

HAWTHORN BANCSHARES, INC.

Form 10-Q

August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2018

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: 0-23636

HAWTHORN BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Missouri

43-1626350

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

132 East High Street, Box 688, Jefferson City, Missouri 65102
(Address of principal executive offices) (Zip Code)

(573) 761-6100
(Registrant's telephone number, including area code)

N/A
(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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer
(Do not check if a smaller reporting company)
Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of August 9, 2018, the registrant had 6,020,915 shares of common stock, par value \$1.00 per share, outstanding

Part I - Financial Information**Item 1. Financial Statements****HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES****Consolidated Balance Sheets (unaudited)**

(In thousands, except per share data)	June 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	\$ 15,921	\$ 23,325
Federal funds sold and other interest-bearing deposits	34,863	39,553
Cash and cash equivalents	50,784	62,878
Certificates of deposit in other banks	10,746	3,460
Investment in available-for-sale securities, at fair value	227,601	226,542
Other investments and securities, at cost	9,323	11,037
Total investment securities	236,924	237,579
Loans	1,094,195	1,068,432
Allowances for loan losses	(11,212)	(10,852)
Net loans	1,082,983	1,057,580
Premises and equipment - net	34,586	34,811
Mortgage servicing rights	2,813	2,713
Other real estate owned and repossessed assets - net	13,236	13,182
Accrued interest receivable	5,294	5,627
Cash surrender value - life insurance	2,516	2,484
Other assets	8,768	8,902
Total assets	\$ 1,448,650	\$ 1,429,216
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Non-interest bearing demand	\$ 250,232	\$ 245,380
Savings, interest checking and money market	614,976	584,468
Time deposits \$250,000 and over	98,638	63,176
Other time deposits	219,540	232,788
Total deposits	1,183,386	1,125,812
Federal funds purchased and securities sold under agreements to repurchase	36,103	27,560
Federal Home Loan Bank advances and other borrowings	74,270	121,382
Subordinated notes	49,486	49,486
Accrued interest payable	790	554
Other liabilities	11,482	13,051
Total liabilities	1,355,517	1,337,845

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Stockholders' equity:

Common stock, \$1 par value, authorized 15,000,000 shares; issued 6,046,907 shares, respectively	6,047	6,047
Surplus	50,456	45,442
Retained earnings	49,594	50,595
Accumulated other comprehensive loss, net of tax	(7,734)	(5,662)
Treasury stock; 257,566 and 248,898 shares, at cost, respectively	(5,230)	(5,051)
Total stockholders' equity	93,133	91,371
Total liabilities and stockholders' equity	\$1,448,650	\$ 1,429,216

See accompanying notes to the consolidated financial statements (*unaudited*).

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**Consolidated Statements of Income** *(unaudited)*

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
INTEREST INCOME				
Interest and fees on loans	\$ 12,853	\$ 11,671	\$ 25,077	\$ 22,721
Interest on investment securities:				
Taxable	984	737	1,930	1,491
Nontaxable	147	168	305	325
Federal funds sold, other interest-bearing deposits, and certificates of deposit in other banks	189	11	295	60
Dividends on other securities	115	94	225	184
Total interest income	14,288	12,681	27,832	24,781
INTEREST EXPENSE				
Interest on deposits:				
Savings, interest checking and money market	1,347	475	2,431	864
Time deposit accounts \$250,000 and over	296	99	434	191
Other time deposits	536	410	1,046	789
Interest on federal funds purchased and securities sold under agreements to repurchase	189	27	360	49
Interest on Federal Home Loan Bank advances	332	419	728	741
Interest on subordinated notes	561	431	1,051	840
Total interest expense	3,261	1,861	6,050	3,474
Net interest income	11,027	10,820	21,782	21,307
Provision for loan losses	450	330	750	680
Net interest income after provision for loan losses	10,577	10,490	21,032	20,627
NON-INTEREST INCOME				
Service charges and other fees	941	851	1,817	1,687
Bank card income and fees	709	663	1,365	1,277
Trust department income	311	266	592	540
Real estate servicing fees, net	161	34	381	487
Gain on sale of mortgage loans, net	242	218	387	374
Other	122	67	245	141
Total non-interest income	2,486	2,099	4,787	4,506
NON-INTEREST EXPENSE				
Salaries and employee benefits	5,813	5,336	11,870	10,774
Occupancy expense, net	725	689	1,413	1,307
Furniture and equipment expense	685	634	1,320	1,232
Processing, network, and bank card expense	889	927	1,747	1,972
Legal, examination, and professional fees	201	317	624	597

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FDIC insurance assessment	146	115	301	216
Advertising and promotion	291	265	544	503
Postage, printing, and supplies	224	252	492	475
Other	957	1,152	1,875	1,961
Total non-interest expense	9,931	9,687	20,186	19,037
Income before income taxes	3,132	2,902	5,633	6,096
Income tax expense	225	983	636	2,076
Net income	2,907	1,919	4,997	4,020
Basic earnings per share	\$ 0.48	\$ 0.32	\$ 0.83	\$ 0.66
Diluted earnings per share	\$ 0.48	\$ 0.32	\$ 0.83	\$ 0.66

See accompanying notes to the consolidated financial statements (*unaudited*).

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**Consolidated Statements of Comprehensive Income** *(unaudited)*

(In thousands)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	\$ 2,907	\$ 1,919	\$ 4,997	\$ 4,020
Other comprehensive income, net of tax				
Investment securities available-for-sale:				
Unrealized (loss) gain on investment securities available-for-sale, net of tax	(442)	595	(2,157)	900
Adjustment for gain on sale of investment securities, net of tax	0	0	0	0
Defined benefit pension plans:				
Amortization of prior service cost included in net periodic pension cost, net of tax	43	13	85	27
Total other comprehensive (loss) income	(399)	608	(2,072)	927
Total comprehensive income	\$ 2,508	\$ 2,527	\$ 2,925	\$ 4,947

See accompanying notes to the consolidated financial statements *(unaudited)*.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**Consolidated Statements of Stockholders' Equity** *(unaudited)*

(In thousands)	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stock - holders' Equity
Balance, December 31, 2016	\$ 5,822	\$41,498	\$51,671	\$ (3,801)	\$ (4,173)	\$91,017
Net income	0	0	4,020	0	0	4,020
Other comprehensive income	0	0	0	927	0	927
Stock based compensation expense	0	2	0	0	0	2
Purchase of treasury stock	0	0	0	0	(89)	(89)
Stock dividend	0	4,165	(4,165)	0	0	0
Cash dividends declared, common stock	0	0	(730)	0	0	(730)
Balance, June 30, 2017	\$ 5,822	\$45,665	\$50,796	\$ (2,874)	\$ (4,262)	\$95,147
Balance, December 31, 2017	\$ 6,047	\$45,442	\$50,595	\$ (5,662)	\$ (5,051)	\$91,371
Net income	0	0	4,997	0	0	4,997
Other comprehensive loss	0	0	0	(2,072)	0	(2,072)
Purchase of treasury stock	0	0	0	0	(179)	(179)
Stock dividend	0	5,014	(5,014)	0	0	0
Cash dividends declared, common stock	0	0	(984)	0	0	(984)
Balance, June 30, 2018	\$ 6,047	\$50,456	\$49,594	\$ (7,734)	\$ (5,230)	\$93,133

See accompanying notes to the consolidated financial statements *(unaudited)*.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows *(unaudited)*

	Six Months Ended	
	June 30,	
(In thousands)	2018	2017
Cash flows from operating activities:		
Net income	\$4,997	\$4,020
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	750	680
Depreciation expense	877	874
Net amortization of investment securities, premiums, and discounts	752	828
Stock based compensation expense	0	2
Change in fair value of mortgage servicing rights	31	(67)
Gain on sale of investment securities	(206)	0
(Gain) loss on sales and dispositions of premises and equipment	(13)	1
Gain on sales and dispositions of other real estate and repossessed assets	(2)	(38)
Provision for other real estate owned	26	215
Decrease in accrued interest receivable	333	429
Increase in cash surrender value - life insurance	(32)	(39)
Decrease (increase) in other assets	873	(545)
Increase (decrease) in accrued interest payable	236	(69)
(Decrease) increase in other liabilities	(1,742)	290
Origination of mortgage loans for sale	(19,597)	(17,101)
Proceeds from the sale of mortgage loans	19,722	16,154
Gain on sale of mortgage loans, net	(387)	(374)
Other, net	(131)	(115)
Net cash provided by operating activities	6,487	5,145
Cash flows from investing activities:		
Net (increase) decrease in certificates of deposit in other banks	(7,286)	1,000
Net increase in loans	(26,272)	(59,846)
Purchase of available-for-sale debt securities	(74,275)	(21,874)
Proceeds from maturities of available-for-sale debt securities	16,445	16,132
Proceeds from calls of available-for-sale debt securities	1,685	4,525
Proceeds from sales of available-for-sale debt securities	51,810	0
Purchases of FHLB stock	(1,370)	(1,203)
Proceeds from sales of FHLB stock	3,084	201
Purchases of premises and equipment	(734)	(863)
Proceeds from sales of premises and equipment	13	0
Proceeds from sales of other real estate and foreclosed assets	304	784
Net cash used in investing activities	(36,596)	(61,144)
Cash flows from financing activities:		
Net increase in demand deposits	4,851	43,659
Net increase in interest-bearing transaction accounts	30,509	48,947
Net increase (decrease) in time deposits	22,214	(20,585)
	8,543	(2,389)

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Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase		
Repayment of FHLB advances and other borrowings	(141,112)	(130,277)
FHLB advances	94,000	152,740
Purchase of treasury stock	(179)	(89)
Cash dividends paid - common stock	(811)	(674)
Net cash provided by financing activities	18,015	91,332
Net (decrease) increase in cash and cash equivalents	(12,094)	35,333
Cash and cash equivalents, beginning of period	62,878	25,995
Cash and cash equivalents, end of period	\$50,784	\$61,328

See accompanying notes to the consolidated financial statements (*unaudited*).

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (continued) (unaudited)

(In thousands)	Six Months Ended June 30,	
	2018	2017
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$5,814	\$3,542
Income taxes	\$50	\$2,185
Noncash investing activities:		
Other real estate and repossessed assets acquired in settlement of loans	\$382	\$155

See accompanying notes to the consolidated financial statements (unaudited).

Hawthorn Bancshares, Inc.

and subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

(1) Summary of Significant Accounting Policies

Hawthorn Bancshares, Inc. (the Company) through its subsidiary, Hawthorn Bank (the Bank), provides a broad range of banking services to individual and corporate customers located within the Missouri communities in and surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, Branson, and the greater Kansas City metropolitan area. The Company is subject to competition from other financial and nonfinancial institutions providing financial products. Additionally, the Company and its subsidiaries are subject to the regulations of certain regulatory agencies and undergo periodic examinations by those regulatory agencies.

The accompanying unaudited consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q, and Rule 10-01 of Regulation S-X. Accordingly, the unaudited consolidated financial statements do not include all of the information and disclosures required by U.S. GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The preparation of the consolidated financial statements includes all adjustments that, in the opinion of management, are necessary in order to make those statements not misleading. Management is required to make estimates and assumptions, including the determination of the allowance for loan losses, real estate acquired in connection with foreclosure or in satisfaction of loans, and fair values of investment securities available-for-sale that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's management has evaluated and did not identify any subsequent events or transactions requiring recognition or disclosure in the consolidated financial statements.

Stock Dividend On July 1, 2018, the Company paid a special stock dividend of four percent to shareholders of record at the close of business on June 15, 2018. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect this change.

The following represents significant new accounting principles adopted in 2018:

Revenue from Contracts with Customers On January 1, 2018, the Company adopted ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* and all subsequent ASUs that modified Topic 606. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as trust department revenue, service charges and fees, debit card income, ATM surcharge income, and other real estate owned sales. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Noninterest revenue streams within the scope of Topic 606 are discussed in Footnote 16.

Financial Instruments The FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, in January 2016. The amendments require all equity investments to be measured at fair value with changes in the fair value recognized through net income, other than those accounted for under the equity method of accounting or those that result in the consolidation of the investee. Additionally, these amendments require presentation in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk for those liabilities measured at fair value. The amendments also require use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes. These amendments are effective for interim and annual periods beginning January 1, 2018. The adoption of the ASU did not have a significant effect on the Company's consolidated financial statements.

Hawthorn Bancshares, Inc.

and subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

The FASB issued ASU 2018-04, *Investments - Debt Securities (Topic 320) and Regulated Operations (Topic 980)*: The amendment in this ASU adds, amends and supersedes various paragraphs that contain SEC guidance in ASC 320, Investments-Debt Securities and ASC 980, Regulated Operations. The amendments in this ASU are effective when a registrant adopts ASU 2016-01, which for the Company was January 1, 2018. This amendment did not have a significant effect on the Company's consolidated financial statements.

Liabilities The FASB issued ASU 2016-04, *Recognition of Breakage for Certain Prepaid Store-Value Products*, in March 2016, in order to address current and potential future diversity in practice related to the derecognition of a prepaid store-value product liability. Such products include prepaid gift cards issued on a specific payment network and redeemable at network-accepting merchant locations, prepaid telecommunication cards, and traveler's checks. The amendments require that the portion of the dollar value of prepaid stored-value products that is ultimately unredeemed (that is, the breakage) be accounted for consistent with the breakage guidance for stored-value product transactions provided in ASC Topic 606 - Revenue from Contracts with Customers. These amendments are effective for interim and annual periods beginning January 1, 2018. The adoption of the ASU did not have a significant effect on the Company's consolidated financial statements.

Pension The FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* in March 2017. Under the new guidance, employers will present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. The ASU is effective for interim and annual reporting periods beginning after December 15, 2017. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. The Company utilizes the ASU's practical expedient allowing entities to estimate amounts for comparative periods using the information previously disclosed in their pension and other postretirement benefit plan footnote. The adoption of the ASU did not have a significant effect on the Company's consolidated financial statements.

(2) Loans and Allowance for Loan Losses

Loans

A summary of loans, by major class within the Company's loan portfolio, at June 30, 2018 and December 31, 2017 is as follows:

(in thousands)	June 30, 2018	December 31, 2017
Commercial, financial, and agricultural	\$200,628	\$ 192,238
Real estate construction - residential	28,285	26,492
Real estate construction - commercial	106,406	98,340
Real estate mortgage - residential	246,415	246,754
Real estate mortgage - commercial	479,571	472,455
Installment and other consumer	32,890	32,153
Total loans	\$1,094,195	\$ 1,068,432

The Bank grants real estate, commercial, installment, and other consumer loans to customers located within the Missouri communities surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, Branson and the greater Kansas City metropolitan area. As such, the Bank is susceptible to changes in the economic environment in these communities. The Bank does not have a concentration of credit in any one economic sector. Installment and other consumer loans consist primarily of the financing of automotive vehicles. At June 30, 2018, loans of \$489.6 million were pledged to the Federal Home Loan Bank as collateral for borrowings and letters of credit.

Hawthorn Bancshares, Inc.

and subsidiaries

Notes to the Consolidated Financial Statements

*(Unaudited)**Allowance for Loan Losses*

The following is a summary of the allowance for loan losses during the periods indicated.

	Three Months Ended June 30, 2018							Un-allocated	Total
	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Commercial	Real Estate Residential	Real Estate Mortgage	Real Estate Mortgage Commercial	Installment and Other Consumer		
(in thousands)									
Balance at beginning of period	\$3,261	\$ 240	\$ 895	\$ 2,057	\$ 4,008	\$ 352	\$ 134	\$10,947	
Additions:									
Provision for loan losses	865	(52)	10	48	(388)	90	(123)	450	
Deductions:									
Loans charged off	193	0	0	12	15	49	0	269	
Less recoveries on loans	(10)	(13)	0	(16)	(25)	(20)	0	(84)	
Net loan charge-offs (recoveries)	183	(13)	0	(4)	(10)	29	0	185	
Balance at end of period	\$3,943	\$ 201	\$ 905	\$ 2,109	\$ 3,630	\$ 413	\$ 11	\$11,212	
	Six Months Ended June 30, 2018								
	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Commercial	Real Estate Residential	Real Estate Mortgage	Real Estate Mortgage Commercial	Installment and Other Consumer	Un-allocated	Total
(in thousands)									
Balance at beginning of period	\$3,325	\$ 170	\$ 807	\$ 1,689	\$ 4,437	345	\$ 79	\$10,852	

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Balance at beginning of period								
Additions:								
Provision for loan losses	898	54	128	416	(809)	131	(68)	750
Deductions:								
Loans charged off	303	48	30	32	29	106	0	548
Less recoveries on loans	(23)	(25)	0	(36)	(31)	(43)	0	(158)
Net loan charge-offs (recoveries)	280	23	30	(4)	(2)	63	0	390
Balance at end of period	\$3,943	\$ 201	\$ 905	\$ 2,109	\$ 3,630	\$ 413	\$ 11	\$11,212

Three Months Ended June 30, 2017

	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Construction Commercial	Real Estate Mortgage Residential	Real Estate Mortgage Commercial	Installment and Other Consumer	Un-allocated	Total
(in thousands)								
Balance at beginning of period	\$2,360	\$ 99	\$ 579	\$ 2,125	\$ 4,731	\$ 322	\$ 46	\$10,262
Additions:								
Provision for loan losses	226	(54)	36	(230)	139	89	124	330
Deductions:								
Loans charged off	32	0	0	62	2	60	0	156
Less recoveries on loans	(24)	(25)	0	(21)	(14)	(25)	0	(109)
Net loan charge-offs (recoveries)	8	(25)	0	41	(12)	35	0	47
Balance at end of period	\$2,578	\$ 70	\$ 615	\$ 1,854	\$ 4,882	\$ 376	\$ 170	\$10,545

Six Months Ended June 30, 2017

	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Construction Commercial	Real Estate Mortgage Residential	Real Estate Mortgage Commercial	Installment and Other Consumer	Un-allocated	Total
(in thousands)								
Balance at beginning of period	\$2,753	\$ 108	\$ 413	\$ 2,385	\$ 3,793	274	\$ 160	\$9,886
Additions:								