

HAWTHORN BANCSHARES, INC.
Form 10-Q
November 09, 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 September 30, 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
(State or other jurisdiction of
of incorporation or organization)

43-1626350
(I.R.S. Employer
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 company

(Do not check if a smaller 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 November 9, 2010 the registrant had 4,474,033 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)

	September 30, 2010	December 31, 2009
ASSETS		
Loans	\$ 933,456,302	\$ 991,614,007
Allowances for loan losses	(13,953,687)	(14,796,549)
Net loans	919,502,615	976,817,458
Investment in available-for-sale securities, at fair value	165,172,611	152,926,685
Federal funds sold and securities purchased under agreements to resell	125,820	89,752
Cash and due from banks	52,099,695	24,575,943
Premises and equipment net	37,236,395	38,623,293
Other real estate owned and repossessed assets	10,012,412	8,490,914
Accrued interest receivable	6,020,411	6,625,557
Mortgage servicing rights	2,198,887	2,020,964
Intangible assets net	1,095,535	1,503,986
Cash surrender value life insurance	1,979,466	1,929,910
Other assets	19,622,328	22,866,092
Total assets	\$ 1,215,066,175	\$ 1,236,470,554
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non-interest bearing demand	\$ 143,143,196	\$ 135,017,639
Savings, interest checking and money market	363,916,607	354,284,004
Time deposits \$100,000 and over	127,609,669	137,860,435
Other time deposits	315,904,482	329,160,719
Total deposits	950,573,954	956,322,797
Federal funds purchased and securities sold under agreements to repurchase	31,460,010	36,645,434
Subordinated notes	49,486,000	49,486,000
Other borrowed money	67,168,047	79,317,302
Accrued interest payable	1,344,701	2,438,121
Other liabilities	5,112,064	4,489,617
Total liabilities	1,105,144,776	1,128,699,271
Stockholders equity:		
Preferred stock, \$1,000 par value		
Authorized and issued 30,255 shares	28,722,124	28,364,768
Common stock, \$1 par value		

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Authorized 15,000,000 shares; issued 4,635,891 and 4,463,813 shares, respectively	4,635,891	4,463,813
Surplus	28,909,244	26,970,745
Retained earnings	48,828,486	50,576,551
Accumulated other comprehensive income, net of tax	2,342,472	912,224
Treasury stock; 161,858 shares, at cost	(3,516,818)	(3,516,818)
Total stockholders equity	109,921,399	107,771,283
Total liabilities and stockholders equity	\$ 1,215,066,175	\$ 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 September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
INTEREST INCOME				
Interest and fees on loans	\$ 13,234,729	\$ 14,340,996	\$ 40,286,802	\$ 43,332,581
Interest on debt securities:				
Taxable	1,054,667	1,152,935	3,236,744	3,430,153
Nontaxable	273,538	350,839	894,293	1,088,561
Interest on federal funds sold and securities purchased under agreements to resell	50	60	133	253
Interest on interest-bearing deposits	27,851	11,556	63,373	43,565
Dividends on other securities	33,577	53,742	119,024	110,010
Total interest income	14,624,412	15,910,128	44,600,369	48,005,123
INTEREST EXPENSE				
Interest on deposits:				
Savings, interest checking and money market	511,442	693,242	1,696,648	2,390,089
Time deposit accounts \$100,000 and over	594,334	949,273	1,956,968	3,056,793
Other time deposit accounts	1,758,850	2,532,085	5,607,583	8,311,234
Interest on federal funds purchased and securities sold under agreements to repurchase	19,690	23,458	59,353	64,028
Interest on subordinated notes	353,536	588,554	1,201,082	1,878,657
Interest on other borrowed money	527,818	687,535	1,794,832	2,320,481
Total interest expense	3,765,670	5,474,147	12,316,466	18,021,282
Net interest income	10,858,742	10,435,981	32,283,903	29,983,841
Provision for loan losses	2,450,000	1,250,000	7,105,000	4,404,000
Net interest income after provision for loan losses	8,408,742	9,185,981	25,178,903	25,579,841
NON-INTEREST INCOME				
Service charges on deposit accounts	1,427,130	1,547,038	4,150,420	4,380,248
Trust department income	186,989	237,939	566,495	623,258
Gain on sale of mortgage loans, net	1,011,253	489,069	1,533,027	2,437,169
Other	284,932	326,560	1,115,838	732,189
Total non-interest income	2,910,304	2,600,606	7,365,780	8,172,864
NON-INTEREST EXPENSE				
Salaries and employee benefits	4,256,523	4,454,183	13,463,964	13,403,853

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Occupancy expense, net	654,687	599,555	1,881,093	1,762,990
Furniture and equipment expense	472,657	506,469	1,499,307	1,794,400
FDIC insurance assessment	442,965	421,690	1,288,163	2,085,472
Legal, examination, and professional fees	348,792	311,780	932,115	985,274
Advertising and promotion	311,219	301,348	886,242	901,066
Postage, printing, and supplies	299,997	271,434	874,353	833,846
Processing expense	853,710	845,288	2,560,570	2,538,067
Other real estate expense	882,264	239,747	2,895,010	575,008
Other	842,703	1,088,245	2,535,084	2,815,972
Total non-interest expense	9,365,517	9,039,739	28,815,901	27,695,948
Income before income taxes	1,953,529	2,746,848	3,728,782	6,056,757
Less income taxes	531,327	840,070	1,030,346	1,889,060
Net income	1,422,202	1,906,778	2,698,436	4,167,697
Preferred stock dividends	378,187	378,187	1,130,360	1,134,562
Accretion of discount on preferred stock	119,119	119,119	357,356	357,356
Net income available to common shareholders	\$ 924,896	\$ 1,409,472	\$ 1,210,720	\$ 2,675,779
Basic earnings per share	\$ 0.21	\$ 0.32	\$ 0.27	\$ 0.60
Diluted earnings per share	\$ 0.21	\$ 0.32	\$ 0.27	\$ 0.60

See accompanying notes to consolidated financial statements.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated other Comprehensive Income (Loss)	Treasury Stock	Total Stock - holders Equity
Balance, December 31, 2009	\$ 28,364,768	\$ 4,463,813	\$ 26,970,745	\$ 50,576,551	\$ 912,224	\$ (3,516,818)	\$ 107,771,283
Net income				2,698,436			2,698,436
Change in unrealized gain (loss) on securities:							
Unrealized gain on debt and equity securities available-for-sale, net of tax					1,394,275		1,394,275
Defined benefit pension plans: Amortization of prior service cost included in net periodic pension cost, net of tax					35,973		35,973
Total other comprehensive income							1,430,248
Total comprehensive income							4,128,684
Stock based compensation expense			68,009				68,009
Accretion of preferred stock discount	357,356			(357,356)			
Stock dividend		172,078	1,870,490	(2,042,568)			
Cash dividends declared, preferred stock				(1,134,562)			(1,134,562)

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Cash dividends declared, common stock				(912,015)			(912,015)
Balance, September 30, 2010	\$ 28,722,124	\$ 4,635,891	\$ 28,909,244	\$ 48,828,486	\$ 2,342,472	\$ (3,516,818)	\$ 109,921,399
Balance, December 31, 2008	\$ 27,888,294	\$ 4,298,353	\$ 25,144,323	\$ 51,598,678	\$ 1,005,553	\$ (3,516,818)	\$ 106,418,383
Net income				4,167,697			4,167,697
Change in unrealized gain (loss) on securities:							
Unrealized loss on debt and equity securities available-for-sale, net of tax					558,218		558,218
Defined benefit pension plans:							
Amortization of prior service cost included in net periodic pension cost, net of tax					36,142		36,142
Total other comprehensive loss							594,360
Total comprehensive income							4,762,057
Stock based compensation expense			99,697				99,697
Accretion of preferred stock discount	357,355			(357,355)			
Stock dividend		165,460	1,695,963	(1,861,423)			
Cash dividends declared, preferred stock				(991,691)			(991,691)
				(1,796,893)			(1,796,893)

Cash dividends
declared, common
stock

**Balance,
September 30,
2009**

\$ 28,245,649 \$ 4,463,813 \$ 26,939,983 \$ 50,759,013 \$ 1,599,913 \$ (3,516,818) \$ 108,491,553

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows *(Unaudited)*

	Nine months Ended September	
	2010	30, 2009
Cash flows from operating activities:		
Net income	\$ 2,698,436	\$ 4,167,697
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	7,105,000	4,404,000
Depreciation expense	1,484,686	1,540,942
Net amortization of debt securities, premiums, and discounts	454,671	366,383
Amortization of intangible assets	408,451	475,592
Stock based compensation expense	68,009	99,697
Loss on sales and dispositions of premises and equipment	59,621	147,166
Other real estate owned impairment charges	1,595,638	62,535
Decrease in deferred tax asset, net	728,912	380,001
Decrease in accrued interest receivable	605,146	598,071
Increase in cash surrender value -life insurance	(49,556)	(57,750)
Decrease in other assets	578,938	93,894
Decrease in accrued interest payable	(1,093,420)	(1,455,466)
Increase in other liabilities	871,960	1,808,432
Origination of mortgage loans held for sale	(72,437,349)	(125,186,177)
Proceeds from the sale of mortgage loans held for sale	69,193,376	127,623,346
Gain on sale of mortgage loans, net	(1,533,027)	(2,437,169)
Other, net	398,872	371,107
Net cash provided by operating activities	11,138,364	13,002,301
Cash flows from investing activities:		
Net decrease in loans	42,321,380	6,768,359
Purchase of available-for-sale debt securities	(154,204,703)	(110,865,517)
Proceeds from maturities of available-for-sale debt securities	105,724,703	83,996,365
Proceeds from calls of available-for-sale debt securities	38,065,100	17,805,000
Proceeds from sales of FHLB stock	995,600	
Purchases of premises and equipment	(320,967)	(420,575)
Proceeds from sales of premises and equipment	34,528	582,816
Proceeds from sales of other real estate owned and repossessions	9,185,427	1,929,955
Net cash provided (used) by investing activities	41,801,068	(203,597)
Cash flows from financing activities:		
Net increase in non-interest-bearing demand deposits	8,125,557	871,554
Net increase in savings, interest checking, and money market accounts	9,632,603	15,278,667
Net decrease in time deposits	(23,507,003)	(3,311,738)
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(5,185,424)	3,235,954
Proceeds from other borrowed money	10,000,000	

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Repayment of other borrowed money	(22,149,255)	(57,576,317)
Cash dividends paid preferred stock	(1,134,562)	(991,691)
Cash dividends paid common stock	(1,161,528)	(2,192,342)
Net cash used by financing activities	(25,379,612)	(44,685,913)
Net increase (decrease) in cash and cash equivalents	27,559,820	(31,887,209)
Cash and cash equivalents, beginning of year	24,665,695	53,827,468
Cash and cash equivalents, end of period	\$ 52,225,515	\$ 21,940,259

Supplemental disclosures of cash flow information:

Cash paid during the year for:

Interest	\$ 13,409,886	\$ 19,476,748
Income taxes	200,000	390,000

Supplemental schedule of noncash investing and financing activities:

Other real estate and repossessions acquired in settlement of loans	\$ 12,665,463	\$ 5,739,740
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 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. Operating results for the three and nine-month periods ended September 30, 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 September 30, 2010, the consolidated statements of operations for the three and nine-month periods ended September 30, 2010 and 2009, and the consolidated statements of cash flows for the nine-month periods ended September 30, 2010 and 2009.

On July 1, 2010, our Company paid a special stock dividend of four percent to common shareholders of record at the close of business on May 19, 2010. 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 September 30, 2010 and December 31, 2009 are as follows:

	September 30, 2010	December 31, 2009
Commercial, financial, and agricultural	\$ 132,919,752	\$ 151,399,300
Real estate construction – residential	38,229,395	38,840,664
Real estate construction – commercial	76,586,537	77,936,569
Real estate mortgage – residential	217,802,375	232,332,124
Real estate mortgage – commercial	433,930,074	453,975,271
Installment loans to individuals	33,821,909	36,966,018
Unamortized loan origination fees and costs, net	166,260	164,061
Total loans	\$ 933,456,302	\$ 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.

As shown in the above table, our Company's total loans have declined \$58,158,000, or 5.9%, since December 31, 2009. Of this decline \$8,466,000 represents loans charged-off and \$12,665,000 represents loans that were foreclosed on and moved to other real estate owned and repossessed assets. Of the remaining \$37,027,000 decrease, \$21,400,000 represents payoffs/paydowns of six large credits.

A summary of impaired loans as of September 30, 2010 and December 31, 2009 is as follows:

	September 30, 2010	December 31, 2009
Loans classified as impaired:		
Non-accrual loans	\$ 49,847,089	\$ 34,153,731
Impaired loans continuing to accrue interest	16,635,933	39,713,014
Total impaired loans	\$ 66,483,022	\$ 73,866,745
Balance of impaired loans with reserves	\$ 34,715,944	\$ 26,294,560
Balance of impaired loans without reserves	31,767,078	47,572,185
Total impaired loans	\$ 66,483,022	\$ 73,866,745
Reserves for impaired loans	\$ 7,797,557	\$ 6,414,729
Average balance of impaired loans during the period	64,700,592	39,048,298
Balance of trouble debt restructured loans included in impaired loans	22,457,385	11,233,326

The table above shows our Company's investment in impaired loans at September 30, 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 \$49,847,089 at September 30, 2010, total impaired loans decreased \$7,383,723. The balance of impaired loans without reserves was 48% of total impaired loans at September 30, 2010 and 64% at December 31, 2009. Management believes the excess value in the collateral was sufficient at September 30, 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 and nine-months ended September 30, 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Balance at beginning of period	\$ 12,231,596	\$ 13,704,736	\$ 14,796,549	\$ 12,666,546
Additions:				
Provision for loan losses	2,450,000	1,250,000	7,105,000	4,404,000
Total additions	2,450,000	1,250,000	7,105,000	4,404,000
Deductions:				
Loans charged off	899,795	1,198,165	8,466,456	3,549,572
Less recoveries on loans	(171,886)	(170,963)	(518,594)	(406,560)

Net loans charged off	727,909	1,027,202	7,947,862	3,143,012
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