

HAWTHORN BANCSHARES, INC.

Form 10-Q

November 09, 2007

Table of Contents

**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, 2007**

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**
(Address of principal executive offices)

64081
(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

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

As of November 9, 2007 the registrant had 4,174,495 shares of common stock, par value \$1.00 per share, outstanding.

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

Item 4. Submission of Matters to a Vote of Security Holders

Item 5. Other Information

Item 6. Exhibits

SIGNATURES

INDEX TO EXHIBITS

302 Certification of Chief Executive Officer

302 Certification of Chief Financial Officer

906 Certification of Chief Executive Officer

906 Certification of Chief Financial Officer

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)

	September 30, 2007	December 31, 2006
ASSETS		
Loans:	\$ 882,889,587	\$ 812,312,759
Less allowance for loan losses	9,217,966	9,015,378
Loans, net	873,671,621	803,297,381
Investments in available for sale debt securities, at fair value	174,344,734	183,566,135
Investments in equity securities, at cost	6,293,350	6,207,175
Federal funds sold and securities purchased under agreements to resell	296,118	9,922,961
Cash and due from banks	27,359,983	43,077,605
Premises and equipment	40,247,769	34,706,857
Other real estate owned and repossessed assets	4,730,314	2,734,500
Accrued interest receivable	9,327,978	8,773,686
Mortgage servicing rights	1,230,062	1,350,375
Goodwill	40,323,775	40,323,775
Intangible assets	3,054,389	3,753,877
Cash surrender value life insurance	1,802,435	1,750,420
Other assets	2,932,079	3,247,150
Total assets	\$ 1,185,614,607	\$ 1,142,711,897
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Demand deposits	\$ 126,728,941	\$ 138,885,883
Time deposits	799,231,085	760,978,851
Total deposits	925,960,026	899,864,734
Federal funds purchased and securities sold under agreements to repurchase	25,996,935	29,460,492
Interest-bearing demand notes to U.S. Treasury		1,735,638
Subordinated notes	49,486,000	49,486,000
Other borrowed money	62,152,260	47,368,315
Accrued interest payable	5,384,915	4,366,250
Other liabilities	6,502,239	5,485,878
Total liabilities	1,075,482,375	1,037,767,307
Stockholders equity:		

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Common stock \$1 par value; 15,000,000 shares authorized; 4,298,353 issued	4,298,353	4,298,353
Surplus	22,460,001	22,248,319
Retained earnings	85,610,413	81,431,713
Accumulated other comprehensive income (loss), net of tax	332,538	(381,286)
Treasury stock, 123,858 and 128,506 shares at cost	(2,569,073)	(2,652,509)
Total stockholders equity	110,132,232	104,944,590
Total liabilities and stockholders equity	\$ 1,185,614,607	\$ 1,142,711,897

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Interest income:				
Interest and fees on loans	\$ 16,893,715	\$ 16,064,823	\$ 48,411,899	\$ 46,545,816
Interest on debt securities:				
Taxable	1,449,274	1,444,437	4,416,454	4,220,388
Nontaxable	498,369	481,074	1,498,268	1,442,210
Interest on federal funds sold and securities purchased under agreements to resell	78,153	221,387	536,009	528,547
Interest on interest-bearing deposits	8,000	19,492	54,220	76,492
Dividends and interest on equity securities	64,656	83,252	243,172	223,699
Total interest income	18,992,167	18,314,465	55,160,022	53,037,152
Interest Expense:				
NOW accounts	417,360	322,507	1,078,231	1,104,083
Savings accounts	63,643	73,324	199,802	226,983
Money market accounts	1,525,207	1,377,511	4,203,301	3,769,533
Certificates of deposit:				
\$100,000 and over	1,658,271	1,420,547	5,084,831	3,685,900
Other time deposits	3,903,084	3,262,639	11,162,624	8,969,634
Federal funds purchased and securities sold under agreements to repurchase	427,592	461,640	1,130,597	1,458,591
Subordinated notes	907,703	912,438	2,698,436	2,628,177
Advances from Federal Home Loan Bank	764,064	750,026	2,045,508	2,153,965
Other borrowed money	2	8,830	10,734	22,188
Total interest expense	9,666,926	8,589,462	27,614,064	24,019,054
Net interest income	9,325,241	9,725,003	27,545,958	29,018,098
Provision for loan losses	225,000	300,000	604,216	928,000
Net interest income after provision for loan losses	9,100,241	9,425,003	26,941,742	28,090,098
Continued on next page				

Table of Contents

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Noninterest income:				
Service charges on deposit accounts	\$ 1,306,969	\$ 1,461,703	\$ 3,892,536	\$ 4,339,408
Trust department income	200,672	214,472	629,223	622,551
Mortgage loan servicing fees, net	60,059	102,370	249,851	326,646
Gain on sale of mortgage loans, net	159,653	126,686	501,156	328,520
Loss on sales and calls of debt securities			(1,747)	(18,351)
Other	367,828	311,342	2,197,372	892,890
Total noninterest income	2,095,181	2,216,573	7,468,391	6,491,664
Noninterest expense:				
Salaries and employee benefits	4,484,240	4,254,272	14,154,003	12,942,420
Occupancy expense	573,762	499,840	1,566,057	1,400,006
Furniture and equipment expense	638,286	591,482	1,797,018	1,653,967
Advertising and promotion	272,796	234,298	701,761	621,636
Postage, printing and supplies	363,566	277,290	922,852	861,209
Legal, examination, and professional fees	292,465	333,575	1,203,555	946,664
Processing expense	324,860	261,202	878,866	776,222
Amortization of intangible assets	222,849	249,369	699,488	783,214
Other	988,349	780,591	2,816,715	2,265,640
Total noninterest expense	8,161,173	7,481,919	24,740,315	22,250,978
Income before income taxes	3,034,249	4,159,657	9,669,818	12,330,784
Income taxes	897,262	1,301,172	2,863,136	3,850,507
Net income	\$ 2,136,987	\$ 2,858,485	\$ 6,806,682	\$ 8,480,277
Basic earning per share	\$ 0.51	\$ 0.69	\$ 1.63	\$ 2.03
Diluted earnings per share	\$ 0.51	\$ 0.68	\$ 1.61	\$ 2.02
Weighed average shares of common stock outstanding				
Basic	4,174,179	4,169,847	4,171,359	4,169,847
Diluted	4,213,563	4,202,485	4,216,682	4,202,762
Dividends per share:				

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Declared	\$	0.21	\$	0.21	\$	0.63	\$	0.63
Paid	\$	0.21	\$	0.21	\$	0.63	\$	0.63

See accompanying notes to unaudited condensed consolidated financial statements.

4

Table of Contents

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

	Nine Months Ended September	
	2007	30, 2006
Cash flow from operating activities:		
Net income	\$ 6,806,682	\$ 8,480,277
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	604,216	928,000
Depreciation expense	1,470,540	1,360,457
Net (accretion) amortization of debt securities premiums and discounts	(29,476)	34,945
Amortization of intangible assets	699,488	783,214
Stock based compensation expense	194,691	162,741
Increase in accrued interest receivable	(554,292)	(615,708)
Increase in cash surrender value life insurance	(52,015)	(47,672)
Increase in other assets	(303,820)	(230,848)
Increase in accrued interest payable	1,018,665	1,212,918
Increase in other liabilities	1,016,361	505,510
Loss on sales and calls of debt securities	1,747	18,351
Origination of mortgage loans for sale	(24,057,146)	(15,247,120)
Proceeds from the sale of mortgage loans held for sale	24,558,302	15,575,640
Gain on sale of mortgage loans	(501,156)	(328,520)
(Gain) Loss on disposition of premises and equipment	(4,271)	25,952
Other, net	413,128	194,697
 Net cash provided by operating activities	 11,281,644	 12,812,834
 Cash flow from investing activities:		
Net increase in loans	(74,226,029)	(8,136,202)
Purchase of available-for-sale debt securities	(44,645,014)	(117,945,571)
Proceeds from maturities of available-for-sale debt securities	37,102,209	109,781,262
Proceeds from calls of available-for-sale debt securities	10,921,200	950,038
Proceeds from sales of available-for-sale debt securities	6,910,634	1,985,020
Purchase of equity securities	(1,310,900)	(1,008,150)
Proceeds from sales of equity securities	1,224,725	742,000
Purchase of premises and equipment	(7,505,467)	(2,020,077)
Proceeds from sales of premises and equipment	498,286	69,202
Proceeds from sales of other real estate owned and repossessions	1,251,760	570,624
 Net cash used in investing activities	 (69,778,596)	 (15,011,854)

Continued on next page

Table of Contents

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(Unaudited)

	Nine Months Ended September	
	2007	30, 2006
Cash flow from financing activities:		
Net (decrease) increase in demand deposits	\$ (12,156,942)	\$ 3,228,761
Net increase (decrease) in interest-bearing transaction accounts	15,212,993	(19,314,069)
Net increase in time deposits	23,039,241	26,366,533
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(3,463,557)	4,548,459
Net (decrease) increase in interest-bearing demand notes to U.S. Treasury	(1,735,638)	791,135
Proceeds from Federal Home Loan Bank advances	103,000,000	176,355,627
Repayment of Federal Home Loan Bank advances	(88,216,055)	(177,924,605)
Cash dividends paid	(2,627,982)	(2,627,004)
Sale of treasury stock	100,427	
 Net cash provided by financing activities	 33,152,487	 11,424,837
 Net (decrease) increase in cash and cash equivalents	 (25,344,465)	 9,225,817
Cash and cash equivalents, beginning of period	53,000,566	47,730,549
 Cash and cash equivalents, end of period	 \$ 27,656,101	 \$ 56,956,366
 Supplemental disclosure of cash flow information - Cash paid during period for:		
Interest	\$ 26,595,399	\$ 22,806,136
Income taxes	2,552,000	4,135,000
 Supplemental schedule of noncash investing activities - Other real estate and repossessions acquired in settlement of loans	 \$ 3,247,574	 \$ 489,498
See accompanying notes to unaudited condensed consolidated financial statements.		

Table of Contents

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. Certain amounts in the 2006 condensed consolidated financial statements have been reclassified to conform to the 2007 condensed consolidated presentation. Such reclassifications have no effect on previously reported net income or stockholders' equity. Operating results for the period ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

These unaudited condensed consolidated interim financial statements should be read in conjunction with our Company's audited consolidated financial statements included in its 2006 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, 2006 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, 2007 and the consolidated statement of earnings for the three and nine month-periods ended September 30, 2007 and 2006 and cash flows for the nine months ended September 30, 2007 and 2006.

Table of Contents**Earnings per Share**

The following table reflects, for the three and nine month periods ended September 30, 2007 and 2006, the numerators (net income) and denominators (average shares outstanding) for the basic and diluted net income per share computations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income, basic and diluted	\$ 2,136,987	\$ 2,858,485	\$ 6,806,682	\$ 8,480,277
Average shares outstanding	4,174,179	4,169,847	4,171,359	4,169,847
Effect of dilutive stock options	39,384	32,638	45,323	32,915
Average shares outstanding including dilutive stock options	4,213,563	4,202,485	4,216,682	4,202,762
Basic earning per share	\$ 0.51	\$ 0.69	\$ 1.63	\$ 2.03
Diluted earnings per share	\$ 0.51	\$ 0.68	\$ 1.61	\$ 2.02

Stock options that have a strike price greater than the current market price are considered anti-dilutive. For the three months ended September 30, 2007 and 2006, 6,258 and 5,524 shares of stock, respectively, are excluded in the calculation because their effect would be anti-dilutive. For the nine months ended September 30, 2007 and 2006, 2,733 and 5,311 shares of stock, respectively, are excluded in the calculation because their effect would be anti-dilutive.

Stock-Based Compensation

Total stock-based compensation expense was \$88,000 (\$58,000 after tax) and \$195,000 (\$128,000 after tax) for the three and nine-month periods ended September 30, 2007, respectively.

Total stock-based compensation expense was \$60,000 (\$40,000 after tax) and \$163,000 (\$107,000 after tax) for the three and nine-month periods ended September 30, 2006, respectively.

As of September 30, 2007, the total unrecognized compensation expense related to non-vested stock awards was \$571,000 and the related weighted average period over which it is expected to be recognized is approximately 3.2 years.

Table of Contents

The following table summarizes our Company's stock option activity for the nine-month period ended September 30, 2007:

	Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (000)	Weighted Average Contractual Term (in years)
Outstanding, January 1, 2007	202,738	\$24.54		
Granted	48,104	33.50		
Exercised	(4,648)	20.13		
Expired				
Forfeited	(3,226)	30.53		
Outstanding, September 30, 2007	242,968	27.23	\$1,143	6.7
Exercisable, September 30, 2007	140,186	23.69	1,077	5.3

Options outstanding at September 30, 2007 had an intrinsic value of \$1,143,000. Options exercisable at September 30, 2007 had an intrinsic value of approximately \$1,077,000. On April 27, 2007, 48,104 stock options were granted.

The weighted average grant date fair values of stock options granted during 2007 and the weighted average significant assumptions used to determine those fair values, using the Black-Scholes option-pricing model, are as follows:

Options granted during 2007:	
Grant date fair value per option	\$ 7.13
Significant assumptions:	
Risk-free interest rate at grant date	4.49%
Expected annual dividend yield	2.50%
Expected stock price volatility	20.00%
Expected life to exercise (years)	6.25

Table of Contents***Comprehensive Income***

Comprehensive income for the three and nine-month periods ended September 30, 2007 and 2006 is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	\$ 2,136,987	\$ 2,858,485	\$ 6,806,682	\$ 8,480,277
Other comprehensive income:				
Unrealized gain on securities:				
Unrealized gain on debt and equity securities available-for-sale, net of tax	1,120,767	1,339,440	678,396	246,978
Adjustment for loss on sales and calls of debt and equity securities, net of tax			1,136	11,928
Defined benefit pension plans:				
Amortization of prior service cost included in net periodic pension cost, net of tax	11,430		34,292	
Total other comprehensive income	1,132,197	1,339,44		