

HAWTHORN BANCSHARES, INC.
Form 10-Q
May 17, 2010

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

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2010**

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 (I.R.S. Employer
of incorporation or organization) Identification No.)
300 Southwest Longview Boulevard, Lees Summit, Missouri 64081
(Address of principal executive offices) (Zip Code)

(816) 347-8100
(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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.:

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

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 May 17, 2010 the registrant had 4,301,955 shares of common stock, par value \$1.00 per share, outstanding.

Index to Exhibits located on page 39

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	March 31, 2010	December 31, 2009
ASSETS		
Loans	\$ 974,187,039	\$ 991,614,007
Allowances for loan losses	(14,657,622)	(14,796,549)
Net loans	959,529,417	976,817,458
Investment in available - for - sale securities, at fair value	159,048,121	152,926,685
Federal funds sold and securities purchased under agreements to resell	225,016	89,752
Cash and due from banks	58,649,312	24,575,943
Premises and equipment - net	38,251,680	38,623,293
Other real estate owned and repossessed assets	11,368,113	8,490,914
Accrued interest receivable	6,015,006	6,625,557
Mortgage servicing rights	2,000,456	2,020,964
Intangible assets - net	1,353,467	1,503,986
Cash surrender value - life insurance	1,948,654	1,929,910
Other assets	22,021,603	22,866,092
Total assets	\$ 1,260,410,845	\$ 1,236,470,554
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non - interest bearing demand	\$ 130,856,351	\$ 135,017,639
Savings, interest checking and money market	402,042,287	354,284,004
Time deposits \$100,000 and over	133,904,306	137,860,435
Other time deposits	322,992,318	329,160,719
Total deposits	989,795,262	956,322,797
Federal funds purchased and securities sold under agreements to repurchase	32,107,860	36,645,434
Subordinated notes	49,486,000	49,486,000
Other borrowed money	74,128,083	79,317,302
Accrued interest payable	2,336,292	2,438,121
Other liabilities	5,006,326	4,489,617
Total liabilities	1,152,859,823	1,128,699,271

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Stockholders' equity:		
Preferred stock, \$1,000 par value Authorized and issued 30,255 shares	28,483,887	28,364,768
Common stock, \$1 par value Authorized 15,000,000 shares; issued 4,463,813 shares	4,463,813	4,463,813
Surplus	26,999,926	26,970,745
Retained earnings	50,099,798	50,576,551
Accumulated other comprehensive income, net of tax	1,020,416	912,224
Treasury stock; 161,858 shares, at cost	(3,516,818)	(3,516,818)
Total stockholders' equity	107,551,022	107,771,283
Total liabilities and stockholders' equity	\$1,260,410,845	\$1,236,470,554

See accompanying notes to consolidated financial statements.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Operations (Unaudited)

	For the Three Months Ended March 31,	
	2010	2009
INTEREST INCOME		
Interest and fees on loans	\$ 13,418,476	\$ 14,444,026
Interest on debt securities:		
Taxable	1,063,979	1,162,507
Nontaxable	326,202	393,616
Interest on federal funds sold and securities purchased under agreements to resell	36	150
Interest on interest - bearing deposits	13,631	14,392
Dividends on other securities	50,697	19,559
Total interest income	14,873,021	16,034,250
INTEREST EXPENSE		
Interest on deposits:		
Savings, interest checking and money market	630,753	949,950
Time deposit accounts \$100,000 and over	711,382	1,080,246
Other time deposit accounts	1,998,651	2,939,881
Interest on federal funds purchased and securities sold under agreements to repurchase	20,540	22,487
Interest on subordinated notes	524,300	662,046
Interest on other borrowed money	676,361	849,183
Total interest expense	4,561,987	6,503,793
Net interest income	10,311,034	9,530,457
Provision for loan losses	2,505,000	1,750,000
Net interest income after provision for loan losses	7,806,034	7,780,457
NON - INTEREST INCOME		
Service charges on deposit accounts	1,296,088	1,377,799
Trust department income	178,862	201,647
Gain on sale of mortgage loans, net	224,573	1,020,971
Other	305,933	164,351
Total non - interest income	2,005,456	2,764,768
NON - INTEREST EXPENSE		
Salaries and employee benefits	4,657,121	4,362,282
Occupancy expense, net	621,672	608,277
Furniture and equipment expense	492,039	563,658
FDIC insurance assessment	410,178	680,781
Legal, examination, and professional fees	247,290	360,870

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Advertising and promotion	278,189	281,271
Postage, printing, and supplies	288,166	284,470
Processing expense	850,365	854,748
Other real estate expense	506,455	164,317
Other	779,271	834,058
Total non - interest expense	9,130,746	8,994,732
Income before income taxes	680,744	1,550,493
Less income taxes	186,976	493,862
Net income	493,768	1,056,631
Preferred stock dividends	369,783	373,985
Accretion of discount on preferred stock	119,119	119,119
Net income available to common shareholders	\$ 4,866	\$ 563,527
Basic earnings per share	\$ 0.00	\$ 0.13
Diluted earnings per share	\$ 0.00	\$ 0.13

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

	Three months Ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 493,768	\$ 1,056,631
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,505,000	1,750,000
Depreciation expense	506,615	525,900
Net amortization of debt securities, premiums, and discounts	160,499	84,597
Amortization of intangible assets	150,519	168,543
Stock based compensation expense	29,181	37,803
(Gain) loss on sales and dispositions of premises and equipment	(104)	3,513
Other real estate owned impairment charges	62,690	815,574
Decrease (increase) in deferred tax asset, net	7,667	(55,965)
Decrease in accrued interest receivable	610,551	480,220
Increase in cash surrender value - life insurance	(18,744)	(8,156)
Decrease in other assets	629,603	460,862
(Decrease) increase in accrued interest payable	(101,829)	137,492
Increase in other liabilities	516,709	94,405
Origination of mortgage loans held for sale	(10,355,738)	(51,495,000)
Proceeds from the sale of mortgage loans held for sale	10,580,311	52,515,971
Gain on sale of mortgage loans, net	(224,573)	(1,020,971)
Other, net	11,991	158,846
Net cash provided by operating activities	5,564,116	5,710,265
Cash flows from investing activities:		
Net decrease in loans	10,683,563	2,631,238
Purchase of available - for - sale debt securities	(108,812,450)	(36,673,418)
Proceeds from maturities of available - for - sale debt securities	81,462,422	31,174,201
Proceeds from calls of available - for - sale debt securities	21,225,800	8,190,000
Proceeds from sales of FHLB stock	230,900	
Purchases of premises and equipment	(135,298)	(166,876)
Proceeds from sales of premises and equipment	400	36,990
Proceeds from sales of other real estate owned and repossessions	1,094,910	224,411
Net cash provided by investing activities	5,750,247	5,416,546
Cash flows from financing activities:		
Net decrease in non - interest - bearing demand deposits	(4,161,288)	(1,565,998)
Net increase in savings, interest checking, and money market accounts	47,758,283	18,131,440
Net (decrease) increase in time deposits	(10,124,530)	19,159,374
Net decrease in federal funds purchased and securities sold under agreements to repurchase	(4,537,574)	(2,816,502)
Repayment of other borrowed money	(5,189,219)	(45,199,639)

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Cash dividends paid - preferred stock	(378,187)	(235,317)
Cash dividends paid - common stock	(473,215)	(868,663)
Net cash provided (used) by financing activities	22,894,270	(13,395,305)
Net increase (decrease) in cash and cash equivalents	34,208,633	(2,268,494)
Cash and cash equivalents, beginning of year	24,665,695	53,827,468
Cash and cash equivalents, end of period	\$ 58,874,328	\$ 51,558,974

Supplemental disclosures of cash flow information:

Cash paid during the year for:

Interest	\$ 4,663,816	\$ 6,366,301
Income taxes	\$ 200,000	\$

Supplemental schedule of noncash investing and financing activities:

Other real estate and repossessions acquired in settlement of loans	\$ 4,099,478	\$ 685,000
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See accompanying notes to consolidated financial statements.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include 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 investments 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. Operating results for the three-month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. Our Company's management has evaluated and did not identify any subsequent events or transactions requiring recognition or disclosure in the consolidated financial statements.

These unaudited condensed consolidated interim financial statements should be read in conjunction with our Company's audited consolidated financial statements included in its 2009 Annual Report to Shareholders under the caption *Consolidated Financial Statements* and incorporated by reference into its Annual Report on Form 10-K for the year ended December 31, 2009 as Exhibit 13.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed and omitted. These financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our Company's consolidated financial position as of March 31, 2010 and the consolidated statements of operations and cash flows for the three-month periods ended March 31, 2010 and 2009.

On July 1, 2009, our Company paid a special stock dividend of four percent to common shareholders of record at the close of business on June 15, 2009. For all periods presented, share information, including basic and diluted earnings per share, have been adjusted retroactively to reflect this change.

Loans and Allowance for Loan Losses

Major classifications in our Company's loan portfolio at March 31, 2010 and December 31, 2009 are as follows:

	March 31, 2010	December 31, 2009
Commercial, financial, and agricultural	\$ 145,576,990	\$ 151,399,300
Real estate construction – residential	39,142,763	38,840,664
Real estate construction – commercial	77,449,610	77,936,569
Real estate mortgage – residential	226,233,066	232,332,124
Real estate mortgage – commercial	450,070,277	453,975,271
Installment loans to individuals	35,547,090	36,966,018
Unamortized loan origination fees and costs, net	167,243	164,061
Total loans	\$974,187,039	\$991,614,007

The Bank grants real estate, commercial, and installment loans to customers located within the communities surrounding Jefferson City, Clinton, Warsaw, Springfield, Branson and Lee's Summit, Missouri. 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 loans consist primarily of the financing of vehicles.

A summary of impaired loans as of March 31, 2010 and December 31, 2009 is as follows:

	March 31, 2010	December 31, 2009
Loans classified as impaired:		
Non-accrual loans	\$ 54,420,542	\$ 34,153,731
Impaired loans continuing to accrue interest	15,810,178	39,713,014
Total impaired loans	\$ 70,230,720	\$ 73,866,745
Balance of impaired loans with reserves	\$ 27,537,263	\$ 26,294,560
Balance of impaired loans without reserves	42,693,457	47,572,185
Total impaired loans	\$ 70,230,720	\$ 73,866,745
Reserves for impaired loans	\$ 6,207,043	\$ 6,414,729
Average balance of impaired loans during the period	66,413,767	39,048,298
Balance of trouble debt restructured loans included in impaired loans	13,605,033	11,233,326

The table above shows our Company's investment in impaired loans at March 31, 2010 and December 31, 2009. These loans consist of loans on non-accrual status and other restructured loans whose terms have been modified and classified as troubled debt restructurings. Although our non-accrual loans significantly increased from \$34,153,731 at December 31, 2009 to \$54,420,542 at March 31, 2010, total impaired loans decreased \$3,636,025. The increase in nonaccrual loans did not impact total impaired loans or reserves for impaired loans as these loans were previously classified as impaired loans continuing to accrue interest, and adequately reserved for at December of 2009. The balance of impaired loans without reserves is 61% of total impaired loans at March 31, 2010 and 64% at December 31, 2009. Management believes the excess value in the collateral was sufficient at March 31, and December 31, and these loans did not require additional reserves.

The following is a summary of the allowance for loan losses for the three months ended March 31, 2010:

	Three Months Ended March 31, 2010	2009
Balance at beginning of period	\$ 14,796,549	\$ 12,666,546
Additions:		
Provision for loan losses	2,505,000	1,750,000
Total additions	2,505,000	1,750,000
Deductions:		
Loans charged off	2,806,275	1,381,358
Less recoveries on loans	(162,348)	(124,237)
Net loans charged off	2,643,927	1,257,121

Balance at end of period	\$14,657,622	\$13,159,425
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Investment Securities

A summary of investment securities by major category, at fair value, consisted of the following at March 31, 2010 and December 31, 2009.

	March 31, 2010	December 31, 2009
U.S. treasury	\$ 1,000,156	\$
Government sponsored enterprises	40,254,563	44,380,798
Asset-backed securities	85,335,896	69,434,650
Obligations of states and political subdivisions	32,457,506	39,111,237
Total available for sale securities	\$ 159,048,121	\$ 152,926,685

The asset backed securities include agency mortgage-backed securities, which are guaranteed by government sponsored agencies such as the FHLMC, FNMA and GNMA. Our Company does not have exposure to subprime originated mortgage-backed or collateralized debt obligation instruments.

The amortized cost and fair value of securities classified as available-for-sale at March 31, 2010 and December 31, 2009 are as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
March 31, 2010				
U.S. treasury	\$ 999,768	\$ 388	\$	\$ 1,000,156
Government sponsored enterprises	40,085,881	243,519	74,837	40,254,563
Asset-backed securities	83,635,365	1,938,086	237,555	85,335,896
Obligations of states and political subdivisions	31,851,353	633,226	27,073	32,457,506
Total available for sale securities	\$ 156,572,367	\$ 2,815,219	\$ 339,465	\$ 159,048,121
December 31, 2009				
Government sponsored enterprises	\$ 44,059,540	\$ 371,258	\$ 50,000	\$ 44,380,798
Asset-backed securities	68,092,852	1,585,774	243,976	69,434,650
Obligations of states and political subdivisions	38,456,246	708,196	53,205	39,111,237
Total available for sale securities	\$ 150,608,638	\$ 2,665,228	\$ 347,181	\$ 152,926,685

Restricted investments in equity securities, reported in other assets, in the amount of \$6,522,650 and \$6,753,550 as of March 31, 2010 and December 31, 2009, respectively, are recorded at cost, and consist primarily of Federal Home Loan Bank Stock and our Company's interest in the statutory trusts.

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The amortized cost and fair value of debt securities classified as available-for-sale at March 31, 2010 and December 31, 2009, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without prepayment penalties.

	Amortized cost	Fair value
Due in one year or less	\$ 9,564,388	\$ 9,657,095
Due after one year through five years	48,132,196	48,579,197
Due after five years through ten years	12,111,354	12,320,776
Due after ten years	3,129,064	3,155,157
	72,937,002	73,712,225
Asset-backed securities	83,635,365	85,335,896
Total available for sale investment securities	\$ 156,572,367	\$ 159,048,121

Debt securities with carrying values aggregating approximately \$149,464,414 and \$132,322,000 at March 31, 2010 and December 31, 2009, respectively, were pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

Gross unrealized losses on debt securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2010 and December 31, 2009, were as follows:

	Less than 12 months		12 months or more		Number of Investment Positions	Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		Fair Value	Unrealized Losses
At March 31, 2010							
Government sponsored enterprises	\$17,465,754	\$ (74,837)	\$	\$	18	\$17,465,754	\$ (74,837)
Asset-backed securities	28,016,205	(237,555)			28	28,016,205	(237,555)
Obligations of states and political subdivisions	2,204,733	(18,932)	231,859	(8,141)	10	2,436,592	(27,073)
	\$47,686,692	\$(331,324)	\$231,859	\$(8,141)	56	\$47,918,551	\$(339,465)
	Less than 12 months		12 months or more		Number of Investment Positions	Total	
	Fair	Unrealized	Fair	Unrealized		Fair	Unrealized

	Value	Losses	Value	Losses	Positions	Value	Losses
At December 31, 2009							
Government sponsored enterprises	\$ 5,943,819	\$ (50,000)	\$	\$	6	\$ 5,943,819	(50,000)
Asset-backed securities	14,600,160	(243,904)	20,551	(72)	15	14,620,711	\$(243,976)
Obligations of states and political subdivisions	3,576,780	(53,205)			14	3,576,780	(53,205)
	\$24,120,759	\$(347,109)	\$ 20,551	\$ (72)	35	\$24,141,310	\$(347,181)

Our Company's available for sale portfolio consists of approximately 290 securities at March 31, 2010, of which 56 securities were temporarily impaired. Two of these securities have been in the loss position for 12 months or longer. Our Company believes the \$339,000 in unrealized losses included in other comprehensive income at March 31, 2010 is attributable to changes in market interest rates and not the credit quality of the issuer and are not considered other-than-temporarily impaired. Our Company does not intend to sell these investments and it is not more likely than not that our Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity.

The \$72 unrealized losses included in other comprehensive income at December 31, 2009 on asset-backed securities were caused by interest rate increases. The contractual cash flows of these securities are guaranteed by various government or government sponsored enterprises. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality these investments are not considered other-than-temporarily impaired.

During the three months ended March 31, 2010 and March 31, 2009, there were no proceeds from sales of securities and no components of investment securities gains and losses which have been recognized in earnings.

Intangible Assets

A summary of other intangible assets at March 31, 2010 and December 31, 2009 is as follows:

	March 31, 2010			December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortizable intangible assets:						
Core deposit intangible	\$7,060,224	\$(5,706,757)	\$1,353,467	\$7,060,224	\$(5,556,238)	\$1,503,986
Mortgage servicing rights	2,887,111	(886,655)	2,000,456	2,945,019	(924,055)	2,020,964