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HEARTLAND PARTNERS L P
Form 10-Q
November 14, 2006

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 June 30, 2006

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 _____ No X _____

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

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Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

HEARTLAND PARTNERS, L.P.
JUNE 30, 2006

TABLE OF CONTENTS

PART I.	FINANCIAL INFORMATION.....	3
ITEM 1.	FINANCIAL STATEMENTS.....	3
	CONSOLIDATED STATEMENT OF NET ASSETS IN LIQUIDATION AND BALANCE SHEET.....	3
	CONSOLIDATED STATEMENT OF CHANGES OF NET ASSETS IN LIQUIDATION AND STATEMENT OF OPERATIONS.....	4
	CONSOLIDATED STATEMENTS OF CASH FLOWS.....	5
	NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.....	6
ITEM 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.....	16
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.....	29
ITEM 4.	CONTROLS AND PROCEDURES.....	29
PART II.	OTHER INFORMATION.....	31
ITEM 1.	LEGAL PROCEEDINGS.....	31
ITEM 1A.	RISK FACTORS.....	31
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.....	31
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES.....	31
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.....	31
ITEM 5.	OTHER INFORMATION.....	32
ITEM 6.	EXHIBITS.....	32
	SIGNATURES.....	33
	EXHIBIT INDEX.....	34

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2

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HEARTLAND PARTNERS, L.P.
CONSOLIDATED STATEMENT OF NET ASSETS IN LIQUIDATION AND BALANCE SHEET

(dollars in thousands)

	Statement of Net Assets in Liquidation June 30, 2006 (unaudited)	Balance Sheet (Going Concern Basis) December 31, 2005
	-----	-----
Assets:		
Cash and cash equivalents	\$6,227	\$1,160
Restricted cash	2,500	1,093
Accounts receivable (net of allowance of \$354 at December 31, 2005)	17	33
Prepaid and other assets	44	137

Total		2,423

Land	59	383
Land held for sale	--	1,569

Net properties	59	1,952

Total assets	\$8,847	\$4,375
	=====	=====
Liabilities:		
Accounts payable and accrued expenses	\$ 708	\$1,011
Allowance for claims and liabilities	5,362	2,128
Unearned rents and deferred income	--	812

Total liabilities	6,070	3,951

Partners' capital:		
General Partner	4	--
Class A Limited Partners - 2,142 units authorized and issued and 2,092 outstanding at June 30, 2006 and December 31, 2005	2,773	424

Total partners' capital (Net assets in liquidation)	2,777	424

Total liabilities and partners' capital	\$8,847	\$4,375
	=====	=====

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

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3

HEARTLAND PARTNERS, L. P.
CONSOLIDATED STATEMENT OF CHANGES OF NET ASSETS
IN LIQUIDATION AND STATEMENT OF OPERATIONS
(dollars in thousands except per unit data)
(Unaudited)

	For the		For the
	Three Months Ended	June 30,	Six Months Ended
	2006	2005	2006
	-----	-----	-----
INCOME:			
Property sales	\$ 2,850	\$ 170	\$ 5,700
Settlement of Condemnation	--	--	3,250
	-----	-----	-----
Total Income	2,850	170	8,950
Less: Cost of property sales	973	6	2,094
	-----	-----	-----
GROSS PROFIT ON PROPERTY SALES			
	1,877	164	6,856
	-----	-----	-----
OPERATING EXPENSES:			
Selling expenses	184	85	444
General and administrative expenses	656	582	1,427
Bad debt expense	--	--	--
Real estate taxes	8	(22)	20
Depreciation	--	1	--
Environmental expenses and other charges (credits)	3,333	(699)	3,540
	-----	-----	-----
TOTAL OPERATING EXPENSES	4,181	(53)	5,431
	-----	-----	-----
OPERATING INCOME (LOSS)	(2,304)	217	1,425
	-----	-----	-----
OTHER INCOME AND (EXPENSES):			
Rental Income-accounting basis change adjustment	793	--	793
Interest income	72	17	77
Rental income and earned rental lease income	19	34	56
Other income	5	9	6
Gain on sale of building and improvements	--	430	--
Management fee	--	(94)	--
Bank fees	(2)	--	(4)
	-----	-----	-----
TOTAL OTHER INCOME (EXPENSE)	887	396	928
	-----	-----	-----
NET INCOME (LOSS)	\$ (1,417)	\$ 613	\$ 2,353
	=====	=====	=====
Net (loss) income allocated to General Partner			
	\$ (14)	\$ --	\$ 23

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Net income (loss) allocated to Class B Limited Partner	=====	=====	=====
	\$ --	\$ 613	\$ --
	=====	=====	=====
Net (loss) income allocated to Class A Limited Partners	\$ (1,403)	\$ --	\$ 2,330
	=====	=====	=====
Net (loss) income per Class A Limited Partnership Unit	\$ (0.67)	\$ --	\$ 1.11
	=====	=====	=====
Weighted average number of Class A Limited Partnership Units outstanding	2,092	2,092	2,092
	=====	=====	=====

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

4

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

	For the Six Months Ended June 30,	
	2006	2005
	-----	-----
CASH FLOW FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 2,353	\$ (474)
Adjustments reconciling net income (loss) to net cash provided by operating activities:		
Unearned Rent Adjustment	(793)	--
Accrued Compensation Adjustment	(232)	--
Gain on Sale of Buildings and Improvements	--	(430)
Depreciation	--	2
Bad debt expense	--	100
Net change in allowance for claims and liabilities	3,234	(1,773)
Net change in assets and liabilities:		
Decrease in accounts receivable	16	427
Decrease in land held for sale	1,893	3,570
(Decrease) increase in accounts payable and accrued expenses	(71)	287
Net change in other assets and liabilities	(38)	121
	-----	-----
Net cash provided by operating activities	6,474	1,830
	-----	-----
CASH FLOW FROM INVESTING ACTIVITIES		
Proceeds from sale of buildings and improvements	--	549
	-----	-----

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Net cash provided by investing activities	--	549
	-----	-----
CASH FLOW FROM FINANCING ACTIVITIES		
Increase in restricted cash	(1,407)	(2,500)
	-----	-----
Net decrease in cash from financing activities	(1,407)	(2,500)
	-----	-----
Net increase (decrease) in cash	5,067	(121)
Cash at beginning of period	1,160	1,450
	-----	-----
Cash at end of period	\$ 6,227	\$ 1,329
	=====	=====

5

Heartland Partners, L.P.
Notes to Consolidated Financial Statements for the
Six Months Ended June 30, 2006
(Unaudited)

These unaudited consolidated financial statements of Heartland Partners, L.P., a Delaware limited partnership, and its subsidiaries (collectively, "Heartland" or 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 2005 Annual Report on Form 10-K (the "2005 Form 10-K"). The following Notes to Consolidated Financial Statements highlight significant changes to the notes included in the 2005 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 other than as they relate to the change in accounting described in Note 2.

1. Organization

Organization and Purpose

Heartland was formed on October 6, 1988. Its partnership agreement provided Heartland's existence would 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. On April 28, 2006, Heartland filed a petition to liquidate under Chapter 11 of the federal bankruptcy laws.

Heartland is now attempting to dispose of its remaining real estate holdings. 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.

On April 20, 2006, Lawrence Adelson, Richard Brandstatter, George Lightbourn,

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and Thomas F. Power, Jr. sold their stock in CMC/Heartland Partners Holdings Corp., a Delaware corporation and sole general partner of Heartland (the "General Partner" or "Holdings"), to LePetomane XIX, Inc., a company owned by Jay Steinberg, for a total of \$100. Richard Brandstatter, George Lightbourn and Thomas F. Power, Jr. then resigned as directors of Holdings. On May 2, 2006, LePetomane XIX sold its stock in Holdings to Mr. Adelson for \$100.

As of June 30, 2006, Holdings, was owned by Lawrence Adelson, Chief Executive Officer of CMC Heartland Partners. CMC Heartland Partners, a Delaware general partnership ("CMC"), is an operating general partnership owned 99.99% by Heartland and 0.01% by Holdings. Until November 14, 2005 the general partner was HTI Interests, LLC ("HTI"). The general partner interest of HTI was transferred

6

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

to Holdings in connection with the Chapter 11 liquidation of HTI and the resulting settlement.

The following table summarizes information for the remaining entity formed by Heartland since its inception that currently hold real estate and other assets, the date and purpose of its formation, development, location and ownership:

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

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

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

2. Summary of Significant Accounting Policies

Liquidation Accounting

The Company began preparing for and filed to liquidate under Chapter 11 of the Bankruptcy Code in April 2006. The Company has adopted the liquidation basis of accounting effective April 1, 2006. Under the liquidation basis of accounting, assets are stated at their estimated net realizable values and liabilities are stated at their estimated settlement amounts, for which estimates will be periodically reviewed and adjusted.

The valuation of assets at their net realizable value and liabilities at their anticipated settlement amounts requires many estimates and assumptions. In addition, there are substantial risks and uncertainties associated with carrying out the dissolution and liquidation of the Company. The valuations presented in the accompanying Statement of Net Assets in Liquidation represent estimates, based on present facts and circumstances, of the net realizable value of assets and costs associated with carrying out the dissolution and liquidation plan based on the assumptions set forth below. The actual values and costs are expected to differ from the amounts shown herein and could be greater or less

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than the amounts recorded. Accordingly, it is not possible to predict the aggregate amount that will ultimately be distributable to unitholders and no assurance can be given that the amount to be received in liquidation will equal or exceed the net assets in liquidation per unit in the accompanying Statement of Net Assets in Liquidation or the price or prices at which the Class A Units have generally traded or trade in the future.

There were two significant adjustments in the quarter as a result of adopting the liquidation basis of accounting. At March 31, 2006, the Company had recorded a liability in the amount of \$793,000 for unearned rents and deferred income. The Company had sold 10 and 20 year fiber optics easements and had received a single payment at the beginning of the term of the easement. The Company was recognizing income ratably over the life of the easements. Under

7

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

liquidation accounting the unrecognized amount was recognized as income and the liability removed. No amounts are reimbursable to the easement purchasers. Also, the \$232,000 accrual for "phantom unit" compensation was reversed as this amount is now not expected to be paid.

Consolidation

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

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable and accounts payable are reasonable estimates of their fair values because of the short maturity of these financial instruments.

Revenue Recognition

Land sales are recognized when the following conditions are met: persuasive evidence of an agreement exists; risks of ownership have passed to the buyer; the Company's price to the buyer is fixed and determinable; and collectibility is reasonably assured.

Property

Properties and improvements were carried at their historical cost up until the change to the liquidation basis of accounting. Depreciation was provided for financial statement purposes over the estimated useful life of the respective assets ranging from seven (7) years for office equipment and fixtures to forty (40) years for building and improvements using the straight-line method.

For properties previously held for sale, an impairment loss was recognized when the fair value of the property, less the estimated cost to sell, was less than the carrying amount of the property. At June 30, 2006, all land held for sale had been sold.

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3. Real Estate Sale Activities

Property sales for the first half of 2006 were \$5,700,000. The Company closed the \$2,850,000 sale of a 1.75-acre parcel of land, and associated air rights, in Chicago, IL to Jewel, a supermarket company and the \$2,850,000 sale of a 1.25 acres parcel in Chicago called Kinzie Station Parcel B.

Property sales during the six months ended June 30, 2005 totaled \$4,373,000 which consisted primarily of the sale of 1.25 acres of land in Chicago, IL (Kinzie Station Phase II) for \$4,200,000 and various minor land held for sale parcels.

At June 30, 2006 the Company had approximately 130 acres of land scattered over 8 states. This land is valued at its estimated net realizable value.

4. Related Party Transactions

8

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

Conflicts of Interest of General Partner and its Officers and Directors

The officers and directors of Holdings, and the officers of Heartland; including Lawrence S. Adelson, President of Holdings and Chief Executive Officer of CMC Heartland, do 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 of Heartland ("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.

5. Legal Proceedings and Contingencies

At June 30, 2006 and December 31, 2005, Heartland's allowance for claims and liabilities was approximately \$5,362,000 and \$2,128,000, respectively. The increase in the allowance was due to the proposed settlement of environmental claims in Montana, discussed below, and an increase in the reserve for off site contamination in the area of the Lite Yard site in Minneapolis, Minnesota partially offset by payments made by Heartland and Borax for remediation of contamination at the Lite Yard site.

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 punitive damages (In the state court case Jacobson claimed damages of \$1,000,000 in salary and \$11,000,000 in incentive compensation. In the bankruptcy proceeding he has claimed damages of \$14,600,000). 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

9

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

his contract claims which the court denied. Jacobson filed a motion for reconsideration that 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 June 15, 2006, Jacobson's claims against Lawrence Adelson, Robert Davis and John Torell, III were dismissed. Jacobson has filed an appeal of the dismissals.

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.

All of the judicial or administrative proceedings to which the Company is a party have been stayed as a result of the Company's voluntary petition under Chapter 11 of the Bankruptcy Code.

RACM

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On July 30, 2003, the Company conveyed 142 acres of property in Milwaukee, Wisconsin to 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. In January 2006, a settlement was reached with RACM agreeing to pay CMC an additional \$3,250,000. The settlement was received in March 2006.

Lite Yard

CMC owned 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 ("Settlement Agreement"), 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 June 30, 2006 and December 31, 2005, the Company's aggregate allowance for claims and liabilities for this site was \$4,000 and \$20,000, respectively. The Lite Yard property was sold to a third party in August 2005. The sale did not affect the Company's environmental responsibility. The Company believes that with the exception of amounts estimated to be less than \$5,000 required to be paid in connection with obtaining regulatory compliance confirmation, it has now completed the environmental remediation of the Lite Yard.

10

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

On September 3, 2004, the United States Environmental Protection Agency ("USEPA") issued an order (the "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, USEPA issued a general notice letter (the "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 Settlement Agreement.

The Company offered USEPA \$300,000 to settle the Company's obligations under the Order and the Letter. USEPA has not yet responded to the Company's offer. The Company believes, based on USEPA publications and a newspaper article, that USEPA has provided \$1,500,000 to \$2,200,000 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 USEPA. The entire cost could be higher or lower. 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 \$3,374,000 to \$3,948,000. However, this estimate was based on limited data available to the consultant. The Company has reserved \$1,432,000 in connection with the Order and the Letter. This reserve amount takes into consideration the estimated range of possible costs and the allocation of costs among the Company and Borax for the on-site remediation at

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the Lite Yard.

Borax filed suit in federal court in Minneapolis, Minnesota seeking contribution from CMC in connection with any liability arising out of arsenic in the nearby residential area. CMC is opposing Borax's lawsuit and believes it has good defenses. The matter is stayed as a result of the Company's Chapter 11 filing.

Miles City Yard

By letter dated June 10, 2004, the Montana Department of Environmental Quality (the "DEQ") demanded that the Company perform a remedial investigation of a railyard in Miles City, Montana previously owned and operated by the Chicago, Milwaukee, St. Paul and Pacific Railroad ("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.

11

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

On November 6, 2006, the Company entered into a settlement agreement (the "DEQ Settlement Agreement") with the DEQ and Trinity whereby the Company will receive a general release from Trinity with respect to Miles City and a general release from the DEQ with respect to all claims related to property owned by the Company or its predecessors within the exterior boundaries of the state of Montana, including, but not limited to, Miles City. In exchange for the release, the \$2,500,000 letter of credit posted by the Company will be cancelled and \$2,500,000 in cash will be disbursed from the Heartland estate to Trinity, the DEQ and the Montana Court. Trinity will also become the holder of an allowed, general unsecured claim against the bankruptcy estate of Heartland in the amount of \$5,000,000; provided, however, that such claim shall be capped at \$800,000 for distribution purposes. Trinity and the DEQ will also receive an aggregate amount of \$250,000 in connection with the DEQ Settlement Agreement. The DEQ Settlement Agreement will not be effective until approved by the Bankruptcy Court. In light of the settlement, the Company has reserved \$3,550,000 for Montana environmental claims including Miles City.

Bozeman

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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 is approximately within a range from \$912,000 to \$920,000. Additional studies by the City of Bozeman on the south half of the property indicate that no further remediation will be required for the south half of the property. The estimated range of costs for the neighboring property is \$111,000 to \$176,000. An adjoining property owner has filed a claim in the amount of \$1,730,000 in the bankruptcy proceeding. 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 believes the proposed DEQ Settlement Agreement settles its liability in connection with this site, but this may be subject to dispute by third parties.

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

12

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

motor oil and diesel fuel, in the operation of a railroad or in operations conducted by its predecessor's lessees.

The DEQ 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 denied liability at certain of these sites based on the reorganization bar of the Company's predecessor. Liability to DEQ for all of these sites is covered by the proposed DEQ Settlement Agreement discussed above in Section 5-Legal Proceedings and Contingencies.

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

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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 June 30, 2006, 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. 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, (ii) with potential environmental liabilities for which the Company has no reasonable basis to estimate or (iii) that 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, 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.

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 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 paid under the 2002 CMC Plan was \$115,000 for the six months ended June 30, 2006.

13

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

Approximately \$55,000 was accrued but not paid in connection with the sale of Kinzie Station Parcel B. That closing took place following the Chapter 11 filing and the compensation is a claim against the estate. The 2002 CMC Plan also provides compensation in the form of 30,000 "phantom units" which are the economic, but not tax, equivalent of Class A Units. Under Mr. Adelson's employment agreement he has 100,000 "phantom units" as well. The expense and accrual previously recorded for these units has been reversed during the quarter ended June 30, 2006 in light of the Company's shift to the liquidation basis of accounting as that amount is now not expected to be paid.

In 2005, the Company entered into a separation and consulting agreement with Mr. Harrison. Under the agreement, Mr. Harrison received \$50,000 in addition to his

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salary during the first half of 2006.

7. Liquidation of Heartland Partners, L.P.

The Company's management intends to sell to unrelated third parties the remainder of its properties and dissolve the partnership.

GENERAL INFORMATION

On April 28, 2006 (the "Petition Date"), the Company and certain of its affiliated entities (collectively, the "Debtors") filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code"), in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division (the "Bankruptcy Court"). The Debtors' cases are being jointly administered under the caption "In re CMC Heartland Partners, L. P., et al., at Case No. 06-B-04769." The Debtors are operating as "debtors-in-possession" under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. In general, as debtors-in-possession, the Debtors are authorized under Chapter 11 to administer their bankruptcy estates, but may not engage in transactions outside the ordinary course of business without the prior approval of the Bankruptcy Court.

Through their bankruptcy proceedings, the Debtors intend to liquidate all outstanding claims against the Debtors, including any environmental claims, and to provide for a fair and equitable distribution of estate property to all creditors.

The Automatic Stay. Subject to certain exceptions under the Bankruptcy Code, the Debtors' Chapter 11 filings served to automatically stay the continuation of any judicial or administrative proceedings or other actions against the Debtors or their property including any actions to recover on, collect or secure a claim that arose prior to the Petition Date. Upon the request of Trinity, the Bankruptcy Court modified the automatic stay in order for Trinity to proceed to liquidate its claim in the Montana state court (see Note 5-Legal Proceedings and Contingencies). In addition, the Debtors expect that plaintiffs in the Jacobson and Borax lawsuits will seek to have the automatic stay modified by the Bankruptcy Court in order to liquidate their claims against the Debtors (see Note 5-Legal Proceedings and Contingencies). The automatic stay has not been modified with respect to any of these creditors such that they might be able to collect on any judgment and thus frustrate the

14

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

bankruptcy process and Debtors do not expect any such modification of the automatic stay.

Appointment of Creditors Committee. The United States Trustee for the Northern District of Illinois has not appointed an official committee of unsecured creditors in the Debtors' cases.

Magnitude of Potential Claims. The Debtors have filed with the Bankruptcy Court schedules and statements of financial affairs setting forth, among other things, the assets and liabilities of the Debtors, subject to the assumptions filed in connection therewith. All of the schedules will be subject to further amendment or modification. Differences between amounts scheduled by the Debtors

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and claims by creditors will be investigated and resolved in connection with the claims resolution process. To that end, the Bankruptcy Court fixed July 31, 2006 as the last date for non-governmental creditors and interest holders to timely file proofs of claim or interest and October 25, 2006 as the last day for governmental units to timely file proofs of claim.

Based on the DEQ Settlement Agreement discussed above in Note 5-Legal Proceedings and Contingencies, the Debtors have scheduled Trinity and DEQ with liquidated, unsecured, non-priority claims related to the Miles City Montana railyard and other Montana properties. Borax and USEPA have been scheduled with significant claims in connection with the clean up of arsenic and other materials in a neighborhood in Minneapolis, Minnesota near the Company's former Lite Yard property. Edwin Jacobson has been scheduled with a contingent, unliquidated, disputed, unsecured, non-priority claim of \$14,600,000 in connection with the termination of his employment contract.

Costs of Liquidation. The Company has incurred and will continue to incur significant costs associated with its Chapter 11 proceedings. The Company believes, however, that the proceedings will produce the best outcome for the Company and its creditors. The Company has accrued \$305,000 for costs in connection with the liquidation. This represents an estimate of a low end of a possible range of costs. Actual results may be different from this estimate.

Effect of Filing on Creditors and Unitholders. Under the priority scheme established by the Bankruptcy Code, unless creditors agree otherwise, pre-petition liabilities and post-petition liabilities must be satisfied in full before Unitholders are entitled to receive any distribution or retain any property under a plan of reorganization. The ultimate recovery to creditors and/or Unitholders, if any, may not be determined until confirmation of a plan or plans of liquidation and, in all likelihood, not until all of the Debtors' assets are fully liquidated and all claims finally determined. No assurance can be given as to what values, if any, will be ascribed in the Chapter 11 proceedings to each of these constituencies or what types or amounts of distributions, if any, they may receive.

As discussed below, if the requirements of Section 1129(b) of the Bankruptcy Code are met, a plan of liquidation can be confirmed notwithstanding its rejection by the Unitholders and notwithstanding the fact that such Unitholders

15

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

do not receive or retain any property on account of their equity interests under the plan. Because of such possibilities, the value of our liabilities and securities, including our partnership units, is highly speculative. We urge that appropriate caution be exercised with respect to existing and future investments in any of the liabilities and/or securities of the Debtors.

LIABILITIES SUBJECT TO COMPROMISE

The following table summarizes the components of liabilities subject to compromise included in our Consolidated Statement of Net Assets in Liquidation and Balance Sheet as of June 30, 2006 and December 31, 2005, respectively:

(in thousands)	JUNE 30, 2006	DECEMBER 31, 2005
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Allowance for claims and liabilities	\$5,362	\$2,128
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	\$5,362	\$2,128
=====		

Liabilities subject to compromise refers to pre-petition obligations, which may be impacted by the Chapter 11 reorganization process. These amounts represent our current estimate of known or potential pre-petition obligations to be resolved in connection with our Chapter 11 proceedings.

Differences between liabilities we have estimated and the claims filed, or to be filed, will be investigated and resolved in connection with the claims resolution process. We will continue to evaluate these liabilities throughout the Chapter 11 process and adjust amounts as necessary. Such adjustments may be material. In light of the expected number of creditors, the claims resolution process may take considerable time to complete. Accordingly, the ultimate number and amount of allowed claims is not presently known.

8. Subsequent Events

Subsequent to June 30, 2006 the Company entered into the DEQ Settlement Agreement discussed above in Note 5-Legal Proceedings and Contingencies described above.

On August 8, 2006, Debtors filed a plan and disclosure statement ("Liquidation Plan") for which key points are summarized as follows:

Process for Plan of Liquidation. In addition to being voted on by holders of impaired claims and equity interests, a plan of liquidation must satisfy certain requirements of the Bankruptcy Code and must be approved, or confirmed, by the Bankruptcy Court in order to become effective. A plan of liquidation will be deemed accepted by holders of claims against and equity interests in the Debtors if (1) at least one-half in number and two-thirds in dollar amount of claims actually voting in each impaired class of claims have voted to accept the plan and (2) at least two-thirds in amount of equity interests actually voting in each impaired class of equity interests has voted to accept the plan.

Under certain circumstances set forth in Section 1129(b) of the Bankruptcy Code, the Bankruptcy Court may confirm a plan even if such plan has not been accepted

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

by all impaired classes of claims and equity interests. A class of claims or equity interests that does not receive or retain any property under the plan on account of such claims or interests is deemed to have voted to reject the plan. The precise requirements and evidentiary showing for confirming a plan notwithstanding its rejection by one or more impaired classes of claims or equity interests depends upon a number of factors, including the status and seniority of the claims or equity interests in the rejecting class (i.e., secured claims or unsecured claims, subordinated or senior claims, preferred or Class A Units). Generally, with respect to equity interests, such as the Class A Units, a plan may be "crammed down" even if the unitholders receive no recovery if the proponent of the plan demonstrates that (1) no class junior to the Class A Units is receiving or retaining property under the plan and (2) no class of

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claims or interests senior to the Class A Units is being paid more than in full.

The Liquidation Plan was confirmed by the Bankruptcy Court on November 7, 2006.

Liquidating Trust. Under the Liquidation Plan, a liquidating trust ("Trust") will be created. The assets of the Company will be transferred to the Trust. The assets consist essentially of cash, the fiber optics agreement and approximately 130 acres of land scattered over 8 states. LePetomane XVIII, Inc. will be appointed trustee of the Trust ("Trustee").

Claims against the Company basically consist of the environmental claims and the Jacobson claim, both of which are described above in Note 5--Legal Proceedings and Contingencies, and certain property tax claims. The value, if any, of the environmental claims, particularly the Miles City and Lite Yard offsite claims, and of the Jacobson claim will be settled either through negotiated settlement or trial. After claims have been liquidated, all allowed claims will be paid in full. If there are assets remaining after payment of claims and costs and expenses, the assets will be distributed to Class A Unitholders as reflected on the Company's books as of the date of transfer to the Liquidating Trust.

17

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.

Chapter 11 Proceedings

On April 28, 2006, the Company and certain of its affiliated entities (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division (the "Bankruptcy Court"). The Debtors' cases are being jointly administered under the caption "In re CMC Heartland Partners, L. P., et al.," at Case No. 06-B-04769.

The Debtors are operating as "debtors-in-possession" under the jurisdiction of

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the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. In general, as debtors-in-possession, the Debtors are authorized under Chapter 11 to administer their bankruptcy estates, but may not engage in transactions outside the ordinary course of business without the prior approval of the Bankruptcy Court. Through their bankruptcy proceedings, the Debtors intend to liquidate all outstanding claims against the Debtors, including any environmental claims, and to provide for a fair and equitable distribution of estate property to all creditors.

Risk Factors

Chapter 11 Bankruptcy

The Company filed for reorganization under Chapter 11 of the Bankruptcy Code on April 28, 2006 and is subject to the risks and uncertainties associated with Chapter 11 proceedings. Risks and uncertainties associated with the Company's Chapter 11 proceedings include the following: (i) the actions and decisions of the Company's creditors and other third parties with interests in the Company's Chapter 11 proceedings may be inconsistent with those of Unitholders, (ii) the

18

ability of the Company to develop, prosecute, confirm and consummate a plan of liquidation with respect to the Chapter 11 proceedings, (iii) the ability of the Company to make distributions will depend on resolution of claims and liabilities in the Chapter 11 proceedings, and (iv) the ultimate distribution, if any, to Unitholders may not reflect the true value of the Units.

Because of the risks and uncertainties associated with the Company's Chapter 11 proceedings, the ultimate impact that events that occur during these proceedings will have on the Company's business and financial condition cannot be accurately predicted or quantified.

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. These risks could adversely affect the Company's financial condition and ability to make distributions to the Unitholders.

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

Pending Litigation

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The Jacobson litigation described above in Note 5 to Notes to Consolidated Financial Statements--Legal Proceedings and Contingencies 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.

As set out above in Note 5 to Notes to Consolidated Financial Statements--Legal Proceedings and Contingencies, Borax has sued the Company for contribution in connection with possible liability for arsenic found in a residential neighborhood near the Lite Yard in Minneapolis, Minnesota. The Company has opposed the Borax motion. The matter is currently stayed by the Company's bankruptcy filing.

Additionally, as discussed above in Note 5 to Notes to Consolidated Financial Statements--Legal Proceedings and Contingencies, 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 has entered into the DEQ Settlement Agreement

19

discussed above in Section 5--Legal Proceedings and Contingencies, to settle this and other liabilities in the State of Montana.

Liquidation of Assets

The Company has filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code. 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 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. The amount and timing of any future cash distributions will depend on generation of cash from sales and claims and the resolution of liabilities. 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 costs of liquidation and meet existing and future liabilities.

Risks Related to the Class A Units

In April 2006, the American Stock Exchange suspended trading of the Company's Class A units. On June 13, 2006, the American Stock Exchange filed an application with the SEC to delist the Class A units. The Company did not oppose or appeal the application to delist the units and, as such, the Class A units are no longer traded on a stock exchange.

Environmental Liabilities

Under various federal, state and local laws, ordinances, and regulations, the

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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.

20

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.

SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES

The Company's most significant accounting estimates relate to the net realizable value of assets, potential environmental liabilities, and the Jacobson litigation.

Net Realizable Value of Assets

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. At June 30, 2006, all land held for sale had been sold.

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

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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 June 30, 2006, the reserve for environmental claims and liabilities was \$5,362,000, 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 \$8,794,000 based on an estimate by outside consultants.

21

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 less expensive to resolve than the amount of the low end of such range. 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.

In connection with the liquidation of the Company under Chapter 11, 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.

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 Milwaukee Road or certain of the Milwaukee Road's lessees and may have further material environmental liabilities that are currently 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

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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. There are 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 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 private parties in

22

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.

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

Lite Yard is a 5 acre site in Minneapolis, Minnesota, formerly owned by CMC, that is impacted with arsenic and lead. On April 29, 2004, a Response Action Plan for the site was approved by the Minnesota Department of Agriculture. The Company filed suit against 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 the Settlement Agreement. 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 June 30, 2006 and December 31, 2005, the Company's aggregate allowance for claims and liabilities for this site was \$4,000 and \$20,000, respectively.

The Company sold the Lite Yard to a third party in August 2005. The sale did not affect the Company's environmental responsibility. The company believes that with the exception of amounts estimated to be less than \$5,000 required to be paid in connection with obtaining regulatory compliance confirmation, it has now completed the environmental remediation of the Lite Yard.

On September 3, 2004, USEPA issued an order (the "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, USEPA issued a general notice letter

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(the "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 is covered by the Settlement Agreement.

The Company offered USEPA \$300,000 to settle the Company's obligations under the Order and the Letter. USEPA has not yet responded to the Company's offer. The Company believes, based on USEPA publications and a newspaper article, that USEPA has provided \$1,500,000 to \$2,200,000 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 USEPA. The entire cost could be higher or lower. 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 \$3,374,000 to \$3,948,000. However, this estimate was based on limited data available to the consultant. The Company has reserved \$1,432,000 in connection with the Order and the Letter. This reserve amount

23

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.

Borax has filed suit in federal court in Minneapolis, Minnesota for seeking contribution from CMC in connection with any liability arising out of arsenic in the nearby residential area. CMC is opposing Borax's lawsuit and believes it has good defenses. The matter is stayed as a result of the Company's Chapter 11 filing.

DEQ Settlement Agreement

The Company has entered into the DEQ Settlement Agreement discussed above in Section 5-Legal Proceedings and Contingencies to resolve certain environmental liabilities in the State of Montana. It is subject to approval by the Bankruptcy Court. The Company has reserved \$3,550,000 in connection with the DEQ Settlement Agreement.

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 June 30, 2006, 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

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approximately \$266,000. 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, (ii) with potential environmental liabilities for which the Company has no reasonable basis to estimate or (iii) that 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.

24

Edwin Jacobson, the former President and Chief Executive Officer of CMC, has sued the Company claiming that it owes him additional salary and incentive compensation based on the terms of his employment contract. In the court case he has demanded \$12,000,000 (\$1,000,000 salary and \$11,000,000 incentive compensation) in damages. Jacobson filed a claim in the bankruptcy proceeding in the amount of \$14,600,000. 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 from Jacobson to the Company (this matter is explained in greater detail above in Note 5 to Notes to Consolidated Financial Statements—Legal Proceedings and Contingencies). 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 and six months ended June 30, 2006 resulted in a net loss of \$(1,417,000) and income of \$2,353,000 or \$(0.67) and \$1.11 per Class A Unit respectively. Operations for the three and six months ended June 30, 2005 resulted in net income of \$613,000 and a net loss of (\$476,000) or \$0.00 and \$0.00 per Class A Unit, respectively.

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Property Sales. Property sales increased \$2,680,000, or 1,576%, to \$2,850,000 for the three months ended June 30, 2006 from \$170,000 for the three months ended June 30, 2005. Second quarter 2006 sales included the Company's remaining acreage in Kinzie Station. During the second quarter of 2005, the Company closed the sale of a Rockford, IL property.

Cost of Property Sales. Cost of property sales increased \$967,000, or 16,117%, to \$973,000 for the three months ended June 30, 2006 from \$6,000 for the three months ended June 30, 2005. The increase was primarily the result of cost of sales recognized in connection with the Kinzie Station North Parcel B sale compared with those recognized in connection with the sale of the Rockford

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property in 2005.

Gross Profit on Property Sales. Gross profit on property sales increased \$1,713,000 to \$1,877,000 for the three months ended June 30, 2006 from \$164,000 for the three months ended June 30, 2005. This increase was primarily the result of higher sales in 2006.

Selling Expenses. Selling expenses increased \$99,000 to \$184,000 for the three months ended June 30, 2006 from \$85,000 for the three months ended June 30, 2005. This increase was primarily the result of higher consulting costs.

General and Administrative Expenses. General and administrative expenses increased \$74,000 to \$656,000 for the three months ended June 30, 2006 from \$582,000 for the three months ended June 30, 2005. This was primarily due to accruing for liquidation expense, offset by lower insurance costs, lower public relations costs, lower board fee expense and lower banking costs.

25

Real Estate Taxes. Real estate taxes increased \$30,000 to \$8,000 for the three months ended June 30, 2006 from (\$22,000) for the three months ended June 30, 2005. Sales of land for which there were accrued real estate taxes in the second quarter of 2005 created negative real estate taxes for that period.

Environmental Expenses and Other Charges. Environmental expenses and other charges increased \$4,032,000 to \$3,333,000 for the three months ended June 30, 2006 from (\$699,000) for the three months ended June 30, 2005. In the second quarter of 2005, the Company received reimbursement from Borax for \$238,000 the Company had spent at the Lite Yard, settled a disputed bill from Exponent, and the reserved amount for Bozeman, Montana was reduced based on additional studies by the City of Bozeman. In 2006, the Company spent money on remediation and increased its reserves for the Lite Yard Offsite and increased its reserve to reflect the DEQ Settlement Agreement discussed above in Note 5 to Notes to Consolidated Financial Statements -Legal Proceedings and Contingencies.

Interest Income. Interest income increased \$55,000 to \$72,000 for the three months ended June 30, 2006 from \$17,000 for the first quarter of 2005. The increase was due to increased cash in 2006.

Rental Income-accounting basis change adjustment. This increased \$793,000 in the second quarter of 2006 compared to \$0 in 2005. The Company recognized \$793,000 of deferred rental income as rental income in the second quarter of 2006. The Company had received prepaid rent from fiber optics easements and was recognizing the income over the life of the easements. When the Company changed its basis of accounting to the liquidation basis it recognized the remaining balance into income in accordance with liquidation accounting.

Rental Income. Total rental income and earned rental lease income decreased \$15,000 to \$19,000 for the three months ended June 30, 2006 from \$34,000 for the three months ended June 30, 2005.

Gain on Sale of Buildings and Improvements. Gain on sale of buildings and improvements decreased by \$430,000 to \$0 for the three months ended June 30, 2006 from \$430,000 for the three months ended June 30, 2005. The Company sold its 4,000 square foot office space in Chicago, Illinois in 2005 for net proceeds of \$549,000 resulting in a net gain of \$430,000 in 2005. The Company had no sales of buildings and improvements in 2006.

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Net Income. Net income decreased \$2,030,000 to a loss of \$(1,417,000) for the three months ended June 30, 2006 from \$613,000 for the three months ended June 30, 2005. This was primarily the result of reflecting the DEQ Settlement Agreement, partially offset by increased sales and increased gross profit on the Kinzie Station sale.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Property Sales. Property sales increased \$1,327,000 to \$5,700,000 for the six months ended June 30, 2006 from \$4,373,000 for the six months ended June 30, 2005. This increase was primarily the result of the sales of the last two parcels of Kinzie Station for a total of \$5,700,000 in the first half of 2006. The Company recorded the \$4,200,000 sale of Kinzie Station Phase II in 2005.

26

Settlement of Condemnation. Settlement of Condemnation increased \$3,250,000 to \$3,250,000 in the first half of 2006 from \$0 in the first half of 2005. The Company received the RACM Settlement in the first half of 2006.

Cost of Property Sales. Cost of property sales decreased \$1,864,000 to \$2,094,000 for the six months ended June 30, 2006 from \$3,958,000 for the six months ended June 30, 2005. This decrease was primarily the result of the high costs of sale recognized in connection with the sale of Kinzie Station Phase II in 2005. These included incentive payments to certain current and former officers and payments due to METRA Rail. However, the most significant factor was the total cost basis of Kinzie Station II of \$3,565,000. These costs did not affect net proceeds received on the sale because they were primarily costs from previous planning, design and marketing of the property.

Gross Profit on Property Sales. Gross profit on property sales increased \$6,441,000 to \$6,856,000 for the six months ended June 30, 2006 from \$415,000 for the six months ended June 30, 2005. This increase was the result of increased sales and the lower cost of sales for properties sold in 2006. The Company received \$3,250,000 from the RACM Settlement in 2006. There were no costs of sale in connection with the settlement as all costs of sale had been recognized upon the taking of the property by RACM in 2003.

Selling Expenses. Selling expenses increased \$72,000 to \$444,000 for the six months ended June 30, 2006 from \$372,000 for the six months ended June 30, 2005. This increase was primarily the result of higher consulting costs.

General and Administrative Expenses. General and administrative expenses increased \$228,000 to \$1,427,000 for the six months ended June 30, 2006 from \$1,199,000 for the six months ended June 30, 2005. This was primarily due to accruing for liquidation costs, partially offset by lower insurance costs, lower public relations costs, lower board fee expense, lower banking costs and the elimination of a reserve for contingent executive compensation related to "phantom units".

Bad Debt Expense. Bad debt expense decreased \$100,000 to \$0 for the six months ended June 30, 2006 from \$100,000 for the six months ended June 30, 2005. In 2005 the Company wrote off an additional \$100,000 in connection with a receivable due from Heartland Technology, Inc., an affiliate.

Environmental Expenses and Other Charges. Environmental expenses and other

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charges increased \$3,939,000 to \$3,540,000 for the six months ended June 30, 2006 from (\$399,000) for the six months ended June 30, 2005. In 2005 the Company received reimbursement from Borax for \$238,000 the Company had spent at the Lite Yard, settled a disputed bill from Exponent and the reserved amount for Bozeman, Montana was reduced based on additional studies by the City of Bozeman. In the six months ended June 30, 2006, the Company increased its environmental reserve for Lite Yard off site costs and recorded additional expense pursuant to the DEQ Settlement Agreement discussed above in Section 5-Legal Proceedings and Contingencies.

27

Interest Income. Interest income increased \$54,000 to \$77,000 for the six months ended June 30, 2006 from \$23,000 for the first half of 2005. The increase was due to increased cash in 2006.

Rental Income-accounting basis change adjustment. This increased \$793,000 in the second quarter of 2006 compared to \$0 in 2005. The Company recognized \$793,000 of deferred rental income as rental income in the second quarter of 2006. The Company had received prepaid rent from fiber optics easements and was recognizing the income over the life of the easements. When the Company changed its basis of accounting to liquidation basis it recognized the remaining balance into income in accordance with liquidation accounting.

Rental Income. Total rental income and earned rental lease income decreased \$27,000 to \$56,000 for the six months ended June 30, 2006 from \$83,000 for the six months ended June 30, 2005.

Other Income. Other income decreased \$61,000 for the first six months of 2006 from \$66,000 for the six months ended June 30, 2005. There was a sale of a fiber optics easement in other income in 2005.

Gain on sale of Buildings and Improvements. Gain on Sale of Buildings and Improvements decreased by \$430,000 to \$0 for the six months ended June 30, 2006 from \$430,000 for the six months ended June 30, 2005. The Company sold its 4,000 square foot office space in Chicago, Illinois in 2005 for net proceeds of \$549,000 and a net gain of \$430,000 in 2005 and had no sales of Buildings and Improvements in 2006.

Net Income (Loss). Net income increased \$2,827,000 to net income of \$2,353,000 for the six months ended June 30, 2006 from net loss of \$(474,000) for the six months ended June 30, 2005. This was the result of higher revenues and higher gross profit on property sales.

Liquidity and Capital Resources

The primary sources of cash for operating activities have been proceeds of property sales, rental income and interest income. Unrestricted Cash was \$6,227,000 at June 30, 2006 and \$1,160,000 at December 31, 2005.

Net cash provided by operating activities was \$6,474,000 for the six months ended June 30, 2006. Cash provided by operating activities increased by \$4,644,000 for the six months ended June 30, 2006. Cash was generated from the sale of land in Kinzie Station and settlement of the RACM litigation. A mortgage on Kinzie Station Parcel B was part of the collateral for a \$2,500,000 letter of credit for the Miles City Yard litigation. When Parcel B was sold, the Company increased cash collateral for the letter of credit by \$1,407,000.

No distributions were made during the first half of 2006. As of June 30, 2006, the Unitholders' capital account balance was \$5,784,000 and the General Partner's capital account balance was \$35,000.

Proceeds from property sales were \$8,950,000 for the six months ended June 30, 2006. During the remainder of 2006, the Company does not expect proceeds from property sales to be significant. 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 six months ended June 30, 2006 and 2005 was \$2,094,000, or 23% of sales proceeds.

On July 30, 2003, the Company conveyed 142 acres of property in Milwaukee, Wisconsin to 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 parties reached a settlement of the appeal in January 2006 and the Company received \$3,250,000 in March 2006.

The Company entered into the DEQ Settlement Agreement discussed above in Section 5-Legal Proceedings and Contingencies. Under the DEQ Settlement Agreement, the Company's environmental liabilities to the State of Montana and Trinity Industries will be resolved for a payment of up to \$3,550,000. The DEQ Settlement Agreement is subject to approval by the Bankruptcy Court.

Economic and Other Conditions

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

As of June 30, 2006, the Company did not have any financial instruments for which there was significant exposure to interest rate changes.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See "Management's Discussion and Analysis of Financial Condition and Results of Operations," 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 believes that the Company's controls and procedures 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, in fact, recorded, processed, summarized and reported. However, the Company did not timely file its Form 10-Q for the first or second quarter of 2006.

Changes in Internal Control over Financial Reporting

Following the April 20, 2006 resignation of the Company's independent directors, the Company does not have any independent directors and has an audit committee comprised of a single, non-independent director.

30

PART II.

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

At June 30, 2006, Heartland's allowance for claims and liabilities was approximately \$5,362,000.

There have been no new legal proceedings instituted against the Company during the six months ended June 30, 2006. Material developments in the legal proceedings disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 since the filing thereof on March 31, 2006 include the RACM Settlement in January 2006. These legal proceedings are discussed above in Note 5 to Notes to Consolidated Financial Statements - Legal Proceedings and Contingencies". In April 2006 the Company filed for liquidation under Chapter 11 of the federal bankruptcy laws. The Company entered into the DEQ Settlement Agreement which, if approved by the Bankruptcy Court, will resolve certain litigation with the Montana Department of Environmental Quality and Trinity Industries.

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ITEM 1A. RISK FACTORS

The Company filed for reorganization under Chapter 11 of the Bankruptcy Code on April 28, 2006 and is subject to the risks and uncertainties associated with Chapter 11 proceedings. Risks and uncertainties associated with the Company's Chapter 11 proceedings include the following: (i) the actions and decisions of the Company's creditors and other third parties with interests in the Company's Chapter 11 proceedings may be inconsistent with those of Unitholders, (ii) the ability of the Company to develop, prosecute, confirm and consummate a plan of liquidation with respect to the Chapter 11 proceedings, (iii) the ability of the Company to make distributions will depend on resolution of claims and liabilities in the Chapter 11 proceedings, and (iv) the ultimate distribution, if any, to Unitholders may not reflect the true value of the Units.

Because of the risks and uncertainties associated with the Company's Chapter 11 proceedings, the ultimate impact that events that occur during these proceedings will have on the Company's business and financial condition cannot be accurately predicted or quantified.

ITEM 2. UNREGISTERED SALES OF EQUITY 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

31

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.

32

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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: November 14, 2006

By /s/ Lawrence S. Adelson

Lawrence S. Adelson
Chief Executive Officer

33

EXHIBIT INDEX

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