigation of possible asbestos ore on the south half of the property sold to the City of Bozeman and a neighboring property. By letter dated November 3, 2004, the Company was notified by the DEQ that the City of Bozeman, Montana had initiated a proceeding under the Montana Controlled Allocation of Liability Act ("CALA") with regard to the sold property. In the administrative proceeding, the DEQ will allocate environmental liability among potentially liable parties. The Company has projected that the total cost of the remediation already performed by the City of Bozeman plus additional remediation which may be required for the south half of the property is approximately within a range from \$997,000 to \$1,645,000. The estimated range of costs for the neighboring property is \$120,000 to \$219,000. The Company believes it has valid defenses to any CALA allocated liability for the clean-up of the north half of the property and could assert a claim against the City of Bozeman for liabilities for any clean-up of the south half of the property. The Company has reserved an aggregate of \$332,000 for all claims and liabilities associated with this property and the neighboring property. This reserve amount reflects the estimated low end of the range of costs for the off-site remediation and the estimated low end of the range of future on-site costs and takes into account the Company's limited liability to the City of Bozeman under the terms of the sale of the property to the City of Bozeman.

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Other Environmental Matters

Under environmental laws, liability for hazardous substance contamination is imposed on the current owners and operators of the contaminated site, as well as the owner or the operator of the site at the time the hazardous substance was disposed or otherwise released. In most cases, this liability is imposed without regard to fault. Currently, the Company has known environmental liabilities associated with certain of its properties arising out of the activities of its predecessor or certain of its predecessor's lessees and may have further material environmental liabilities as yet unknown. The majority of the Company's known environmental liabilities stem from the use of petroleum products, such as motor oil and diesel fuel, in the operation of a railroad or in operations conducted by its predecessor's lessees.

The DEQ has asserted that the Company is liable for some or all of the investigation and remediation of certain properties in Montana sold by its predecessor's reorganization trustee prior to the consummation of its predecessor's reorganization. The Company has denied liability at certain of these sites based on the reorganization bar of the Company's predecessor. The Company's potential liability for the investigation and remediation of these sites was discussed in detail at a meeting with the DEQ in April 1997. While the DEQ has not formally changed its position, DEQ has not elected to file suit.

At two separate sites, the Company has been notified that releases arising out of the operations of a lessee, former lessee or other third party have been reported to government agencies. At each of these sites, the third party is voluntarily cooperating with the appropriate agency by investigating the extent of any such contamination and performing the appropriate remediation, if any.

In November 1995, the Company settled a claim with respect to the so-called "Wheeler Pit" site near Janesville, Wisconsin. The Company's only outstanding obligation under the settlement is to pay 32% of the monitoring costs for twenty-five years beginning in 1997. At March 31, 2005, Heartland's allowance for claims and liabilities for this site is \$191,000. By letter dated April 6, 2005, the lead PRP at this site offered to settle the Company's future obligations for approximately \$266,000. The Company's management believes this offer to be higher than the historical operating costs at this site and therefore has reserved a lower amount. Additionally, the lead PRP at this site previously made a demand for monitoring costs of \$53,000 incurred through March of 2004. The Company has not paid any amounts to the PRP in respect of monitoring costs for this site to date.

In addition to the environmental matters set forth above, there may be other properties, i), with environmental liabilities not yet known to the Company, or ii), with potential environmental liabilities for which the Company has no reasonable basis to estimate or, iii), which the Company believes the Company is not reasonably likely to ultimately bear the liability, but the investigation or remediation of which may require future expenditures. Management is not able to express an opinion at this time whether the environmental expenditures for these properties will or will not be material.

The Company has given notice to its insurers, which issued policies to the Milwaukee Road railroad, of certain of the Company's environmental liabilities. Due to the high deductibles on these policies, the Company has not yet demanded that any insurer indemnify or defend the Company. Consequently, management has not formed an opinion regarding the legal sufficiency of the Company's claims for insurance coverage.

Heartland Partners, L.P.
Notes to Consolidated Financial Statements
(Unaudited)

6. Compensation and Benefits

Effective January 1, 2002, the CMC Heartland Partners 2002 Incentive Plan ("2002 CMC Plan") was approved by the Company. The aggregate benefits payable under the 2002 CMC Plan shall be computed by multiplying 2% by the net proceeds from the sale of certain land parcels for the period January 1, 2002 to December 31, 2004. Effective December 22, 2004, the 2002 CMC Plan was amended to extend to the later of December 31, 2006, or the conclusion of litigation brought by the Company against the RACM for recovery of the fair value of 142 acres of property previously conveyed to RACM. One current and two former officers of the Company are eligible for benefits under the 2002 CMC Plan. Total compensation expense under the 2002 CMC Plan was \$74,000 for the three months ended March 31, 2005, which was recorded as a component of cost of property sales.

In 2005 the Company entered into a separation and consulting agreement with Mr. Brandstatter. Under the agreement, Mr. Brandstatter will receive an annual consulting fee of \$100,000 for ongoing consulting services during 2005 and can receive \$15,000 for assistance with any transition to a trustee for dissolution or liquidation. Additionally, Mr. Brandstatter was paid a \$45,000 bonus during the first quarter of 2005 that was earned during the fourth quarter of 2004 that was related to the achievement of certain criteria established by the General Partner.

7. Liquidation of Heartland Partners, L.P.

The Company's management intends to sell to unrelated third parties the remainder of its properties with a view towards eventually dissolving the partnership within the next two years. The Unitholders will not have control over the divestiture of the Company's remaining assets or, if the partnership is dissolved, the liquidation process. The Company cannot make any assurance that changes in its policies will serve fully the interests of all Unitholders or that the Unitholders will receive any liquidating distributions of cash or other property. The Company is working to resolve its remaining liabilities which primarily consist of environmental matters and Edwin Jacobson's claim against the Company. In addition, the Company is pursuing recovery on the RACM claim it has against local governmental units in Wisconsin and foreclosing on its Class B Partnership Interest. Significant estimates are used in the preparation of financial statements to value the Class B Interest which represents the collateral of the HTI note receivable owed to the Company and CMC, the recoverability of the total cost of properties and the Company's environmental liabilities. The amount and timing of any future cash distributions will depend on generation of cash from sales and claims and the resolution of liabilities. The Company has experienced recurring operating losses for the three months ended March 31, 2005 and for the years ended December 31, 2004, 2003, and 2002 and there can be no assurance that the amounts available from internally generated funds, cash on hand, and sale of the remaining assets of the Company will be sufficient to fund Heartland's anticipated operations and meet existing and future liabilities. These losses, uncertainty as to the amount and timing of additional compensation from the RACM claim, if any, and the uncertainty surrounding such environmental liabilities and other claims, particularly the Edwin Jacobson lawsuit, create uncertainties about the Company's ability to meet existing and future liabilities as they become due. The Company has taken certain steps, including the reduction of fixed overhead and conservation of cash, in light of these uncertainties. The Company may be required to seek additional capital in the form of bank financing, however, there is no assurance

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that such bank financing will be available or, if available, will be on terms favorable to the Company.

8. Subsequent Events

In April 2005 Company entered into a contract to sell approximately 4,000 square feet of commercial space and 11 parking spaces in the Kinzie Station Phase I building in Chicago, Illinois. The sales price is \$550,000. The sale is scheduled to close in June 2005.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This report includes forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements generally can be identified by phrases such as Heartland or the Company, or its management "believes," "expects," "anticipates," "foresees," "forecasts," "estimates," or other words or phrases of similar import. Similarly, statements in this report that describe the Company's plans, outlook, objectives, intentions or goals are also forward-looking statements. Forward-looking statements are not guarantees of future performance. They involve risks and uncertainties that are difficult to predict. The Company's actual future results, actions, performance or achievement of results and the value of the partnership Units may differ materially from what is forecast in any forward-looking statements. We caution you not to put undue reliance on any forward-looking statement in these documents. The Company does not undertake any obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report.

Risk Factors

Real Estate Investment Risks; General Economic Conditions Affecting Real Estate Industry

The Company faces risks associated with local real estate conditions in areas where the Company owns properties. These risks include, but are not limited to: liability for environmental hazards; changes in general or local economic conditions; changes in real estate and zoning laws; changes in income taxes, real estate taxes, or federal or local taxes; floods, earthquakes, and other acts of nature; and other factors beyond the Company's control. The illiquidity of real estate investments generally may impair the Company's ability to respond promptly to changing circumstances. The inability of management to respond promptly to changing circumstances could adversely affect the Company's financial condition and ability to make distributions to the Unitholders.

The real estate industry generally is highly cyclical and is affected by changes in national, global and local economic conditions and events, such as employment levels, availability of financing, interest rates, consumer confidence and the demand for housing and other types of construction. Sellers of real estate are subject to various risks, many of which are outside the control of the seller, including real estate market conditions, changing demographic conditions, adverse weather conditions and natural disasters, such as hurricanes and tornadoes, changes in government regulations or requirements and increases in real estate taxes and other local government fees. The occurrence of any of the

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foregoing could have a material adverse effect on the financial condition of Heartland.

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Environmental Liabilities

Under various federal, state and local laws, ordinances, and regulations, the owner or operator of real property may be liable for the costs of removal or remediation of hazardous or toxic substances located on or in, or emanating from, such property, as well as costs of investigation and property damages. Such laws often impose such liability without regard to whether the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. The presence of such substances, or the failure to properly remediate such substances, may adversely affect the owner or operator's ability to sell or lease a property or borrow using the property as collateral. Other statutes may require the removal of underground storage tanks. Noncompliance with these and other environmental, health or safety requirements may result in substantial costs to us or may result in the need to cease or alter operations on the property and may reduce the value of the property or our ability to sell it.

Environmental laws may impose liability on a previous owner or operator of a property that owned or operated the property at a time when hazardous or toxic substances were disposed on, or released from, the property. A conveyance of the property, therefore, does not relieve the owner or operator from liability. The Company cannot assure that environmental liability claims will not arise in the future.

Heartland is subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites. Heartland is in the process of assessing its environmental exposure, including obligations and commitments for remediation of contaminated sites and assessments of ranges and probabilities of recoveries from other responsible parties. Because of the regulatory complexities and risk of unidentified contaminants on its properties, the potential exists for remediation costs to be materially different from the costs Heartland has estimated. Some of the property owned by the Company consists of land formerly used for railroad. Other properties were leased to tenants that used hazardous materials in their businesses. Any contamination of that property may affect adversely the Company's ability to sell such property.

Notes Receivable from HTI

HTI owes Heartland an aggregate of \$9,734,000 of which \$8,464,000 relates to promissory notes issued in 2000 and 2001 (the "2000 Notes") and \$1,270,000 relates to the Company's purchase of certain notes from PG Oldco, Inc., a creditor of HTI ("PG Oldco Notes") and both of which are secured by the Class B Interest. Heartland has recorded an allowance for doubtful accounts of approximately \$7,334,000 related thereto. Upon either the acquisition of the Class B Interest pursuant to a proposed settlement agreement or the foreclosure on the Class B Interest, the receivable amount in respect of the 2000 Notes and the PG Oldco Notes reflected in the "Due from Affiliate" account will be reduced to zero, and the Class B Interest and the Class B Interest's capital account balance will be cancelled. If cancelled, the Class B Interest will no longer be entitled to receive any distributions of cash or other property from Heartland. Although Heartland's management believes it is unlikely, there can be no assurance that either the settlement agreement will be approved by HTI's stockholders or that Heartland will be able to foreclose on the Class B Interest. If the Class B Interest is not foreclosed upon and cancelled, it will be entitled to receive distributions in accordance with the terms of the

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Partnership Agreement.

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Pending Litigation

The Jacobson litigation described in Note 5--Legal Proceedings and Contingencies to the unaudited consolidated financial statements above may not be resolved in the Company's favor, and the Company may incur significant costs associated therewith. If the Company is required to pay substantial amounts with respect to the Jacobson litigation, the Company may not be left with any cash or other property to distribute to the Unitholders.

Additionally, as discussed in Note 5--Legal Proceedings and Contingencies to the unaudited consolidated financial statements above, a state court in Montana issued an order requiring the Company to escrow cash, post a bond, or provide another guarantee, of \$2,500,000 to cover possible remediation and clean-up costs on land formerly owned by the Company, or its predecessor-in-interest, in Miles City, Montana. The Company is considering an appeal of this order and is negotiating a letter of credit to comply with the terms of such order.

Access to Financing

As of March 31, 2005, Heartland's total consolidated indebtedness was zero. There can be no assurance that the amounts available from internally generated funds, cash on hand and sale of assets will be sufficient to fund Heartland's anticipated operations. Heartland may be required to seek additional capital in the form of bank financing. No assurance can be given that such financing will be available or, if available, will be on terms favorable to Heartland. If Heartland is not successful in obtaining sufficient capital to fund the implementation of its liquidation strategy and for other expenditures, properties might be sold for far less than their value. Any such discounted sale could adversely affect Heartland's future results of operations and future cash flows. However, management does not have any intention to discount the sale of properties for far less than their value.

Period-to-Period Fluctuations

Heartland's sales activity varies from period to period, and the ultimate success of this sales activity cannot always be determined from results in any particular period or periods. Thus, the timing and amount of revenues arising from this sales activity is subject to considerable uncertainty. The inability of Heartland to manage effectively their cash flows from operations would have an adverse effect on their ability to service any future debt, and to meet working capital requirements.

Potential Liquidation of Assets

The Company's management expects to sell to unrelated third parties the remainder of its properties with a view towards eventually dissolving the partnership within the next two years. If such sales do occur, the Company may subsequently determine to liquidate the Company pursuant to the dissolution and liquidation provisions of its partnership agreement. The Company might also determine to liquidate in the context of a bankruptcy proceeding if the Company believes that such a proceeding would likely serve to maximize value for the Company's Unitholders by providing greater certainty with respect to the satisfaction of, or provision for, the Company's known and contingent liabilities. The Unitholders will not have control over the divestiture of the Company's remaining assets or the liquidation process. The Company cannot make any assurance that changes in its policies will serve fully the interests of all Unitholders or that the Unitholders will receive any liquidating distributions

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of cash or other property.

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The Company is working to resolve its remaining liabilities which primarily consist of environmental matters and Edwin Jacobson's claim against the Company. In addition, the Company is pursuing a condemnation claim against the Redevelopment Authority of the City of Milwaukee ("RACM") and foreclosing on its Class B Partnership Interest. Significant estimates are used in the preparation of financial statements to value the Class B Interest which represents the collateral of the HTI note receivable owed to the Company and CMC, the recoverability of the total cost of properties and the Company's environmental liabilities. The amount and timing of any future cash distributions will depend on generation of cash from sales and claims and the resolution of liabilities. The Company has experienced recurring operating losses for the three months ended March 31, 2005 and the years ended December 31, 2004, 2003, and 2002 and there can be no assurance that the amounts available from internally generated funds, cash on hand, and sale of the remaining assets of the Company will be sufficient to fund Heartland's anticipated operations and meet existing and future liabilities. These losses, uncertainty as to the amount and timing of additional compensation from the RACM claim, if any, and the uncertainty surrounding such environmental liabilities and other claims, particularly the Edwin Jacobson lawsuit, create uncertainties about the Company's ability to meet existing and future liabilities as they become due. The Company has taken certain steps, including the reduction of fixed overhead and conservation of cash, in light of these uncertainties. The Company may be required to seek additional capital in the form of bank financing, however, there is no assurance that such bank financing will be available or, if available, will be on terms favorable to the Company.

Risks Related to the Class A Units

The market value of the Class A units could decrease based on the Company's performance, market perception and conditions. The market value of the Class A units may be based primarily upon the market's perception of the Company's growth potential and current and future cash distributions, and may be secondarily based upon the real estate market value of the Company's underlying assets. The market price of the Class A units may be influenced by the distributions on the Class A units relative to market interest rates. Rising interest rates may lead potential buyers of the Class A units to expect a higher distribution rate, which would adversely affect the market price of the Class A units. In addition, if the Company were to borrow, rising interest rates could result in increased expense, thereby adversely affecting the cash flow and the Company's ability to service its indebtedness and make distributions.

The Class A units have been traded since June 20, 1990. The Company believes that factors such as (but not limited to) announcements of developments related to the Company's business, fluctuations in the Company's quarterly or annual operating results, failure to meet expectations, results of pending litigation (including the Company's pending suit against RACM and Trinity's suit against the Company) and general economic conditions, could cause the price of the Company's units to fluctuate substantially. In recent years the stock market has experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. Such fluctuations could adversely affect the market price of the Class A units.

The Class A units are currently traded on the American Stock Exchange under the symbol "HTL". The Class A units are thinly traded. There are no assurances that the Company will maintain its listing on the exchange. If the Class A units should be delisted from the exchange, it is likely that it could materially and/or adversely effect any future liquidity in the Class A units.

Potential Environmental Liabilities

Estimation of Amount of Reserve for Environmental Claims and Liabilities:

The Company evaluates the environmental liabilities associated with its properties on a regular basis. The Company records an allowance, or reserve, for known potential environmental claims and liabilities, including remediation, legal and consulting fees, to the extent it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. The reserve amount does not include any estimated amounts for unknown claims and liabilities. The Company estimates its reserve for known environmental claims and liabilities independent from any claims the Company may have for recovery against third parties, including from governmental sponsored clean-up funds. If the Company cannot reasonably estimate the amount of an environmental claim or liability, but (i) the Company's management is able to determine that the amount of the liability is likely to fall within a range and (ii) no amount within that range can be determined to be a better estimate than any other amount, then the Company records the reserve at the minimum amount of the range. At March 31, 2005, the reserve for environmental claims and liabilities was \$3,665,000, which represents the minimum amount of the range of the Company's estimate of environmental claims and liabilities. The upper range of the Company's environmental claims and liabilities is estimated to be approximately \$10,961,000 based on an estimate by outside consultants.

Actual Costs Likely to Exceed Amount of Reserve:

If the Company were to use a different approach than that described above, the amount of the reserve could be materially higher. Additionally, the Company believes it is likely that the actual amount of the Company's environmental claims and liabilities, when fully resolved or provided for, will be higher than the reserve amount because it is unlikely that, as a whole, such claims and liabilities will be resolved for in the amount currently reserved since the Company records a reserve at the low end of the range if no estimate is better than any other amount. Also, as noted above, the Company does not include in the amount of the reserve any estimated amounts for unknown claims and liabilities. This means that as new claims arise the amount of the reserve will generally need to be increased. For example, as the Company incurs environmental remediation and other costs for new environmental claims, the Company pays for, and records as an operating expense, the amount of such costs and accrues an environmental reserve if necessary. However, because new environmental claims arise periodically, the amount of the Company's reserve for environmental claims and liabilities has not historically declined, but rather has remained flat or increased over time.

The Company expects to sell to unrelated third parties its remaining properties with a view towards eventually dissolving the partnership within the next two years. If such sales do occur, the Company may then adopt a plan of dissolution. Prior to any such dissolution, the Company will have to make a provision for all of its potential environmental liabilities, including known liabilities and unknown liabilities that are likely to arise or become known within at least ten years after the date of dissolution. In connection with any future dissolution of the Company, the Company may determine it to be in the best interests of the Company and the Unitholders to purchase environmental liability insurance or to pay a third party to assume the Company's environmental liabilities if it appears that the cost to do so will likely be less than the cost of maintaining

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the Company's overhead to resolve and manage the environmental claims and remediation process going forward. The Company has had preliminary discussions with environmental claims management firms regarding the potential cost at which such firms would agree to assume the Company's known and unknown environmental liabilities. Based on these preliminary discussions, the Company believes that the cost associated with the assumption by a third party of such environmental liabilities could be in excess of \$10,000,000. At this time, however, the Company has not yet determined whether it would be more cost effective to undertake such an arrangement or to manage for its own account the environmental claims and remediation process going forward.

In connection with the Company's efforts to obtain environmental insurance or transfer its environmental claims and liabilities to third parties, the Company engaged an outside consultant to estimate the potential environmental exposure for claims (other than those related to the Wheeler Pit and Company owned property at the Lite Yard) based on an "expected value" methodology. While an expected value methodology is an accepted approach to valuation, it incorporates certain assumptions, including estimates for unknown claims and liabilities, and, as a result, is not recognized under generally accepted accounting principles. The expected value for the Company's current portfolio estimated by the outside consultant (which, as noted above, does not include estimates for claims related to the Wheeler Pit or Company owned property at the Lite Yard) is approximately \$5,450,000, with an upper range of \$9,410,000.

Factors and Properties Affecting the Amount of the Company's Environmental Liabilities:

Under environmental laws, liability for hazardous substance contamination is imposed on the current owners and operators of the contaminated site, as well as the owner or the operator of the site at the time the hazardous substance was disposed or otherwise released. In most cases, this liability is imposed without regard to fault. Currently, the Company has known environmental liabilities associated with certain of its properties arising out of the activities of the Chicago, Milwaukee, St. Paul and Pacific Railroad (the "Milwaukee Road") or certain of the Milwaukee Road's lessees and may have further material environmental liabilities as yet unknown. The majority of the Company's known environmental liabilities stem from the use of petroleum products, such as motor oil and diesel fuel, in the operation of a railroad or in operations conducted by the Milwaukee Road's lessees.

From time to time contaminants are discovered on property the Company now owns. Some of these may have resulted from the historical activities of the Milwaukee Road. In other cases the property was leased to a tenant who released contaminants onto the property. The Company's property may also be polluted by a release or migration of contaminants onto the Company's property by unrelated third parties. The Company has not investigated all of its properties and does not know how many of them may be contaminated.

The Company's practice when it sells land is to sell the property "as is, where is" without any representation or indemnification for environmental conditions. The Company has one active site, however, Miles City, Montana, where the Milwaukee Road and its successor may have issued certain limited indemnities to the buyer for specified environmental concerns. There are other cases in which the Company has had a claim arising out of alleged contamination on sold property. In some, but not all, of these instances, the Company has been successful in asserting that such liabilities were discharged in the bankruptcy proceedings of the Milwaukee Road.

The Company may be responsible for certain liabilities that arise from the

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historical operations of the Milwaukee Road railroad that have nothing to do with the ownership of property. The Company has been, for example, named as a "potentially liable party" or had claims asserted by a private parties in landfill-clean-up cases in which there is an allegation that the Milwaukee Road generated or transported materials to the landfill. Additional claims may arise in the future. In certain of these cases, the Company has asserted that such liabilities were discharged in the bankruptcy proceedings of the Milwaukee Road.

The Montana Department of Environmental Quality ("DEQ") has asserted that the Company is liable for some or all of the investigation and remediation of certain properties in Montana sold by the Milwaukee Road's reorganization trustee prior to the consummation of its reorganization. The Company has denied liability at certain of these sites based on the reorganization bar of the Milwaukee Road. The Company's potential liability for the investigation and remediation of these sites was discussed in detail at a meeting with the DEQ in April 1997. While the DEQ has not formally changed its position, the DEQ has not elected to file suit.

At two separate sites, the Company has been notified that releases arising out of the operations of a lessee, former lessee or other third party have been reported to government agencies. At each of these sites, the third party is voluntarily cooperating with the appropriate agency by investigating the extent of any such contamination and performing the appropriate remediation, if any.

Lite Yard

CMC owns a 5 acre site in Minneapolis, Minnesota that is impacted with arsenic and lead ("Lite Yard"). On April 29, 2004, a Response Action Plan for the site was approved by the Minnesota Department of Agriculture. The Company filed suit against US Borax Inc. ("Borax") on July 23, 2003, in the United States District Court for the District of Minnesota for contribution. Borax, which discontinued operations in 1968, is a former operator of a pesticide/herbicide facility on the property. This matter was settled pursuant to a Confidential Settlement Agreement and Release dated September 27, 2004, between the Company and Borax. Pursuant to the settlement agreement, Borax has agreed to pay a portion of the Company's past and future response costs at the site. At March 31, 2005 and December 31, 2004, the Company's aggregate allowance for claims and liabilities for this site was \$1,044,000 and \$1,588,000, respectively. Of this amount, \$19,000 was billed, but not yet paid, in respect to work related to the site through March 31, 2005.

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At March 31, 2005, the Company has recorded a \$638,000 receivable for the portion of these amounts due from Borax under the settlement agreement.

On September 3, 2004, the United States Environmental Protection Agency ("USEPA") issued an order ("Order") requiring the Company and Borax to remediate arsenic in the soils of a nearby residential neighborhood on an emergency basis. On January 24, 2005, the USEPA issued a general notice letter ("Letter") to the Company and Borax requesting that the Company and Borax perform a remedial investigation and feasibility study on the soils of the same nearby residential neighborhood on a non-emergency basis for matters not covered by the Order. Neither the Order nor the Letter are covered by the Confidential Settlement Agreement and Release between the Company and Borax.

The Company offered the USEPA \$300,000 to settle the Company's obligations under the Order and Letter. The USEPA has not yet responded to the Company's offer. The Company believes, based on USEPA publications, that the USEPA has provided \$1,500,000 for past and future remediation activities in the residential neighborhood. This amount does not necessarily represent the entire cost of the

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cleanup being undertaken by the USEPA. The entire cost could be higher or lower. The USEPA could seek substantial penalties against the Company in addition to remediation costs. The Company engaged an environmental engineering consultant to review information available regarding the possible scope and cost of USEPA activities. The consultant projected a range of possible costs of \$2,841,000 to \$3,833,000. However, this estimate was based on limited data available to the consultant. The Company has reserved \$1,196,000 in connection with the Order and Letter. This reserve amount takes into consideration the estimated range of possible costs and the allocation of costs among PRPs for the on-site remediation at the Lite Yard.

A former consultant for the Company at the Lite Yard, Exponent, Inc., filed suit against the Company in Minnesota state court on January 27, 2005. The complaint alleges that the Company owes Exponent \$361,000 in unpaid consultant fees. CMC has disputed the reasonableness of Exponent's invoices.

Miles City Yard

By letter dated June 10, 2004, the DEQ demanded that the Company perform a remedial investigation of a railyard in Miles City, Montana previously owned and operated by the Milwaukee Road. The Company has, for many years, been conducting a clean-up of a substantial diesel fuel release at this site. On September 7, 2004, Trinity Railcar Repair, Inc. ("Trinity") filed suit against the Company and CMC in Custer County, Montana state court, for contribution under state environmental law, for indemnification under sale agreements between the Company's predecessors-in-interest and Trinity's alleged predecessors and for injunctive relief prohibiting the Company from dissolving or making any distributions to its Unitholders. On September 14, 2004, Trinity filed a motion for a preliminary injunction to prohibit the Company from liquidating or making distributions to its Unitholders. On January 10, 2005, the court held a hearing at which the Company's engineering witness testified that the maximum cost of investigation and remediation could be as much as \$1,250,000. However, this estimate was not based on any direct investigation of conditions at the site. On March 24, 2005, the court ordered the Company to escrow cash, post a bond, or provide another guarantee, of \$2,500,000 to cover possible remediation and clean-up costs for the site. The court did not make a determination as to the

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requirement for any remediation, the costs of remediation or liability for any costs. The Company is considering an appeal of this order and is negotiating a letter of credit to comply with the terms of such order. The Company, based on current review of the site believes that the range of costs of investigation and remediation, including the ongoing diesel fuel clean-up could be between \$618,000 and \$1,740,000. At March 31, 2005, the Company's aggregate allowance for claims and liabilities for this site (including costs of investigation, remediation and legal fees relating to the litigation) is \$618,000.

Bozeman

In 2001 the Company sold a 14 acre property to the City of Bozeman, Montana that was known to be contaminated with asbestos ore. As part of the sale, the City of Bozeman released the Company from all environmental liability. The City of Bozeman performed a clean-up of the north half of the property. In September 2003, the Company received a letter from the DEQ requesting an investigation of possible asbestos ore on the south half of the property sold to the City of Bozeman and a neighboring property. By letter dated November 3, 2004, the Company was notified by the DEQ that the City of Bozeman, Montana had initiated a proceeding under the Montana Controlled Allocation of Liability Act ("CALA") with regard to the sold property. In the administrative proceeding, DEQ will allocate environmental liability among potentially liable parties. The Company

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has projected that the total cost of the remediation already performed by the City of Bozeman plus additional remediation which may be required for the south half of the property is approximately within a range from \$997,000 to \$1,645,000. The estimated range of costs for the neighboring property is \$120,000 to \$219,000. The Company believes it has valid defenses to any CALA allocated liability for the clean-up of the north half of the property and could assert a claim against the City of Bozeman for liabilities for any clean-up of the south half of the property. The Company has reserved an aggregate of \$332,000 for all claims and liabilities associated with this property and the neighboring property. This reserve amount reflects the estimated low end of the range of costs for the off-site remediation and the estimated low end of the range of future on-site costs and takes into account the Company's limited liability to the City of Bozeman under the terms of the sale of the property to the City of Bozeman.

Other

The Canadian Pacific Railroad, formerly known as the Soo Line Railroad Company, has asserted that the Company is liable for, among other things, the remediation of releases of petroleum or other regulated materials at six different sites located in Iowa, Minnesota and Wisconsin that Canadian Pacific acquired from the Company. The Company has denied liability based on the underlying sale agreement. The environmental claims are all currently being handled by Canadian Pacific, and the Company understands that Canadian Pacific has paid settlements on certain of these claims. Because Canadian Pacific has been handling these matters exclusively, the Company has made no determination as to the merits of the claims and is unable to determine their materiality.

In November 1995, the Company settled a claim with respect to the so-called "Wheeler Pit" site near Janesville, Wisconsin. The Company's only outstanding obligation under the settlement is to pay 32% of the monitoring costs for twenty-five years beginning in 1997. At March 31, 2005, Heartland's allowance for claims and liabilities for this site is \$191,000. By letter dated April 6,

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2005, the lead PRP at this site offered to settle the Company's future obligations for approximately \$266,000. The Company's management believes this offer to be higher than the historical operating costs at this site and therefore has reserved a lower amount. Additionally, the lead PRP at this site previously made a demand for monitoring costs of \$53,000 incurred through March of 2004. The Company has not paid any amounts to the PRP in respect of monitoring costs for this site to date.

In addition to the environmental matters set forth above, there may be other properties with environmental liabilities not yet known to the Company, with potential environmental liabilities for which the Company has no reasonable basis to estimate, or for which the Company believes it is not reasonably likely to ultimately bear responsibility for the liability but the investigation or remediation of which may require future expenditures. Management is not able to express an opinion at this time whether the environmental expenditures for these properties will or will not be material.

The Company has given notice to insurers, which issued policies to the Milwaukee Road of certain of the Company's environmental liabilities. Due to the high deductibles on these policies, the Company has not yet demanded that any insurer indemnify or defend the Company. Consequently, management has not formed an opinion regarding the legal sufficiency of the Company's claims for insurance coverage.

Treatment of Certain Loans from HTI to Heartland

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As of March 31, 2005 and December 31, 2004, HTI owed Heartland an aggregate of \$9,734,000 of which \$8,464,000 relates to promissory notes issued in 2000 and 2001 (the "2000 Notes") and \$1,270,000 relates to the Company's purchase of certain notes from PG Oldco, Inc., a creditor of HTI ("PG Oldco Notes"). The 2000 Notes and the PG Oldco Notes are collateralized by a security interest in the Class B Interest (the "Collateral"). Heartland has recorded an allowance for doubtful accounts of approximately \$7,334,000 and \$7,234,000 on the 2000 Notes and PG Oldco Notes receivable balance of \$9,734,000 at March 31, 2005 and December 31, 2004, respectively. An additional allowance for doubtful accounts of \$100,000 was recorded for the three months ended March 31, 2005 due to continued operating costs above amounts estimated in prior periods. Because Heartland intends to acquire the Class B Interest from HTI either pursuant to a proposed settlement agreement between HTI and certain of its creditors or upon a foreclosure of the Class B Interest, as discussed below, Heartland has determined that the amount due from affiliate should reflect the value of the Class B Interest based on the estimated amount of potential future cash distributions distributable in respect of the Class B Interest upon a liquidation of Heartland (assuming that the Class B Interest is not cancelled and remains outstanding). In the event that the proposed settlement agreement is not approved by HTI's other creditors, Heartland anticipates that it will exercise its rights under the 2000 Notes, the PG Oldco Notes, the related security agreements and applicable law to foreclose on the Class B Interest. Upon either the acquisition of the Class B Interest pursuant to the proposed settlement agreement or the foreclosure on the Class B Interest, the receivable amount in respect of the 2000 Notes and the PG Oldco Notes reflected in the "Due from Affiliate" account will be reduced to zero, and the Class B Interest and the Class B Interest's capital account balance will be cancelled. If cancelled, the Class B Interest will no longer be entitled to receive any distributions of cash or other property from Heartland. Although Heartland's management believes it is unlikely, there can be no assurance that either the settlement agreement will be approved by HTI's creditors or that Heartland will be able to foreclose on the Class B Interest. If the Class B Interest is not foreclosed upon and cancelled, it will be entitled to receive distributions in accordance with the terms of the partnership agreement.

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Jacobson Litigation

Edwin Jacobson, the former President and C.E.O. of CMC, has sued the Company claiming that it owes him additional salary and incentive compensation based on the terms of his employment contract. He has demanded \$12,000,000 (\$1,000,000 salary and \$11,000,000 incentive compensation) in damages. The Company has denied Mr. Jacobson's claims and has countersued to recover past payments made to him and to collect \$332,000 in principal and interest under a note Jacobson made to the Company (this matter is explained in greater detail in Note 5--Legal Proceedings above). The Company offered to settle the lawsuits in exchange for forgiving Jacobson's debt to the Company. When it made the offer, the Company established an allowance against the Note Receivable of \$316,000. CMC has made no other provision for this potential liability.

Results of Operations

Operations for the three months ended March 31, 2005 and 2004 resulted in net loss of (\$1,087,000) and net income of \$937,000 or \$0.00 and \$0.42 per Class A Unit, respectively. The loss for the three months ended March 31, 2005 was allocated to the Class B partnership interest in accordance with the terms of the partnership agreement.

Three Months Ended March 31, 2005 Compared to Three Months Ended March 31, 2004

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Property Sales. Property sales increased \$1,088,000 or 35% to \$4,203,000 for the three months ended March 31, 2005 from \$3,115,000 for the three months ended March 31, 2004. This increase was primarily the result of the sale of a single parcel of land in March 2005 comprising approximately 1.25 acres known as Kinzie Station Phase II for \$4,200,000.

Cost of Property Sales. Cost of property sales increased \$3,208,000, or 431% to \$3,952,000 for the three months ended March 31, 2005 from \$744,000 for the three months ended March 31, 2004. This increase was the result of the the cost of property sales related to Kinzie Station Phase II. There were substantial capitalized development costs for Kinzie Station Phase II.

Gross Profit on Property Sales. Gross profit on property sales decreased \$2,120,000, or 89% to \$251,000 for the three months ended March 31, 2005 from \$2,371,000 for the three months ended March 31, 2004. Higher sales in the first quarter of 2005 were offset by higher costs of sales.

Selling Expenses. Selling expenses decreased \$54,000, or 16% to \$287,000 for the three months ended March 31, 2005 from \$341,000 for the three months ended March 31, 2004. A decrease in selling expenses from the elimination of the Company's in-house sales function was offset by an increase in outside broker commissions on the sale of Kinzie Station Phase II.

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General and Administrative Expenses. General and administrative expenses decreased \$209,000, or 25% to \$617,000 for the three months ended March 31, 2005 from \$826,000 for the three months ended March 31, 2004. Reductions in overhead-particularly salary and fringe benefits-were partially offset by increased accounting expense.

Interest Expense. Interest expense decreased \$17,000, or 100% to \$0 for the three months ended March 31, 2005 from \$17,000 for the three months ended March 31, 2004. In March 2004 Heartland paid a fee to LaSalle National Bank related to a line of credit agreement. There was no outstanding debt during the three months ended March 31, 2005.

Real Estate Taxes. Real estate taxes decreased \$29,000, or 41% to \$42,000 for the three months ended March 31, 2005 from \$71,000 for the three months ended March 31, 2004. The decrease was the result of the Company owning fewer properties in 2005 due to the number of sales that took place in 2004.

Environmental Expenses and Other Charges. Environmental expenses and other charges decreased \$186,000, or 38% to \$300,000 for the three months ended March 31, 2005 from \$486,000 for the three months ended March 31, 2004. This decrease was primarily the result of lower consulting fees that were partially offset by higher legal fees.

Rental Income. Total rental income decreased \$348,000, or 88% to \$49,000 for the three months ended March 31, 2005 from \$397,000 for the three months ended March 31, 2004. This decrease was primarily the result of the Company recognizing \$360,000 of deferred rental income as rental income in January 2004 related to the sale of the Petit Point property located near Milwaukee, Wisconsin to an unrelated third party. The Company had received prepaid rent from a lease on this property that it was able to retain as a condition of the closing.

Net (loss) Income. Net income decreased by \$2,024,000, or 216% to a loss of (\$1,087,000) for three months ended March 31, 2005 from net income of \$937,000 for three months ended March 31, 2004. This was the result of a decrease in gross profit on property sales in 2005 compared to 2004, primarily the low gross

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profit on the Kinzie Station Phase II sale.

Liquidity and Capital Resources

Cash flow for operating activities has been derived primarily from proceeds of property sales, rental income and interest income. Cash was \$4,396,000 at March 31, 2005 and \$1,450,000 at December 31, 2004.

Net cash provided by operating activities was \$2,946,000 and \$183,000 for the three months ended March 31, 2005 and 2004, respectively. Cash provided by operating activities increased by \$2,763,000 for the three months ended March 31, 2005 compared to the three months ended March 31, 2004, which is primarily attributable to cash received from the sale in March 2005 of Kinzie Station Phase II.

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No distributions were made during the first quarter of 2005. As of March 31, 2005, the Unitholders' capital account balance was \$0, the Class B Interest's capital account balance was \$4,049,000, and the General Partner's capital account balance was \$0.

Proceeds from property sales were \$4,203,000 and \$3,115,000 for the three months ended March 31, 2005 and 2004, respectively. During 2005 and 2006, the Company expects proceeds from property sales to consist primarily of the sale of the remaining Kinzie Station North acreage, Kinzie Station commercial space and parking spaces, remaining sites in Wisconsin and Minnesota and other land held for sale acreage (157 acres of scattered land parcels located in 9 states). The Company may also receive proceeds from the sale of fiber optics easements across or along 83 miles of rail right of way running from downtown Chicago, Illinois, west to Elgin, Illinois and northwest to Fox Lake, Illinois.

The cost of property sales for the three months ended March 31, 2005 and 2004 was \$3,592,000 or 85% of sales proceeds and \$744,000 or 24% of sales proceeds, respectively. Cost of property sales will continue to vary in the future depending on which properties are sold in any given period.

As of March 31, 2005, Heartland had designated 4 sites, or approximately 55 acres with a book value of approximately \$2,343,000 for sale. Land held for sale will be disposed of in an orderly fashion; however, it is anticipated that the disposal of such properties may extend beyond the year 2005. The Company is also exploring the sale of these properties as a whole to a third party.

Real Estate Sale Activities

At March 31, 2005 the Company had about 4,000 square feet of commercial space and 2.85 acres of remaining property and air rights at Kinzie Station in Chicago, Illinois, a 20-acre property in Glendale, Wisconsin, 28 acres in Rockford, Illinois, 5 acres in Minneapolis, Minnesota, and approximately 157 acres of land scattered over 9 states. In addition, although the Company conveyed its property in Menomonee Valley to the RACM in 2003, it retained the right to appeal the purchase price and to seek additional consideration. The Company exercised such right to appeal in April 2004 by filing suit in the Milwaukee County Circuit Court against RACM appealing the condemnation award.

Kinzie Station

Kinzie Station is a master-planned redevelopment of a rail yard in the West Loop neighborhood of Chicago, Illinois. In March 2005, The Company closed the sale of a 1.25 acre parcel known as Kinzie Station Phase II to a developer for \$4,200,000. That developer also has a contract to buy the Company's remaining

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4,000 square feet of commercial space and 11 parking spaces.

A site known as Kinzie Station North Parcel B is under contract for \$2,850,000, contingent on the vacation of a city street by the City of Chicago. The Company's management believes that this street vacation, and closing of the sale could take place during 2005. The Company has entered into an agreement, subject to certain contingencies, to sell the remaining parcel of Kinzie Station which is zoned for a grocery store for \$2,850,000. This sale is also anticipated to close in 2005.

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Menomonee Valley

On July 30, 2003, the Company conveyed 142 acres of property in Milwaukee, Wisconsin to the Redevelopment Authority of the City of Milwaukee ("RACM") in consideration of \$3.55 million in lieu of condemnation. The Company reserved the right to appeal the fair market value of the property and filed that appeal on April 6, 2004, in Milwaukee County, Wisconsin Circuit court. The most recent appraisal performed on behalf of the Company opines that the property had a fair market value of \$15 million. There is no assurance that a court will award that amount at trial or that RACM would offer that amount to settle the litigation. A court could find that the property was worth less than \$3.55 million and order the Company to return money to RACM. Any determination of fair market value and award to the Company will be net of the \$3.55 million which the Company has already received. In the event of a court decision that determines the value of the property to be more than 115% of \$3.55 million, the Company will be entitled to recover certain costs of the appeal.

Property Sales and Leasing Activities

The Company has the right to sell easements for fiber optic lines along or across 83 miles of rail right of way running from downtown Chicago west to Elgin, Illinois and northwest to Fox Lake, Illinois. The Company shall receive 2/3 of the proceeds of any sale.

Economic and Other Conditions Generally

The real estate industry is highly cyclical and is affected by changes in local, national, and global economic conditions and events, such as employment levels, availability of financing, interest rates, consumer confidence and the demand for housing and other types of construction. Sellers of real estate are subject to various risks, many of which are outside the control of the seller, including real estate market conditions, changing demographic conditions, adverse weather conditions and natural disasters, such as hurricanes and tornadoes, changes in government regulations or requirements, increases in real estate taxes and other local government fees and availability and cost of land. The occurrence of any of the foregoing could have a material adverse effect on the financial condition and results of operations of Heartland.

Interest Rate Sensitivity

The Company's total consolidated indebtedness at March 31, 2005 was zero. As of March 31, 2005 the Company did not have any other financial instruments for which there was a significant exposure to interest rate changes.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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See "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Access to Financing," "Economic and Other Conditions Generally" and "Interest Rate Sensitivity." The Company is not subject to significant foreign currency exchange rate risk, commodity price risk or other relevant market price risks.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer has evaluated the Company's disclosure controls and procedures as of the end of the period covered by this report and has concluded that, except with respect to the matters discussed below, these controls and procedures are effective as of the end of the period covered by this report and are adequate to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. As previously disclosed on Form 12b-25 in two separate filings with the Securities and Exchange Commission, the Company has experienced delays in the completion of (i) its financial statements for the year ended December 31, 2004 and the accompanying annual report on Form 10-K and (ii) its financial statements for the three months ended March 31, 2005 and the accompanying quarterly report on Form 10-Q. These delays were due principally to the resignation of the Company's chief financial officer and the resulting transition of the provision of accounting services by an independent contractor. The Company is working diligently with such independent contractor to streamline the processes involved in the preparation of its financial statements and is considering other options, including the engagement of a different independent contractor to provide accounting services.

Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during the first quarter of 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II.

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

At March 31, 2005, Heartland's allowance for claims and liabilities was approximately \$3,665,000.

A former consultant for the Company at the Lite Yard, Exponent, Inc., filed suit against the Company in Minnesota state court on January 27, 2005. The complaint alleges that the Company owes Exponent \$361,000 in unpaid consultant fees. CMC has disputed the reasonableness of Exponent's invoices.

During the three months ended March 31, 2005, there have been no material developments in the legal proceedings disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 since the filing thereof on April 28, 2005. These legal proceedings are additionally discussed above in Note 5--Legal Proceedings and Contingencies to the unaudited

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consolidated financial statements of the Company for the three month period ended March 31, 2005.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.	Description
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Attached hereto.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

HEARTLAND PARTNERS, L.P.

(Registrant)

Date: May 24, 2005

By

/s/ Lawrence S. Adelson

Lawrence S. Adelson
Chief Executive Officer

EXHIBIT INDEX

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