Section 1: 10-Q (10-Q)

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, 2019

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 every Interactive Data File required to be submitted 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 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.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

Securities registered pursuant to Section 12(g) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $1.00 par value	HWBK	The Nasdaq Stock Market LLC

As of May 8, 2019, the registrant had 6,034,843 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

(In thousands, except per share data)	March 31, 2019	December 31, 2018
	(Unaudited)	
ASSETS		
Cash and due from banks	$ 15,679	$ 23,687
Federal funds sold and other interest-bearing deposits	75,035	18,396
Cash and cash equivalents	90,714	42,083
Certificates of deposit in other banks	12,741	12,247
Available-for-sale debt securities, at fair value	218,539	218,205
Other investments	5,735	5,675
Total investment securities	224,274	223,880
Loans	1,154,652	1,146,627
Allowances for loan losses	(11,845)	(11,652)
Net loans	1,142,807	1,134,975
Premises and equipment - net	35,953	34,894
Mortgage servicing rights	2,875	2,931
Other real estate owned - net	13,537	13,691
Accrued interest receivable	6,160	6,162
Cash surrender value - life insurance	2,562	2,542
Other assets	6,688	8,277
Total assets	$ 1,538,311	$ 1,481,682
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Non-interest bearing demand	$ 264,218	$ 262,857
Savings, interest checking and money market	625,522	614,040
Time deposits $250,000 and over	140,886	104,900
Other time deposits	219,946	216,671
Total deposits	1,250,572	1,198,468
Federal funds purchased and securities sold under agreements to repurchase	22,097	24,647
Federal Home Loan Bank advances and other borrowings	95,096	95,153
Subordinated notes	49,486	49,486
Operating lease liabilities	2,347	—
Accrued interest payable	1,093	1,035
Other liabilities	12,750	13,479
Total liabilities	1,433,441	1,382,268
Stockholders' equity:		
Common stock, $1 par value, authorized 15,000,000 shares; issued 6,278,481 shares, respectively	6,279	6,279
Surplus	50,173	50,173
Retained earnings	58,168	54,105
Accumulated other comprehensive loss, net of tax	(4,706)	(6,099)
Treasury stock; 243,638 shares, at cost, respectively	(5,044)	(5,044)
Total stockholders' equity	104,870	99,414
Total liabilities and stockholders' equity	$ 1,538,311	$ 1,481,682

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 March 31, 2019	2018
INTEREST INCOME		
Interest and fees on loans	$ 14,106	$ 12,223
Interest on investment securities:		
Taxable	1,000	947
Nontaxable	141	158
Federal funds sold, other interest-bearing deposits, and certificates of deposit in other banks	602	106
Dividends on other investments	66	110
Total interest income	15,915	13,544
INTEREST EXPENSE		
Interest on deposits:		
Savings, interest checking and money market	1,716	1,084
Time deposit accounts $250,000 and over	665	138
Time deposits	706	511
Total interest expense on deposits	3,087	1,733
Interest on federal funds purchased and securities sold under agreements to repurchase	33	171
Interest on Federal Home Loan Bank advances	542	395
Interest on subordinated notes	624	491
Total interest expense on borrowings	1,199	1,057
Total interest expense	4,286	2,790
Net interest income	11,629	10,754
Provision for loan losses	150	300
Net interest income after provision for loan losses	11,479	10,454
NON-INTEREST INCOME		
Service charges and other fees	862	876
Bank card income and fees	695	656
Trust department income	293	280
Real estate servicing fees, net	84	221
Gain on sale of mortgage loans, net	105	146
Other	52	36
Total non-interest income	2,091	2,215
Investment securities gain, net	1	98
Gain on branch sale, net	2,074	—
NON-INTEREST EXPENSE		
Salaries and employee benefits	5,438	6,057
Occupancy expense, net	698	689
Furniture and equipment expense	809	635
Processing, network, and bank card expense	1,001	859
Legal, examination, and professional fees	329	422
Advertising and promotion	258	252
Postage, printing, and supplies	210	268
Other	1,145	1,084
Total non-interest expense	9,888	10,266
Income before income taxes	5,757	2,501
Income tax expense	1,091	411
Net income	$ 4,666	$ 2,090
Basic earnings per share	$ 0.77	$ 0.35
Diluted earnings per share	$ 0.77	$ 0.35

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

(In thousands)	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Net income	$ 4,666	$ 2,090
Other comprehensive income, net of tax		
Investment securities available-for-sale:		
Unrealized gain (loss) on investment securities available-for-sale, net of tax	1,378	(1,715)
Adjustment for gain on sale of investment securities, net of tax	—	—
Defined benefit pension plans:		
Amortization of prior service cost included in net periodic pension cost, net of tax	15	42
Total other comprehensive income (loss)	1,393	(1,673)
Total comprehensive income	$ 6,059	$ 417

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, 2017	$ 6,047	$ 45,442	$ 50,595	$ (5,662)	$ (5,051)	$ 91,371
Net income	—	—	2,090	—	—	2,090
Other comprehensive loss	—	—	—	(1,673)	—	(1,673)
Purchase of treasury stock	—	—	—	—	(112)	(112)
Cash dividends declared, common stock	—	—	(405)	—	—	(405)
Balance, March 31, 2018	$ 6,047	$ 45,442	$ 52,280	$ (7,335)	$ (5,163)	$ 91,271
Balance, December 31, 2018	$ 6,279	$ 50,173	$ 54,105	$ (6,099)	$ (5,044)	$ 99,414
Net income	—	—	4,666	—	—	4,666
Other comprehensive income	—	—	—	1,393	—	1,393
Cash dividends declared, common stock	—	—	(603)	—	—	(603)
Balance, March 31, 2019	$ 6,279	$ 50,173	$ 58,168	$ (4,706)	$ (5,044)	$ 104,870

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

	Three Months Ended March 31,	
(In thousands)	**2019**	**2018**
Cash flows from operating activities:		
Net income	$ 4,666	$ 2,090
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	150	300
Depreciation expense	441	435
Net amortization of investment securities, premiums, and discounts	312	356
Change in fair value of mortgage servicing rights	94	(18)
Investment securities gain, net	(1)	(98)
Loss (gain) on sales and dispositions of premises and equipment	19	(13)
Gain on sales and dispositions of other real estate	(6)	(2)
Gain on branch sale, net	(2,074)	—
Provision for other real estate owned	28	1
Operating lease payment	1	—
Decrease in accrued interest receivable	2	297
Increase in cash surrender value - life insurance	(20)	(15)
Decrease in other assets	1,180	156
Increase in accrued interest payable	58	34
Decrease in other liabilities	(729)	(989)
Origination of mortgage loans for sale	(5,420)	(7,587)
Proceeds from the sale of mortgage loans	5,096	7,587
Gain on sale of mortgage loans, net	(105)	(146)
Other, net	(38)	(50)
Net cash provided by operating activities	3,654	2,338
Cash flows from investing activities:		
Purchase of certificates of deposit in other banks	(494)	(1,352)
Net increase in loans	(7,669)	(16,231)
Purchase of available-for-sale debt securities	(12,751)	(28,134)
Proceeds from maturities of available-for-sale debt securities	10,030	9,119
Proceeds from calls of available-for-sale debt securities	3,820	1,685
Proceeds from sales of available-for-sale debt securities	—	25,723
Purchases of FHLB stock	(62)	(1,370)
Proceeds from sales of FHLB stock	3	2,682
Purchases of premises and equipment	(971)	(401)
Proceeds from sales of premises and equipment	—	13
Payment for branch sale, net	(6,700)	—
Proceeds from sales of other real estate and repossessed assets	248	224
Net cash used in investing activities	(14,546)	(8,042)
Cash flows from financing activities:		
Net increase (decrease) in demand deposits	9,723	(546)
Net increase in interest-bearing transaction accounts	12,066	32,426
Net increase in time deposits	40,944	22,688
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(2,550)	7,235
Repayment of FHLB advances and other borrowings	(57)	(131,055)
FHLB advances	—	94,000
Purchase of treasury stock	—	(112)
Cash dividends paid - common stock	(603)	(406)
Net cash provided by financing activities	59,523	24,230
Net increase in cash and cash equivalents	48,631	18,526
Cash and cash equivalents, beginning of year	42,083	62,878
Cash and cash equivalents, end of year	$ 90,714	$ 81,404
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$ 15,913	$ 2,755
Income taxes	$ —	$ —
Noncash investing and financing activities:		
Other real estate and repossessed assets acquired in settlement of loans	$ 116	$ 278
Net deposits and fixed assets transferred to other assets held for sale	$ (8,885)	$ —
Right of use assets obtained in exchange for new operating lease liabilities	$ 2,369	$ —

See accompanying 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, 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, 2018.

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 other than mentioned below.

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.

Summary of Recent Transactions and Events On February 8, 2019, Hawthorn Bank, a wholly-owned subsidiary of the Company, completed the sale of its branch located in Branson, Missouri with total deposits of approximately $10.6 million to Branson Bank in Branson, Missouri. The transaction excludes loans assigned to the branch. The sale resulted in a pre-tax gain of approximately $2.1 million, or $1.6 million after tax.

The following represents significant new accounting principles adopted in 2019:

Leases On January 1, 2019, the Company adopted ASU No. 2016-02, *Leases (Topic 842)* which requires that lessees and lessors recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. The ASU primarily affects lessee accounting, which requires the lessee to recognize a right-of-use asset (ROU) and a liability to make lease payments for those leases classified as operating leases. For leases with a term of 12 months or less, an election by class of underlying asset not to recognize lease assets and lease liabilities is permitted. The ASU also provides additional guidance as to the definition of a lease, identification of lease components, and sale and leaseback transactions. The Company's operating leases primarily relate to office space and bank branches.

In January 2018, the FASB issued ASU 2018-01, which allows entities the option to apply the provisions of the new lease guidance at the effective date without adjusting the comparative periods presented. In July 2018, the FASB issued ASU 2018-10, which provides narrow-scope improvements to the lease standard and ASU 2018-11, which allows entities to choose an additional transition method, under which an entity initially applies the new lease standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Under this transitional method, the entity shall recognize and measure the leases that exist at the adoption date and the prior comparative periods are not adjusted. The Company adopted this ASU as of January 1, 2019 using the transitional method. In addition, the Company utilized the practical expedients that allowed it to retain the classifications of existing leases, not re-assess if existing leases have initial direct costs, and hindsight when determining the lease term and assessment of impairment. The adoption of ASU 2016-02 and related transition guidance resulted in the recording of right-of-use assets and lease liabilities on the consolidated balance sheets of $2.3 million and $2.3 million, respectively; however, it did not have a material impact on the Company's other consolidated financial statements. See Note 7 - *Leases* for additional information.

Derivatives and Hedging The FASB issued guidance within ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities (Topic 815)* in August 2017. The amendments in ASU 2017-12 to Topic 815, Derivatives and Hedging, are intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting, and increase transparency as to the scope and results of hedging programs. The guidance also amends the presentation and disclosure requirements and changes how companies assess effectiveness. Under the new guidance, public companies will have until the end of the first quarter in which a hedge is designated to perform an initial assessment of a hedge's effectiveness. After initial qualification, the new guidance permits a qualitative effectiveness assessment for certain hedges instead of a quantitative test if the company can reasonably support an expectation of high effectiveness throughout the term of the hedge. Additional disclosures include cumulative basis adjustments for fair value hedges and the effect of hedging on individual income statement line items. The amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. 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 March 31, 2019 and December 31, 2018 is as follows:

(in thousands)	March 31, 2019	December 31, 2018
Commercial, financial, and agricultural	$ 204,759	$ 207,720
Real estate construction - residential	26,082	28,610
Real estate construction - commercial	109,766	106,784
Real estate mortgage - residential	248,059	241,517
Real estate mortgage - commercial	534,121	529,536
Installment and other consumer	31,865	32,460
Total loans	$ 1,154,652	$ 1,146,627

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, 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 March 31, 2019, loans of $519.3 million were pledged to the Federal Home Loan Bank as collateral for borrowings and letters of credit.

Allowance for Loan Losses

The following table illustrates the changes in the allowance for loan losses by portfolio segment:

	Three Months Ended March 31, 2019							
(in thousands)	Commercial, Financial, & Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment and Other Consumer	Un-allocated	Total
Balance at beginning of period	**$ 3,237**	**$ 140**	**$ 757**	**$ 2,071**	**$ 4,914**	**$ 334**	**$ 199**	**$11,652**
Additions:								
Provision for loan losses	(60)	(66)	(119)	(196)	617	18	(44)	150
Deductions:								
Loans charged off	53	—	—	84	8	52	—	197
Less recoveries on loans	(108)	—	—	(99)	—	(33)	—	(240)
Net loan charge-offs (recoveries)	(55)	—	—	(15)	8	19	—	(43)
Balance at end of period	**$ 3,232**	**$ 74**	**$ 638**	**$ 1,890**	**$ 5,523**	**$ 333**	**$ 155**	**$11,845**

	Three Months Ended March 31, 2018							
(in thousands)	Commercial, Financial, & Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment and Other Consumer	Un-allocated	Total
Balance at beginning of period	**$ 3,325**	**$ 170**	**$ 807**	**$ 1,689**	**$ 4,437**	**345**	**$ 79**	**$10,852**
Additions:								
Provision for loan losses	33	106	118	369	(421)	40	55	300
Deductions:								
Loans charged off	110	48	30	20	14	57	—	279
Less recoveries on loans	(13)	(12)	—	(19)	(6)	(24)	—	(74)
Net loan charge-offs (recoveries)	97	36	30	1	8	33	—	205
Balance at end of period	**$ 3,261**	**$ 240**	**$ 895**	**$ 2,057**	**$ 4,008**	**$ 352**	**$ 134**	**$10,947**

Loans, or portions of loans, are charged off to the extent deemed uncollectible or a loss is confirmed. Loan charge-offs reduce the allowance for loan losses, and recoveries of loans previously charged off are added back to the allowance. If management determines that it is probable that all amounts due on a loan will not be collected under the original terms of the loan agreement, the loan is considered to be impaired. These loans are evaluated individually for impairment, and in conjunction with current economic conditions and loss experience, specific reserves are estimated as further discussed below. Loans not individually evaluated are aggregated by risk characteristics and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type, delinquencies, current economic conditions, loan risk ratings and industry concentration.

Beginning with the first quarter 2019, management adjusted the look-back period to begin with loss history in the first quarter 2012 and continue to include this starting point going forward. Management determined that with the current economic recovery continuing to set records for its length, the look-back period needed to be expanded to account for this extended economic cycle. This ever increasing look-back period will then be adjusted once a loss producing downturn is recognized by allowing the look-back period to shift forward by eliminating the earliest loss period and replenishing it with losses from the most recent period. Prior to 2019, the Company utilized a five-year look-back period, which was considered a representative historical loss period. The look-back period is consistently evaluated for relevance given the current facts and circumstances.

The following table illustrates the allowance for loan losses and recorded investment by portfolio segment:

(in thousands)	Commercial, Financial, and Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment and Other Consumer	Un-allocated	Total
March 31, 2019								
Allowance for loan losses:								
Individually evaluated for impairment	$ 512	$ —	$ —	$ 475	$ 25	$ 27	$ —	$ 1,039
Collectively evaluated for impairment	2,720	74	638	1,415	5,498	306	155	10,806
Total	$ 3,232	$ 74	$ 638	$ 1,890	$ 5,523	$ 333	$ 155	$ 11,845
Loans outstanding:								
Individually evaluated for impairment	$ 2,376	$ —	$ 151	$ 4,851	$ 881	$ 264	$ —	$ 8,523
Collectively evaluated for impairment	202,383	26,082	109,615	243,208	533,240	31,601	—	1,146,129
Total	$ 204,759	$ 26,082	$ 109,766	$ 248,059	$ 534,121	$ 31,865	$ —	$1,154,652
December 31, 2018								
Allowance for loan losses:								
Individually evaluated for impairment	$ 551	$ —	$ —	$ 579	$ 37	$ 27	$ —	$ 1,194
Collectively evaluated for impairment	2,686	140	757	1,492	4,877	307	199	10,458
Total	$ 3,237	$ 140	$ 757	$ 2,071	$ 4,914	$ 334	$ 199	$ 11,652
Loans outstanding:								
Individually evaluated for impairment	$ 2,428	$ —	$ 153	$ 4,793	$ 850	$ 254	$ —	$ 8,478
Collectively evaluated for impairment	205,292	28,610	106,631	236,724	528,686	32,206	—	1,138,149
Total	$ 207,720	$ 28,610	$ 106,784	$ 241,517	$ 529,536	$ 32,460	$ —	$1,146,627

Impaired Loans

Loans evaluated under ASC 310-10-35 include loans which are individually evaluated for impairment. All other loans are collectively evaluated for impairment under ASC 450-20. Impaired loans individually evaluated for impairment totaled $8.5 million at both March 31, 2019 and December 31, 2018, respectively, and are comprised of loans on non-accrual status and loans which have been classified as troubled debt restructurings (TDRs).

The net carrying value of impaired loans is based on the fair values of collateral obtained through independent appraisals or internal evaluations, or by discounting the total expected future cash flows. At both March 31, 2019 and December 31, 2018, $3.8 million of impaired loans were evaluated based on the fair value less estimated selling costs of the loan's collateral. Once the impairment amount is calculated, a specific reserve allocation is recorded. At March 31, 2019, $1.0 million of the Company's allowance for loan losses was allocated to impaired loans totaling $8.5 million compared to $1.2 million of the Company's allowance for loan losses allocated to impaired loans totaling approximately $8.5 million at December 31, 2018. Management determined that $2.3 million, or 27%, of total impaired loans required no reserve allocation at March 31, 2019 compared to $2.1 million, or 25%, at December 31, 2018, primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

The categories of impaired loans at March 31, 2019 and December 31, 2018 are as follows:

(in thousands)	March 31, 2019	December 31, 2018
Non-accrual loans	$ 5,431	$ 5,414
Performing TDRs	3,092	3,064
Total impaired loans	$ 8,523	$ 8,478

The following tables provide additional information about impaired loans at March 31, 2019 and December 31, 2018, respectively, segregated between loans for which an allowance has been provided and loans for which no allowance has been provided.

(in thousands)	Recorded Investment	Unpaid Principal Balance	Specific Reserves
March 31, 2019			
With no related allowance recorded:			
Commercial, financial and agricultural	$ 1,203	$ 1,516	$ —
Real estate - construction commercial	151	179	—
Real estate - residential	703	762	—
Real estate - commercial	233	373	—
Total	$ 2,290	$ 2,830	$ —
With an allowance recorded:			
Commercial, financial and agricultural	$ 1,173	$ 1,252	$ 512
Real estate - residential	4,148	4,421	475
Real estate - commercial	648	874	25
Installment and other consumer	264	294	27
Total	$ 6,233	$ 6,841	$ 1,039
Total impaired loans	$ 8,523	$ 9,671	$ 1,039

(in thousands)	Recorded Investment	Unpaid Principal Balance	Specific Reserves
December 31, 2018			
With no related allowance recorded:			
Commercial, financial and agricultural	$ 1,264	$ 1,550	$ —
Real estate - construction commercial	153	180	—
Real estate - residential	561	602	—
Real estate - commercial	115	119	—
Total	$ 2,093	$ 2,451	$ —
With an allowance recorded:			
Commercial, financial and agricultural	$ 1,164	$ 1,236	$ 551
Real estate - residential	4,232	4,458	579
Real estate - commercial	735	1,093	37
Installment and other consumer	254	280	27
Total	$ 6,385	$ 7,067	$ 1,194
Total impaired loans	$ 8,478	$ 9,518	$ 1,194

The following table presents by class, information related to the average recorded investment and interest income recognized on impaired loans during the periods indicated.

	Three Months Ended March 31,			
	2019		2018	
(in thousands)	Average Recorded Investment	Interest Recognized For the Period Ended	Average Recorded Investment	Interest Recognized For the Period Ended
With no related allowance recorded:				
Commercial, financial and agricultural	$ 1,330	$ —	$ 906	$ —
Real estate - construction commercial	158	—	—	—
Real estate - residential	850	—	919	3
Real estate - commercial	170	—	—	—
Installment and other consumer	34	—	—	—
Total	$ 2,542	$ —	$ 1,825	$ 3
With an allowance recorded:				
Commercial, financial and agricultural	$ 1,276	$ 11	$ 1,857	$ 8
Real estate - construction residential	—	—	15	—
Real estate - residential	4,160	25	4,379	32
Real estate - commercial	946	9	2,012	15
Installment and other consumer	232	1	139	—
Total	$ 6,614	$ 46	$ 8,402	$ 55
Total impaired loans	$ 9,156	$ 46	$ 10,227	$ 58

The recorded investment varies from the unpaid principal balance primarily due to partial charge-offs taken resulting from current appraisals received. The amount recognized as interest income on impaired loans continuing to accrue interest, primarily related to troubled debt restructurings, was $46,000 for the three months ended March 31, 2019 compared to $58,000 for the three months ended March 31, 2018. The average recorded investment in impaired loans is calculated on a monthly basis during the periods reported.

Delinquent and Non-Accrual Loans

The delinquency status of loans is determined based on the contractual terms of the notes. Borrowers are generally classified as delinquent once payments become 30 days or more past due. The Company’s policy is to discontinue the accrual of interest income on any loan when, in the opinion of management, the ultimate collectability of interest or principal is no longer probable. In general, loans are placed on non-accrual when they become 90 days or more past due. However, management considers many factors before placing a loan on non-accrual, including the delinquency status of the loan, the overall financial condition of the borrower, the progress of management’s collection efforts and the value of the underlying collateral. Subsequent interest payments received on non-accrual loans are applied to principal if any doubt exists as to the collectability of such principal; otherwise, such receipts are recorded as interest income on a cash basis. Non-accrual loans are returned to accrual status when, in the opinion of management, the financial condition of the borrower indicates that the timely collectability of interest and principal is probable and the borrower demonstrates the

ability to pay under the terms of the note through a sustained period of repayment performance, which is generally six months.

The following table provides aging information for the Company's past due and non-accrual loans at March 31, 2019 and December 31, 2018.

(in thousands)	Current or Less Than 30 Days Past Due	30 - 89 Days Past Due	90 Days Past Due And Still Accruing	Non-Accrual	Total
March 31, 2019					
Commercial, Financial, and Agricultural	$ 202,850	$ 162	$ —	$ 1,747	$ 204,759
Real Estate Construction - Residential	26,082	—	—	—	26,082
Real Estate Construction - Commercial	109,143	472	—	151	109,766
Real Estate Mortgage - Residential	243,864	1,252	140	2,803	248,059
Real Estate Mortgage - Commercial	532,539	1,074	—	508	534,121
Installment and Other Consumer	31,391	247	5	222	31,865
Total	$ 1,145,869	$ 3,207	$ 145	$ 5,431	$ 1,154,652
December 31, 2018					
Commercial, Financial, and Agricultural	$ 205,597	$ 266	$ —	$ 1,857	$ 207,720
Real Estate Construction - Residential	28,404	206	—	—	28,610
Real Estate Construction - Commercial	106,531	100	—	153	106,784
Real Estate Mortgage - Residential	235,734	2,907	156	2,720	241,517
Real Estate Mortgage - Commercial	527,968	1,094	—	474	529,536
Installment and Other Consumer	32,002	242	6	210	32,460
Total	$ 1,136,236	$ 4,815	$ 162	$ 5,414	$ 1,146,627

Credit Quality

The Company categorizes loans into risk categories based upon an internal rating system reflecting management's risk assessment. Loans are placed on *watch* status when one or more weaknesses are identified that may result in the borrower being unable to meet repayment terms or the Company's credit position could deteriorate at some future date. Loans classified as *substandard* are inadequately protected by the current sound worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified may have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Such loans are characterized by the distinct possibility that the Company may sustain some loss if the deficiencies are not corrected. A loan is classified as a *troubled debt restructuring* (*TDR)* when a borrower is experiencing financial difficulties that lead to the restructuring of a loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. Loans classified as TDRs that are accruing interest are classified as performing TDRs. Loans classified as TDRs, that are not accruing interest are classified as nonperforming

TDRs and are included with all other nonaccrual loans for presentation purposes. It is the Company's policy to discontinue the accrual of interest income on loans when management believes that the collection of interest or principal is doubtful.

The following table presents the risk categories by class at March 31, 2019 and December 31, 2018.

(in thousands)	Commercial, Financial, & Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment and other Consumer	Total
At March 31, 2019							
Watch	$ 10,254	$ 583	$ 4,032	$ 11,831	$ 36,716	$ 8	$63,424
Substandard	173	—	—	1,391	696	3	2,263
Performing TDRs	629	—	—	2,048	373	42	3,092
Non-accrual	1,747	—	151	2,803	508	222	5,431
Total	$ 12,803	$ 583	$ 4,183	$ 18,073	$ 38,293	$ 275	$74,210
At December 31, 2018							
Watch	$ 8,871	$ 588	$ 4,063	$ 12,790	$ 36,408	$ 8	$62,728
Substandard	53	—	—	1,411	702	3	2,169
Performing TDRs	570	—	—	2,073	377	44	3,064
Non-accrual	1,857	—	153	2,720	474	210	5,414
Total	$ 11,351	$ 588	$ 4,216	$ 18,994	$ 37,961	$ 265	$73,375

Troubled Debt Restructurings

At March 31, 2019, loans classified as TDRs totaled $5.0 million, of which $1.9 million were classified as non-performing TDRs and included in non-accrual loans and $3.1 million were classified as performing TDRs. At December 31, 2018, loans classified as TDRs totaled $5.0 million, of which $2.0 million were classified as non-performing TDRs and included in non-accrual loans and $3.0 million were classified as performing TDRs. Both performing and nonperforming TDRs are considered impaired loans. When an individual loan is determined to be a TDR, the amount of impairment is based upon the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral less applicable selling costs. Accordingly, specific reserves of $512,000 and $543,000 related to TDRs were allocated to the allowance for loan losses at March 31, 2019 and December 31, 2018, respectively.

The following table summarizes loans that were modified as TDRs during the periods indicated.

	Three Months Ended March 31,					
	2019			2018		
		Recorded Investment (1)			Recorded Investment (1)	
(in thousands)	Number of Contracts	Pre-Modification	Post-Modification	Number of Contracts	Pre-Modification	Post-Modification
Troubled Debt Restructurings						
Commercial, financial and agricultural	2	$ 80	$ 80	—	$ —	$ —
Total	2	$ 80	$ 80	—	$ —	$ —

(1) The amounts reported post-modification are inclusive of all partial pay-downs and charge-offs, and no portion of the debt was forgiven. Loans modified as a TDR that were fully paid down, charged-off or foreclosed upon during the period ended are not reported.

The Company's portfolio of loans classified as TDRs include concessions for the borrower given financial condition such as interest rates below the current market rate, deferring principal payments, and extending maturity dates. There were two loans meeting the TDR criteria that were modified during the three months ended March 31, 2019, compared to no loans during the three months ended March 31, 2018.

The Company considers a TDR to be in default when it is 90 days or more past due under the modified terms, a charge-off occurs, or it is the process of foreclosure. There were no loans modified as a TDR that defaulted during any of the three months ended March 31, 2019 and 2018, respectively, and within twelve months of their modification date. During 2018, one real estate mortgage loan went to foreclosure totaling $48,000. See *Lending and Credit Management* section for further information.

(3) Other Real Estate Acquired in Settlement of Loans

(in thousands)	March 31, 2019	December 31, 2018
Commercial	$ 1,168	$ 1,168
Real estate construction - residential	—	179
Real estate construction - commercial	11,999	12,101
Real estate mortgage - residential	453	336
Real estate mortgage - commercial	2,909	2,909
Total	$ 16,529	$ 16,693
Less valuation allowance for other real estate owned	(2,992)	(3,002)
Total other real estate owned	$ 13,537	$ 13,691

Changes in the net carrying amount of other real estate owned were as follows for the periods indicated:

	Three Months Ended March 31,	
	2019	2018
Balance at beginning of period	$ 16,693	$ 16,403
Additions	116	278
Proceeds from sales	(248)	(224)
Charge-offs against the valuation allowance for other real estate owned, net	(38)	(195)
Net gain on sales	6	2
Total other real estate owned	$ 16,529	$ 16,264
Less valuation allowance for other real estate owned	(2,992)	(3,025)
Balance at end of period	$ 13,537	$ 13,239

At March 31, 2019, $263,000 of consumer mortgage loans secured by residential real estate properties were in the process of foreclosure compared to $200,000 of consumer mortgage loans at December 31, 2018.

Activity in the valuation allowance for other real estate owned was as follows for the periods indicated:

(in thousands)	Three Months Ended March 31, 2019	2018
Balance, beginning of period	$ 3,002	$ 3,221
Provision for other real estate owned	28	(1)
Charge-offs	(38)	(195)
Balance, end of period	$ 2,992	$ 3,025

(4) Investment Securities

Available for sale securities

The amortized cost and fair value of debt securities classified as available-for-sale at March 31, 2019 and December 31, 2018 were as follows:

(in thousands)	Total Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2019				
U.S. Treasury	$ 2,666	$ —	$ (11)	$ 2,655
U.S. government and federal agency obligations	9,745	—	(230)	9,515
Government sponsored enterprises	39,790	43	(279)	39,554
Obligations of states and political subdivisions	38,408	67	(239)	38,236
Mortgage-backed securities	126,072	125	(1,954)	124,243
Other debt securities (a)	3,000	—	(1)	2,999
Bank issued trust preferred securities (a)	1,486	—	(149)	1,337
Total available-for-sale securities	$ 221,167	$ 235	$ (2,863)	$ 218,539
December 31, 2018				
U.S. Treasury	$ 1,984	$ —	$ (32)	$ 1,952
U.S. government and federal agency obligations	10,235	—	(269)	9,966
Government sponsored enterprises	43,784	23	(472)	43,335
Obligations of states and political subdivisions	40,859	28	(501)	40,386
Mortgage-backed securities	121,230	72	(3,110)	118,192
Other debt securities (a)	3,000	—	—	3,000
Bank issued trust preferred securities (a)	1,486	—	(112)	1,374
Total available-for-sale securities	$ 222,578	$ 123	$ (4,496)	$ 218,205

(a) Certain hybrid instruments possessing characteristics typically associated with debt obligations.

The Company's investment securities are classified as available for sale. Agency bonds and notes, Small Business Administration guaranteed loan certificates (SBA), residential and commercial agency mortgage-backed securities, and agency collateralized mortgage obligations (CMO) include securities issued by the Government National Mortgage Association (GNMA), a U.S. government agency, and the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), and the Federal Home Loan Bank (FHLB), which are U.S. government-sponsored enterprises.

Debt securities with carrying values aggregating approximately $176.0 million and $153.0 million at March 31, 2019 and December 31, 2018, respectively, were pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities classified as available-for-sale at March 31, 2019, 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.

(in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 21,449	$ 21,361
Due after one year through five years	53,793	53,389
Due after five years through ten years	11,409	11,285
Due after ten years	8,444	8,261
Total	95,095	94,296
Mortgage-backed securities	126,072	124,243
Total available-for-sale securities	$ 221,167	$ 218,539

Other securities

Other investment securities include equity securities with readily determinable fair values and other investment securities that do not have readily determinable fair values. Investments in Federal Home Loan Bank (FHLB) stock, and Midwest Independent Bank (MIB) bankers bank stock, that do not have readily determinable fair values, are required for membership in those organizations.

(in thousands)	March 31, 2019	December 31, 2018
Other securities:		
FHLB stock	$ 5,571	$ 5,512
MIB stock	151	151
Equity securities with readily determinable fair values	13	12
Total other investment securities	$ 5,735	$ 5,675

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, 2019 and December 31, 2018 were as follows:

	Less than 12 months		12 months or more		Total	Total
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At March 31, 2019						
U.S. Treasury	$ —	$ —	$ 1,974	$ (11)	$ 1,974	$ (11)
U.S. government and federal agency obligations	—	—	9,515	(230)	9,515	(230)
Government sponsored enterprises	500	—	32,036	(279)	32,536	(279)
Obligations of states and political subdivisions	4,042	(14)	21,790	(225)	25,832	(239)
Mortgage-backed securities	11,589	(72)	93,328	(1,882)	104,917	(1,954)
Other debt securities	2,999	(1)	—	—	2,999	(1)
Bank issued trust preferred securities	—	—	1,337	(149)	1,337	(149)
Total	$ 19,130	$ (87)	$ 159,980	$ (2,776)	$ 179,110	$ (2,863)

(in thousands)						
At December 31, 2018						
U.S. Treasury	$ —	$ —	$ 1,952	$ (32)	$ 1,952	$ (32)
U.S. government and federal agency obligations	—	—	9,966	(269)	9,966	(269)
Government sponsored enterprises	1,997	(3)	33,346	(469)	35,343	(472)
Obligations of states and political subdivisions	5,851	(16)	28,832	(485)	34,683	(501)
Mortgage-backed securities	10,085	(61)	99,321	(3,049)	109,406	(3,110)
Bank issued trust preferred securities	—	—	1,374	(112)	1,374	(112)
Total	$ 17,933	$ (80)	$ 174,791	$ (4,416)	$ 192,724	$ (4,496)

The total available for sale portfolio consisted of approximately 353 securities at March 31, 2019. The portfolio included 258 securities having an aggregate fair value of $179.1 million that were in a loss position at March 31, 2019. Securities identified as temporarily impaired which had been in a loss position for 12 months or longer totaled $160.0 million at fair value. The $2.9 million aggregate unrealized loss included in accumulated other comprehensive income at March 31, 2019 was caused by interest rate fluctuations.

The total available for sale portfolio consisted of approximately 366 securities at December 31, 2018. The portfolio included 317 securities having an aggregate fair value of $192.7 million that were in a loss position at December 31, 2018. Securities identified as temporarily impaired which had been in a loss position for 12 months or longer had a fair value of $174.8 million at December 31, 2018. The $4.5 million aggregate unrealized loss included in accumulated other comprehensive loss at December 31, 2018 was caused by interest rate fluctuations.

Because the decline in fair value is attributable to changes in interest rates and not credit quality, these investments were not considered other-than-temporarily impaired at March 31, 2019 and December 31, 2018, respectively. In the absence of changes in credit quality of these investments, the fair value is expected to recover on all debt securities as they approach their maturity date or re-pricing date, or if market yields for such investments decline. In addition, the Company does not have the intent to sell these investments over the period of recovery, and it is not more likely than not that the Company will be required to sell such investment securities.

The table presents the components of investment securities gains and losses, which have been recognized in earnings:

	Three Months Ended March 31,	
(in thousands)	**2019**	**2018**
Investment securities gains, net		
Available for sale securities:		
Gains realized on sales	$ —	$ 98
Losses realized on sales	—	—
Other-than-temporary impairment recognized	—	—
Other investment securities:		
Fair value adjustments, net	1	—
Investment securities gains, net	**$ 1**	**$ 98**

During the three months ended March 31, 2018, the Company received $25.7 million from proceeds from a series of short-term sales of U.S. Treasury securities purchased with repurchase agreements and recognized gains of $98,000 in order to generate capital gains to offset capital losses that were to expire during 2018 and 2019. There were no security sales during the three months ended March 31, 2019.

(5) Intangible Assets

Mortgage Servicing Rights

At March 31, 2019, the Company was servicing approximately $275.7 million of loans sold to the secondary market compared to $279.9 million at December 31, 2018, and $283.1 million at March 31, 2018. Mortgage loan servicing fees, reported in real estate servicing fees, net, earned on loans sold were $178,000 for the three months ended March 31, 2019, compared to $203,000 for the three months ended March 31, 2018.

The table below presents changes in mortgage servicing rights (MSRs) for the periods indicated.

	Three Months Ended March 31,	
(in thousands)	**2019**	**2018**
Balance at beginning of period	$ 2,931	$ 2,713
Originated mortgage servicing rights	38	50
Changes in fair value:		
Due to changes in model inputs and assumptions (1)	(32)	103
Other changes in fair value (2)	(62)	(85)
Total changes in fair value	(94)	18
Balance at end of period	$ 2,875	$ 2,781

(1) The change in fair value resulting from changes in valuation inputs or assumptions, reported in real estate servicing fees, net, used in the valuation model reflects the change in discount rates and prepayment speed assumptions primarily due to changes in interest rates.
(2) Other changes in fair value, reported in real estate servicing fees, net, reflect changes due to customer payments and passage of time.

The following key data and assumptions were used in estimating the fair value of the Company's MSRs as of March 31, 2019 and 2018, respectively:

	Three Months Ended March 31,	
	2019	**2018**
Weighted average constant prepayment rate	9.47 %	9.07 %
Weighted average note rate	3.96 %	3.87 %
Weighted average discount rate	9.77 %	10.39 %
Weighted average expected life (in years)	6.00	6.20

(6) Federal funds purchased and securities sold under agreements to repurchase

(in thousands)	**March 31, 2019**	**December 31, 2018**
Federal funds purchased	$ —	$ 8,000
Repurchase agreements	22,097	16,647
Total	$ 22,097	$ 24,647

The Company offers a sweep account program whereby amounts in excess of an established limit are "swept" from the customer's demand deposit account on a daily basis into retail repurchase agreements pursuant to individual repurchase agreements between the Company and its customers. Repurchase agreements are agreements to sell securities subject to an obligation to repurchase the same or similar securities. They are accounted for as collateralized financing transactions, not as sales and purchases of the securities portfolio. The securities collateral pledged for the repurchase agreements with customers is maintained by a designated third party custodian. The collateral amounts pledged to repurchase agreements by remaining maturity in the table below are limited to the outstanding balances of the related asset or liability; thus amounts of excess collateral are not shown.

Repurchase Agreements	**Remaining Contractual Maturity of the Agreements**			
(in thousands)	**Overnight and continuous**	**Less than 90 days**	**Greater than 90 days**	**Total**
At March 31, 2019				
U.S. Treasury	$ 738	$ —	$ —	$ 738
U.S. government and federal agency obligations	2,378	—	—	2,378
Government sponsored enterprises	9,975	—	—	9,975
Asset-backed securities	9,006	—	—	9,006
Total	$ 22,097	$ —	$ —	$ 22,097
At December 31, 2018				
U.S. Treasury	$ 1,464	$ —	$ —	$ 1,464
Government sponsored enterprises	12,976	—	—	12,976
Asset-backed securities	2,207	—	—	2,207
Total	$ 16,647	$ —	$ —	$ 16,647

(7) Leases

The Company's leases primarily consist of office space and bank branches with remaining lease terms of generally 1 to 10 years. As of March 31, 2019, operating ROU assets and liabilities were $2.3 million and $2.3 million, respectively. As of

March 31, 2019, the weighted-average remaining lease term on these operating leases is approximately 9.29 years and the weighted-average discount rate used to measure the lease liabilities is approximately 4.0%.

Operating leases in which the Company is the lessee are recorded as operating lease right-of-use assets and operating lease liabilities. Currently, the Company does not have any finance leases. The ROU assets are included in premises and equipment, net on the consolidated balance sheets.

Operating lease right-of-use assets represent the Company's right to use an underlying asset during the lease term and operating lease liabilities represent the Company's obligation to make lease payments arising from the lease. Right-of-use assets and operating lease liabilities are recognized at lease commencement based on the present value of the remaining lease payments using a discount rate that represents the Company's incremental borrowing rate at the lease commencement date.

Operating lease cost, which is comprised of amortization of the right-of-use asset and the implicit interest accreted on the operating lease liability, is recognized on a straight-line basis over the lease term, and is recorded in net occupancy expense in the consolidated statements of income. The operating lease cost for the three months ended March 31, 2019 was $32,000.

At adoption of ASU 2016-02 on January 1, 2019, lease and non-lease components of new lease agreements are accounted for separately. Lease components include fixed payments including rent, real estate taxes and insurance costs and non-lease components include common-area maintenance costs. Leases with an initial term of 12 months or less are not recorded on the balance sheet; the Company recognizes lease expense for these leases on a straight-line basis over the lease term. Operating lease expense for these leases was $33,000 and $48,000 for the three months ended March 31, 2019 and 2018, respectively.

The table below summarizes the maturity of remaining operating lease liabilities:

Lease payments due in:		**Operating Lease**
(in thousands)		
2019 (excluding the 1st quarter ending March 31, 2019)	$	227
2020		305
2021		308
2022		310
2023		312
Thereafter		1,345
Total lease payments		2,807
Less imputed interest		(460)
Total lease liabilities, as reported	$	2,347

As of March 31, the Company has $58,000 in additional operating leases for office space that have not yet commenced that are anticipated to commence during the second quarter of 2019.

(8) Income Taxes

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 18.9% for the three months ended March, 2019 compared to 16.4% for the three months March 31, 2018. The change in the effective tax rate in the first quarter of 2019 over the first quarter of 2018 is primarily due to an increase in taxable income, which included a $2.1 million pre-taxable gain from the sale of the Branson branch.

The federal corporate income tax rate declined from 34% to 21% effective January 1, 2018 as a result of the Tax Cuts and Jobs Act, (Tax Act). The Company's tax rate is lower than the federal statutory rate for the quarters ending March 31, 2019 and 2018, respectively, primarily due to tax-exempt income and additional tax planning initiatives. The provisional adjustments recorded in the fourth quarter of 2017 related to the enactment of the Tax Act were finalized during the third quarter of 2018 with the filing of the Company's 2017 tax return, within the one-year measurement period provided under Staff Accounting Bulletin No. 118 in regards to the application of FASB's ASC Topic 740, *Income Taxes*.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income of the appropriate character during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning initiatives in making this assessment. In management's opinion, the Company will more likely than not realize the benefits of its deferred tax assets and, therefore, has not established a valuation allowance against its deferred tax assets as of March 31, 2019. Management arrived at this conclusion based upon the level of historical taxable income and projections for future taxable income of the appropriate character over the periods in which the deferred tax assets are deductible.

As of March 31, 2018, the Company had a $46,000 valuation reserve against its capital loss carry forward deferred tax asset related to approximately $219,000 of capital losses during 2013 and 2014 as a result of disposing of certain limited partnership interests. The Company released this valuation allowance against certain capital loss carryforwards during the second quarter of 2018 as a result of the execution of certain tax planning initiatives that generated sufficient capital gain income prior to the expiration of the carryforwards.

The Company follows ASC Topic 740, *Income Taxes,* which addresses the accounting for uncertain tax positions. For each of the three months ended March 31, 2019 and 2018, respectively, the Company did not have any uncertain tax provisions, and did not record any related tax liabilities.

(9) Stockholders' Equity

Accumulated Other Comprehensive Loss

The following details the change in the components of the Company's accumulated other comprehensive loss for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31, 2019		
(in thousands)	Unrealized Gain (Loss) on Securities (1)	Unrecognized Net Pension and Postretirement Costs (2)	Accumulated Other Comprehensive (Loss) Income
Balance at beginning of period	$ (3,455)	$ (2,644)	$ (6,099)
Other comprehensive income, before reclassifications	1,745	19	1,764
Amounts reclassified from accumulated other comprehensive (loss) income	—	—	—
Current period other comprehensive income, before tax	1,745	19	1,764
Income tax expense	(367)	(4)	(371)
Current period other comprehensive income, net of tax	1,378	15	1,393
Balance at end of period	$ (2,077)	$ (2,629)	$ (4,706)

	Three Months Ended March 31, 2018		
(in thousands)	Unrealized Gain (Loss) on Securities (1)	Unrecognized Net Pension and Postretirement Costs (2)	Accumulated Other Comprehensive Loss
Balance at beginning of period	$ (2,500)	$ (3,162)	$ (5,662)
Other comprehensive (loss) income, before reclassifications	(2,171)	54	(2,117)
Amounts reclassified from accumulated other comprehensive (loss) income	—	—	—
Current period other comprehensive (loss) income, before tax	(2,171)	54	(2,117)
Income tax benefit (expense)	456	(12)	444
Current period other comprehensive (loss) income, net of tax	(1,715)	42	(1,673)
Balance at end of period	$ (4,215)	$ (3,120)	$ (7,335)

(1) The pre-tax amounts reclassified from accumulated other comprehensive loss are included in *gain on sale of investment securities* in the consolidated statements of income.

(2) The pre-tax amounts reclassified from accumulated other comprehensive loss are included in the computation of net periodic pension cost.

(10) Employee Benefit Plans

Employee Benefits

Employee benefits charged to operating expenses are summarized in the table below for the periods indicated.

	Three Months Ended March 31,	
(in thousands)	**2019**	**2018**
Payroll taxes	$ 346	$ 351
Medical plans	450	548
401k match and profit sharing	276	186
Periodic pension cost	379	405
Other	15	15
Total employee benefits	$ 1,466	$ 1,505

The Company's profit-sharing plan includes a matching 401k portion, in which the Company matches the first 3% of eligible employee contributions. The Company made annual contributions in an amount up to 6% of income before income taxes and before contributions to the profit-sharing and pension plans for all participants, limited to the maximum amount deductible for federal income tax purposes, for each of the periods shown. In addition, employees were able to make additional tax-deferred contributions.

Other Plans

On November 7, 2018, the Board of Directors of the Company adopted a supplemental executive retirement plan (SERP) which became effective on January 1, 2018. The SERP provides select employees who satisfy certain eligibility requirements with certain benefits upon retirement, termination of employment or death.

As of March 31, 2019, the accrued liability was $400,000 and expense for the three months ended March 31, 2019 was $80,000, and is recognized over the required service period. After the plan was adopted in November 2018, $320,000 was accrued and recognized over the required service period.

Pension

The Company provides a noncontributory defined benefit pension plan for all full-time employees. Beginning January 1, 2018 and for all retrospective periods presented, the Company adopted the guidance under ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Under the new guidance, only the service cost component of the net periodic benefit cost is reported in the same income statement line item as salaries and benefits, and the remaining components are reported as other non-interest expense. An employer is required to recognize the funded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Under the Company's funding policy for the defined benefit pension plan, contributions are made to a trust as necessary to provide for current service and for any unfunded accrued actuarial liabilities over a reasonable period. To the extent that these requirements are fully covered by assets in the trust, a contribution might not be made in a particular year. The Company made a pension contribution of $1.6 million on April 17, 2019. Effective July 1, 2017, the Company amended the pension plan to effectuate a "soft freeze" such that no individual hired (or rehired in the case of a former employee) by the Company after September 30, 2017, whether or not such individual is or was a vested member in the plan, will be eligible to be an active member and be entitled to accrue any benefits under the plan.

Components of Net Pension Cost and Other Amounts Recognized in Accumulated Other Comprehensive Income

The following items are components of net pension cost for the periods indicated:

	Pension Benefits	
(in thousands)	**2019**	**2018**
Service cost - benefits earned during the year	$ 1,516	$ 1,707
Interest costs on projected benefit obligations (a)	1,168	1,037
Expected return on plan assets (a)	(1,393)	(1,327)
Expected administrative expenses (a)	100	93
Amortization of prior service cost (a)	79	79
Amortization of unrecognized net loss (a)	—	140
Net periodic pension cost	$ 1,470	$ 1,729
Net periodic pension cost for the three months ended March 31, (actual)	$ 379	$ 405

(a) The components of net periodic pension cost other than the service cost component are included in other non-interest expense.

Net periodic pension benefit costs include interest costs based on an assumed discount rate, the expected return on plan assets based on actuarially derived market-related values, and the amortization of net actuarial losses. Net periodic postretirement benefit costs include service costs, interest costs based on an assumed discount rate, and the amortization of prior service credits and net actuarial gains. Differences between expected and actual results in each year are included in the net actuarial gain or loss amount, which is recognized in other comprehensive income. The net actuarial gain or loss in excess of a 10% corridor is amortized in net periodic benefit cost over the average remaining service period of active participants in the Plans. The prior service credit is amortized over the average remaining service period to full eligibility for participating employees expected to receive benefits.

(11) Earnings per Share

Stock Dividend On July 1, 2018, the Company paid a special stock dividend of 4% to common 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.

Basic earnings per share is computed by dividing income available to shareholders by the weighted average number of shares outstanding during the year. Diluted earnings per share gives effect to all dilutive potential shares that were outstanding during the year.

Presented below is a summary of the components used to calculate basic and diluted earnings per common share, which have been restated for all stock dividends:

(dollars in thousands, except per share data)	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Basic earnings per share:		
Net income available to shareholders	$ 4,666	$ 2,090
Average shares outstanding	6,034,843	6,028,708
Basic earnings per share	$ 0.77	$ 0.35
Diluted earnings per share:		
Net income available to shareholders	$ 4,666	$ 2,090
Average shares outstanding	6,034,843	6,028,708
Effect of dilutive stock options	—	5,949
Average shares outstanding including dilutive stock options	6,034,843	6,034,657
Diluted earnings per share	$ 0.77	0.35

Under the treasury stock method, outstanding stock options are dilutive when the average market price of the Company's common stock, when combined with the effect of any unamortized compensation expense, exceeds the option price during the period, except when the Company has a loss from continuing operations available to shareholders. In addition, proceeds from the assumed exercise of dilutive options along with the related tax benefit are assumed to be used to repurchase common shares at the average market price of such stock during the period. There were no outstanding stock options for any of the three months ended March 31, 2019 and 2018, respectively, that were omitted from the computation of diluted earnings per share as a result of being considered anti-dilutive.

(12) Fair Value Measurements

Fair value represents the amount expected to be received to sell an asset or paid to transfer a liability in its principal or most advantageous market in an orderly transaction between market participants at the measurement date.

Depending on the nature of the asset or liability, the Company uses various valuation methodologies and assumptions to estimate fair value. The measurement of fair value under US GAAP uses a hierarchy intended to maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows. During the three months ended March 31, 2019 and the year ended December 31, 2018, respectively, there were no transfers into or out of Levels 1-3.

The fair value hierarchy is as follows:

Level 1 – Inputs are unadjusted quoted prices for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and is used to measure fair value whenever available. A contractually binding sales price also provides reliable evidence of fair value.

Level 2 – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 – Inputs are unobservable inputs for the asset or liability and significant to the fair value. These may be internally developed using the Company's best information and assumptions that a market participant would consider.

In accordance with fair value accounting guidance, the Company measures, records, and reports various types of assets and liabilities at fair value on either a recurring or non-recurring basis in the Consolidated Financial Statements. Nonfinancial assets measured at fair value on a nonrecurring basis would include foreclosed real estate, long-lived assets, and core deposit intangible assets, which are reviewed when circumstances or other events indicate that impairment may have occurred.

Valuation Methods for Assets and Liabilities Measured at Fair Value on a Recurring Basis

Following is a description of the Company's valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis:

Available-for-Sale Securities

The fair value measurements of the Company's investment securities are determined by a third party pricing service which considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. The fair value measurements are subject to independent verification to another pricing source by management each quarter for reasonableness.

Mortgage Servicing Rights

The fair value of mortgage servicing rights is based on the discounted value of estimated future cash flows utilizing contractual cash flows, servicing rate, constant prepayment rate, servicing cost, and discount rate factors. Accordingly, the fair value is estimated based on a valuation model that calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds, market discount rates, cost to service, float earnings

rates, and other ancillary income, including late fees. The valuation models estimate the present value of estimated future net servicing income. The Company classifies its servicing rights as Level 3.

		Fair Value Measurements		
(in thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2019				
Assets:				
U.S. Treasury	$ 2,655	$ 2,655	—	$ —
U.S. government and federal agency obligations	9,515	—	9,515	—
Government sponsored enterprises	39,554	—	39,554	—
Obligations of states and political subdivisions	38,236	—	38,236	—
Mortgage-backed securities	124,243	—	124,243	—
Other debt securities	2,999	—	2,999	—
Bank-issued trust preferred securities	1,337	—	1,337	—
Equity securities	13	—	13	—
Mortgage servicing rights	2,875	—	—	2,875
Total	$ 221,427	$ 2,655	$ 215,897	$ 2,875
December 31, 2018				
Assets:				
U.S. Treasury	$ 1,952	$ 1,952	—	$ —
U.S. government and federal agency obligations	9,966	—	9,966	—
Government sponsored enterprises	43,335	—	43,335	—
Obligations of states and political subdivisions	40,386	—	40,386	—
Mortgage-backed securities	118,192	—	118,192	—
Other debt securities	3,000	—	3,000	—
Bank-issued trust preferred securities	1,374	—	1,374	—
Equity securities	12	—	12	—
Mortgage servicing rights	2,931	—	—	2,931
Total	$ 221,148	$ 1,952	$ 216,265	$ 2,931

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Mortgage Servicing Rights	
	Three Months Ended March 31,	
(in thousands)	2019	2018
Balance at beginning of period	$ 2,931	$ 2,713
Total (losses) or gains (realized/unrealized):		
Included in earnings	(94)	18
Included in other comprehensive income	—	—
Purchases	—	—
Sales	—	—
Issues	38	50
Settlements	—	—
Balance at end of period	$ 2,875	$ 2,781

Valuation methods for Assets and Liabilities measured at fair value on a nonrecurring basis

Following is a description of the Company's valuation methodologies used for assets and liabilities recorded at fair value on a nonrecurring basis:

Collateral dependent impaired loans

While the overall loan portfolio is not carried at fair value, the Company periodically records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral dependent loans when establishing the allowance for loan losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan. In determining the value of real estate collateral, the Company relies on external and internal appraisals of property values depending on the size and complexity of the real estate collateral. The Company maintains staff that is trained to perform in-house evaluations and also review third party appraisal reports for reasonableness. In the case of non-real estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgments based on the experience and expertise of internal specialists. Values of all loan collateral are regularly reviewed by senior loan committee. Because many of these inputs are not observable, the measurements are classified as Level 3. As of March 31, 2019, the Company identified $3.8 million in collateral dependent impaired loans that had specific allowances for losses aggregating $702,000. Related to these loans, there were no charge-offs recorded during the three months ended March 31, 2019. As of March 31, 2018, the Company identified $3.8 million in collateral dependent impaired loans that had specific allowances for losses aggregating $1.0 million. Related to these loans, there was $57,000 in charge-offs recorded during the three months ended March 31, 2018.

Other Real Estate and Foreclosed Assets

Other real estate owned (OREO) and foreclosed assets consisted of loan collateral that has been repossessed through foreclosure. This collateral is comprised of commercial and residential real estate and other non-real estate property, including autos, manufactured homes, and construction equipment. Subsequent to foreclosure, these assets initially

are carried at fair value of the collateral less estimated selling costs. Fair value, when recorded, is generally based upon appraisals by approved, independent state certified appraisers. Like impaired loans, appraisals on OREO may be discounted based on the Company's historical knowledge, changes in market conditions from the time of appraisal or other information available. During the holding period, valuations are updated periodically, and the assets may be written down to reflect a new cost basis. Because many of these inputs are not observable, the measurements are classified as Level 3.

		Fair Value Measurements Using			
(in thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Three Months Ended March 31, Total Gains (Losses)*
March 31, 2019					
Assets:					
Collateral dependent impaired loans:					
Commercial, financial, & agricultural	$ 1,263	$ —	$ —	$ 1,263	$ —
Real estate construction - commercial	151	—	—	151	—
Real estate mortgage - residential	1,480	—	—	1,480	—
Real estate mortgage - commercial	233	—	—	233	—
Installment and other consumer	—	—	—	—	—
Total	$ 3,127	$ —	$ —	$ 3,127	$ —
Other real estate and repossessed assets	$ 13,537	$ —	$ —	$ 13,537	$ (106)
March 31, 2018					
Assets:					
Collateral dependent impaired loans:					
Commercial, financial, & agricultural	$ 1,369	$ —	$ —	$ 1,369	$ —
Real estate construction - commercial	—	—	—	—	(27)
Real estate mortgage - residential	886	—	—	886	—
Real estate mortgage - commercial	595	—	—	595	(20)
Installment and other consumer	—	—	—	—	(10)
Total	$ 2,850	$ —	$ —	$ 2,850	$ (57)
Other real estate and repossessed assets	$ 13,239	$ —	$ —	$ 13,239	$ 1

* Total gains (losses) reported for other real estate and foreclosed assets includes charge-offs, valuation write downs, and net losses taken during the periods reported.

(13) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate such value:

Loans

Fair values are estimated for portfolios with similar financial characteristics. Loans are segregated by type, such as commercial, real estate, and consumer. Each loan category is further segmented into fixed and variable interest rate

categories. The fair value of loans, or exit price, is estimated by using the future value of discounted cash flows using comparable market rates for similar types of loan products and adjusted for market factors. The discount rates used are estimated using comparable market rates for similar types of loan products adjusted to be commensurate with the credit risk, overhead costs, and optionality of such instruments.

Investment Securities

A detailed description of the fair value measurement of the debt instruments in the available-for-sale sections of the investment security portfolio is provided in the *Fair Value Measurement* section above. A schedule of investment securities by category and maturity is provided in the notes on *Investment Securities*.

Other investment securities

Other investment securities include equity securities with readily determinable fair values and other investment securities that do not have readily determinable fair values. Investments in Federal Home Loan Bank (FHLB) stock, and Midwest Independent Bank (MIB) bankers bank stock, that do not have readily determinable fair values, are required for membership in those organizations.

Equity securities with readily determinable fair values are recorded at fair value, with changes in fair value reflected in earnings. Equity securities that do not have readily determinable fair values are carried at cost and are periodically assessed for impairment.

Federal Funds Sold, Cash, and Due from Banks

The carrying amounts of short-term federal funds sold, interest earning deposits with banks, and cash and due from banks approximate fair value. Federal funds sold classified as short-term generally mature in 90 days or less.

Certificates of Deposit in other banks

Certificates of deposit are other investments made by the Company with other financial institutions that are carried at cost.

Cash Surrender Value - Life Insurance

The fair value of Bank owned life insurance (BOLI) approximates the carrying amount. Upon liquidation of these investments, the Company would receive the cash surrender value which equals the carrying amount.

Accrued Interest Receivable and Payable

For accrued interest receivable and payable, the carrying amount is a reasonable estimate of fair value because of the short maturity for these financial instruments.

Deposits

The fair value of deposits with no stated maturity, such as noninterest-bearing demand, NOW accounts, savings, and money market, is equal to the amount payable on demand. The fair value of time deposits is based on the

discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Federal funds purchased and Securities Sold under Agreements to Repurchase

For Federal funds purchased and securities sold under agreements to repurchase, the carrying amount is a reasonable estimate of fair value, as such instruments reprice in a short time period.

Subordinated Notes and Other Borrowings

The fair value of subordinated notes and other borrowings is based on the discounted value of contractual cash-flows. The discount rate is estimated using the rates currently offered for other borrowed money of similar remaining maturities.

A summary of the carrying amounts and fair values of the Company's financial instruments at March 31, 2019 and December 31, 2018 is as follows:

	March 31, 2019		March 31, 2019 Fair Value Measurements		
(in thousands)	Carrying amount	Fair value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Net Significant Unobservable Inputs (Level 3)
Assets:					
Cash and due from banks	$ 15,679	$ 15,679	$ 15,679	$ —	$ —
Federal funds sold and overnight interest-bearing deposits	75,035	75,035	75,035	—	—
Certificates of deposit in other banks	12,741	12,741	12,741	—	—
Available for sale securities	218,539	218,539	2,655	215,884	—
Other investment securities	5,735	5,735	—	5,735	—
Loans, net	1,142,807	1,117,708	—	—	1,117,708
Mortgage servicing rights	2,875	2,875	—	—	2,875
Cash surrender value - life insurance	2,562	2,562	—	2,562	—
Accrued interest receivable	6,160	6,160	6,160	—	—
	$ 1,482,133	$ 1,457,034	$ 112,270	$ 224,181	$ 1,120,583
Liabilities:					
Deposits:					
Non-interest bearing demand	$ 264,218	$ 264,218	$ 264,218	$ —	$ —
Savings, interest checking and money market	625,522	625,522	625,522	—	—
Time deposits	360,832	359,231	—	—	359,231
Federal funds purchased and securities sold under agreements to repurchase	22,097	22,097	22,097	—	—
Federal Home Loan Bank advances and other borrowings	95,096	95,524	—	95,524	—
Subordinated notes	49,486	44,512	—	44,512	—
Accrued interest payable	1,093	1,093	1,093	—	—
	$ 1,418,344	$ 1,412,197	$ 912,930	$ 140,036	$ 359,231

(in thousands)	December 31, 2018 Carrying amount	December 31, 2018 Fair value	December 31, 2018 Fair Value Measurements: Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Net Significant Unobservable Inputs (Level 3)
Assets:					
Cash and due from banks	$ 23,687	$ 23,687	$ 23,687	$ —	$ —
Federal funds sold and overnight interest-bearing deposits	18,396	18,396	18,396	—	—
Certificates of deposit in other banks	12,247	12,247	12,247	—	—
Available-for-sale securities	218,205	218,205	1,952	216,253	—
Other investment securities	5,675	5,675	—	5,675	—
Loans, net	1,134,975	1,115,003	—	—	1,115,003
Mortgage servicing rights	2,931	2,931	—	—	2,931
Cash surrender value - life insurance	2,542	2,542	—	2,542	—
Accrued interest receivable	6,162	6,162	6,162	—	—
	$ 1,424,820	$ 1,404,848	$ 62,444	$ 224,470	$ 1,117,934
Liabilities:					
Deposits:					
Non-interest bearing demand	$ 262,857	$ 262,857	$ 262,857	$ —	$ —
Savings, interest checking and money market	614,040	614,040	614,040	—	—
Time deposits	321,571	318,949	—	—	318,949
Federal funds purchased and securities sold under agreements to repurchase	24,647	24,647	24,647	—	—
Federal Home Loan Bank advances and other borrowings	95,153	94,326	—	94,326	—
Subordinated notes	49,486	45,749	—	45,749	—
Accrued interest payable	1,035	1,035	1,035	—	—
	$ 1,368,789	$ 1,361,603	$ 902,579	$ 140,075	$ 318,949

Off-Balance Sheet Financial Instruments

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the likelihood of the counterparties drawing on such financial instruments, and the present creditworthiness of such counterparties. The Company believes such commitments have been made on terms that are competitive in the markets in which it operates.

Limitations

The fair value estimates provided are made at a point in time based on market information and information about the financial instruments. Because no market exists for a portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and

involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the fair value estimates.

(14) Commitments and Contingencies

The Company issues financial instruments with off-balance-sheet risk in the normal course of business of meeting the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments may involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Company's extent of involvement and maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for financial instruments included on its consolidated balance sheets. At March 31, 2019, no amounts have been accrued for any estimated losses for these financial instruments.

The contractual amount of off-balance-sheet financial instruments were as follows as of the dates indicated:

(in thousands)	March 31, 2019	December 31, 2018
Commitments to extend credit	$ 254,735	$ 267,314
Commitments to originate residential first and second mortgage loans	4,356	1,759
Standby letters of credit	112,236	82,895
Total	371,327	351,968

Commitments

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since certain of the commitments and letters of credit are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, furniture and equipment, and real estate.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These standby letters of credit are primarily issued to support contractual obligations of the Company's customers. The approximate remaining term of standby letters of credit range from one month to five years at March 31, 2019.

Pending Litigation

The Company and its subsidiaries are defendants in various legal actions incidental to the Company's past and current business activities. Based on the Company's analysis, and considering the inherent uncertainties associated with litigation, management does not believe that it is reasonably possible that these legal actions will materially adversely affect the Company's consolidated financial condition or results of operations in the near term. The Company records a loss accrual for all legal matters for which it deems a loss is probable and can be reasonably estimated. Some legal matters, which are

at early stages in the legal process, have not yet progressed to the point where a loss is deemed probable or an amount can be estimated.

(15) Revenue Recognition

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.

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 not in the 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 sales of other real estate owned. However, the recognition of these revenue streams did not change current business practices or result in any changes to the Company's consolidated financial statements.

Descriptions of our revenue-generating activities within the scope of this guidance, which are presented in our income statement as components of noninterest income are as follows:

- Service charges on deposit accounts - represents fees generated from a variety of deposit products and services provided to customers under a day-to-day contract. These fees are recognized on a daily or monthly basis.

- Bank card income and fees – represents fees, exchange, and other service charge revenue earned from merchant, debit and credit cards that are recognized when the services are rendered or upon completion. These fees are recognized on a daily or monthly basis.

- Gain on sale of other real estate - represents income recognized at the time of control of a property is transferred to the buyer.

Item 2 - ***Management's Discussion and Analysis of Financial Condition And Results of Operations***

Forward-Looking Statements

This report contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company, Hawthorn Bancshares, Inc., and its subsidiaries, including, without limitation:

- statements that are not historical in nature, and
- statements preceded by, followed by or that include the words *believes*, *expects, may, will, should, could, anticipates, estimates, intends* or similar expressions.

Forward-looking statements are not guarantees of future performance or results. They involve risks, uncertainties and assumptions. Actual results may differ materially from those contemplated by the forward-looking statements due to, among others, the following factors:

- competitive pressures among financial services companies may increase significantly,
- changes in the interest rate environment may reduce interest margins,
- general economic conditions, either nationally or in Missouri, may be less favorable than expected and may adversely affect the quality of our loans and other assets,
- increases in non-performing assets in the Company's loan portfolios and adverse economic conditions may necessitate increases to our provisions for loan losses,
- costs or difficulties related to the integration of the business of the Company and its acquisition targets may be greater than expected,
- legislative, regulatory or tax law changes may adversely affect the business in which the Company and its subsidiaries are engaged, and
- changes may occur in the securities markets.

We have described under the caption *Risk Factors* in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, and in other reports filed with the SEC from time to time, additional factors that could cause actual results to be materially different from those described in the forward-looking statements. Other factors that have not been identified in this report could also have this effect. You are cautioned not to put undue reliance on any forward-looking statement, which speak only as of the date they were made.

Overview

Crucial to the Company's community banking strategy is growth in its commercial banking services, retail mortgage lending and retail banking services. Through the branch network of its subsidiary bank, the Company, with $1.5 billion in assets at March 31, 2019, provides a broad range of commercial and personal banking services. The Bank's specialties include commercial banking for small and mid-sized businesses, including equipment, operating, commercial real estate, Small Business Administration (SBA) loans, and personal banking services including real estate mortgage lending, installment and consumer loans, certificates of deposit, individual retirement and other time deposit accounts, checking accounts, savings accounts, and money market accounts. Other financial services that the Company provides include trust services that include estate planning, investment and asset management services and a comprehensive suite of cash management services. The geographic areas in which the Company provides products and services include the Missouri communities in and surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, and the greater Kansas City metropolitan area.

The Company's primary source of revenue is net interest income derived primarily from lending and deposit taking activities. Much of the Company's business is commercial, commercial real estate development, and residential mortgage lending. The Company's income from mortgage brokerage activities is directly dependent on mortgage rates and the level of home purchases and refinancing activity.

The success of the Company's growth strategy depends primarily on the ability of its banking subsidiary to generate an increasing level of loans and deposits at acceptable risk levels and on acceptable terms without significant increases in non-interest expenses relative to revenues generated. The Company's financial performance also depends, in part, on its ability to manage various portfolios and to successfully introduce additional financial products and services by expanding new and existing customer relationships, utilizing improved technology, and enhancing customer satisfaction. Furthermore, the success of the Company's growth strategy depends on its ability to maintain sufficient regulatory capital levels during periods in which general economic conditions are unfavorable and despite economic conditions being beyond its control.

The Company's subsidiary bank is a full-service bank conducting a general banking business, offering its customers checking and savings accounts, debit cards, certificates of deposit, safety deposit boxes and a wide range of lending services, including commercial and industrial loans, residential real estate loans, single payment personal loans, installment loans and credit card accounts. In addition, the Bank provides trust services.

The deposit accounts of the Bank are insured by the Federal Deposit Insurance Corporation (FDIC) to the extent provided by law. The operations of the Bank are supervised and regulated by the FDIC and the Missouri Division of Finance. Periodic examinations of the Bank are conducted by representatives of the FDIC and the Missouri Division of Finance. Such regulations, supervision and examinations are principally for the benefit of depositors, rather than for the benefit of shareholders. The Company is subject to supervision and examination by the Board of Governors of the Federal Reserve System.

CRITICAL ACCOUNTING POLICIES

The following accounting policies are considered most critical to the understanding of the Company's financial condition and results of operations. These critical accounting policies require management's most difficult, subjective and complex judgments about matters that are inherently uncertain. Because these estimates and judgments are based on current circumstances, they may change over time or prove to be inaccurate based on actual experiences. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of a materially different financial condition and/or results of operations could reasonably be expected. The impact and any associated risks related to the critical accounting policies on the business operations are discussed throughout *Management's Discussion and Analysis of Financial Condition and Results of Operations*, where such policies affect the reported and expected financial results.

Allowance for Loan Losses

Management has identified the accounting policy related to the allowance for loan losses as critical to the understanding of the Company's results of operations, since the application of this policy requires significant management assumptions and estimates that could result in materially different amounts to be reported if conditions or underlying circumstances were to change. Further discussion of the methodology used in establishing the allowance and the impact of any associated risks related to these policies on the Company's business operations is provided in note 1 to the Company's unaudited consolidated financial statements and is also discussed in the *Lending and Credit Management* section below. Many of the loans are deemed collateral dependent for purposes of the measurement of the impairment loss, thus the fair value of the underlying collateral and sensitivity of such fair values due to changing market conditions, supply and demand, condition of the collateral and other factors can be volatile over periods of time. Such volatility can have an impact on the financial performance of the Company.

SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents selected consolidated financial information for the Company as of and for each of the three months ended March 31, 2019 and 2018, respectively. The selected consolidated financial data should be read in

conjunction with the unaudited consolidated financial statements of the Company, including the related notes, presented elsewhere herein.

Selected Financial Data

	Three Months Ended March 31,	
(In thousands, except per share data)	**2019**	**2018**
Per Share Data		
Basic earnings per share	$ 0.77	$ 0.35
Diluted earnings per share	0.77	0.35
Cash dividends paid on common stock	603	406
Book value per share	17.38	15.14
Market price per share	23.24	19.84
Selected Ratios		
(Based on average balance sheets)		
Return on total assets	1.23 %	0.60 %
Return on stockholders' equity	18.41 %	9.32 %
Stockholders' equity to total assets	6.68 %	6.41 %
Efficiency ratio (1)	72.07 %	79.16 %
Net interest spread (Ytd)	2.95 %	3.09 %
Net interest margin (Ytd)	3.26 %	3.30 %
(Based on end-of-period data)		
Stockholders' equity to assets	6.82 %	6.28 %
Total risk-based capital ratio	13.39 %	12.87 %
Tier 1 risk-based capital ratio	11.41 %	10.61 %
Common equity Tier 1 capital	8.65 %	8.04 %
Tier 1 leverage ratio (2)	9.38 %	9.17 %

(1) Efficiency ratio is calculated as non-interest expense as a percentage of revenue. Total revenue includes net interest income and non-interest income.

(2) Tier 1 leverage ratio is calculated by dividing Tier 1 capital by average total consolidated assets.

Use of Non-GAAP Measures

Several financial measures in this report are non-GAAP, meaning they are not presented in accordance with generally accepted accounting principles (GAAP) in the U.S. The non-GAAP items presented in this report are non-GAAP net income, non-GAAP basic earnings per share, non-GAAP diluted earnings per share, non-GAAP return on average assets and non-GAAP return on average common equity. These measures include the adjustment to exclude the impact of the gain on the sale of our Branson branch that closed during the current quarter, which is non-recurring and not considered indicative of underlying earnings performance. The Company believes that the exclusion of this item provides a useful basis for evaluating the Company's underlying performance, but should not be considered in isolation and is not in accordance with, or a substitute for, evaluating performance utilizing GAAP financial information. The Company uses non-GAAP measures to analyze its financial performance and to make financial comparisons to prior periods presented on a similar basis. The Company believes that providing such adjusted results allows investors to better understand the Company's comparative operating performance for the periods presented. Non-GAAP measures are not formally defined by GAAP or codified in the federal banking regulations, and other entities may use calculation methods that differ from those used by the Company. The Company has reconciled each of these measures to a comparable GAAP measure below:

Income Statement Data

(*In thousands, except per share data*)	Three Months Ended March 31, 2019	2018
Net income - GAAP	$ 4,666	$ 2,090
Effect of net gain on branch sale (a)	(1,638)	—
Net income - non-GAAP	$ 3,028	$ 2,090
Per Share Data		
Basic earnings per share - GAAP	$ 0.77	$ 0.35
Effect of net gain on branch sale (a)	(0.27)	—
Basic earnings per share - non-GAAP	$ 0.50	$ 0.35
Diluted earnings per share - GAAP	$ 0.77	$ 0.35
Effect of net gain on branch sale (a)	(0.27)	—
Diluted earnings per share - non-GAAP	$ 0.50	$ 0.35
Key Ratios		
Return on average total assets - GAAP	1.23 %	0.60 %
Effect of net gain on branch sale (a)	(0.43)%	— %
Return on average total assets - non-GAAP	0.80 %	0.60 %
Return on average stockholders' equity - GAAP	18.41 %	9.32 %
Effect of net gain on branch sale (a)	(6.46)%	— %
Return on average stockholders' equity - non-GAAP	11.95 %	9.32 %

(a) The pre-tax gain on the sale of the Branson Branch was $2.1 million and $1.6 million after tax.

RESULTS OF OPERATIONS ANALYSIS

The Company has prepared all of the consolidated financial information in this report in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In preparing the consolidated financial statements in accordance with U.S. GAAP, the Company makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurances that actual results will not differ from those estimates.

	Three Months Ended March 31,			
(*In thousands*)	2019	2018	$ Change	% Change
Net interest income	$ 11,629	$ 10,754	$ 875	8.1 %
Provision for loan losses	150	300	(150)	(50.0)
Noninterest income	2,091	2,215	(124)	(5.6)
Investment securities gains, net	1	98	(97)	(99.0)
Gain on branch sale, net	2,074	—	2,074	NM
Noninterest expense	9,888	10,266	(378)	(3.7)
Income before income taxes	5,757	2,501	3,256	130.2
Income tax expense	1,091	411	680	165.5
Net income	$ 4,666	$ 2,090	$ 2,576	123.3 %

Consolidated net income of $4.7 million, or $0.77 per diluted share, for the three months ended March 31, 2019 increased $2.6 million compared to $2.1 million, or $0.35 per diluted share, for the three months ended March 31, 2018. For the three months ended March 31, 2019, the return on average assets was 1.23%, the return on average stockholders’ equity was 18.41%, and the efficiency ratio was 72.07%.

Net interest income was $11.6 million for the three months ended March 31, 2019, compared to $10.8 million for the three months ended March 31, 2018. The net interest margin (expressed on a fully taxable equivalent basis) decreased to 3.26% for the three months ended March 31, 2019 compared to 3.30% for the three months ended March 31, 2018. These changes are discussed in greater detail under the *Average Balance Sheets and Rate and Volume Analysis* section below.

A $150,000 ***provision for loan losses*** was recorded for the three months ended March 31, 2019 compared to a $300,000 provision for the three months ended March 31, 2018.

The Company's net loan recoveries were ($43,000), or (0.00%), of average loans for the three months ended March 31, 2019 compared to net charge-offs of $205,000, or 0.02%, of average loans, of average loans for the three months ended March 31, 2018.

Non-performing loans totaled $5.6 million, or 0.48% of total loans, at March 31, 2019 compared to $5.6 million, or 0.49% of total loans, at December 31, 2018, and $5.5 million, or 0.51% of total loans, at March 31, 2018. These changes are discussed in greater detail under the *Lending and Credit Management* section below.

Non-interest income decreased $124,000, or 5.6%, for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. These changes are discussed in greater detail under the *Non-interest Income and Expense* section below.

Investment securities gains, net of $1,000 were recorded for the three months ended March 31, 2019 compared to $98,000 for the three months ended March 31, 2018. Securities gains for the three months ended March 31, 2018 included gains realized from a series of short-term sales of U.S. Treasury securities with repurchase agreements in order to generate capital gains to offset capital losses expiring in 2018 and 2019.

Gain on branch sale, net On February 8, 2019, Hawthorn Bank, a wholly-owned subsidiary of Hawthorn Bancshares, Inc., completed the sale of its branch located in Branson, Missouri to Branson Bank, Branson, Missouri. The Company sold the land and building for $3.5 million with a net book value of $1.7 million and transferred approximately $10.6 million in deposits, subject to future adjustments required in the definitive agreement for a deposit premium of 4.1%, or $0.3 million, excluding future contingent adjustments. The sale resulted in a pre-tax gain of approximately $2.1 million, or $1.6 million after tax.

Non-interest expense decreased $378,000, or 3.7%, for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. These changes are discussed in greater detail under the *Non-interest Income and Expense* section below.

Average Balance Sheets

Net interest income is the largest source of revenue resulting from the Company's lending, investing, borrowing, and deposit gathering activities. It is affected by both changes in the level of interest rates and changes in the amounts and mix of interest earning assets and interest bearing liabilities. The following table presents average balance sheets, net interest

income, average yields of earning assets, average costs of interest bearing liabilities, net interest spread and net interest margin on a fully taxable equivalent basis for each of the periods ended March 31, 2019 and 2018, respectively.

	Three Months Ended March 31,					
	2019			2018		
(In thousands)	Average	Interest Income/	Rate Earned/	Average	Interest Income/	Rate Earned/
ASSETS						
Loans: (2) (4)						
Commercial	$ 205,728	$ 2,742	5.41 %	$ 190,698	$ 2,289	4.87 %
Real estate construction - residential	28,454	420	5.99	28,470	342	4.87
Real estate construction - commercial	109,769	1,403	5.18	101,856	1,172	4.67
Real estate mortgage - residential	244,343	3,047	5.06	247,579	2,859	4.68
Real estate mortgage - commercial	526,069	6,240	4.81	471,927	5,360	4.61
Installment and other consumer	32,238	336	4.23	32,342	293	3.67
Total loans	$1,146,601	$14,188	5.02 %	$1,072,872	$12,315	4.66 %
Investment securities: (3)						
U.S. Treasury	$ 2,491	$ 13	2.12 %	$ 17,502	$ 60	1.39 %
U.S. government and federal agency obligations	51,963	239	1.87	49,399	190	1.56
Obligations of states and political subdivisions	38,937	222	2.31	44,807	270	2.44
Mortgage-backed securities	116,330	667	2.33	125,453	680	2.20
Other debt securities	4,409	64	5.89	4,486	60	5.42
Total investment securities	$ 214,130	$ 1,205	2.28 %	$ 241,647	$ 1,260	2.11 %
Other investment securities	5,677	66	4.71	5,424	50	3.74
Federal funds sold and interest bearing deposits in other financial institutions	99,013	602	2.47	24,573	106	1.75
Total interest earning assets	$1,465,421	$16,061	4.44 %	$1,344,516	$13,731	4.14 %
All other assets	84,740			85,116		
Allowance for loan losses	(11,786)			(10,916)		
Total assets	$1,538,375			$1,418,716		
LIABILITIES AND STOCKHOLDERS' EQUITY						
NOW accounts	$ 238,076	$ 781	1.33 %	$ 243,245	$ 533	0.89 %
Savings	92,426	17	0.07	94,356	12	0.05
Interest checking	10,556	49	1.88	1,604	4	1.01
Money market	295,335	869	1.19	265,994	535	0.82
Time deposits	362,660	1,371	1.53	289,970	649	0.91
Total interest bearing deposits	$ 999,053	$ 3,087	1.25 %	$ 895,169	$ 1,733	0.79 %
Federal funds purchased and securities sold under agreements to repurchase	20,836	33	0.64	43,060	171	1.61
Federal Home Loan Bank advances and other borrowings	95,133	542	2.31	93,041	395	1.72
Subordinated notes	49,486	624	5.11	49,486	491	4.02
Total borrowings	$ 165,455	$ 1,199	2.94 %	$ 185,587	$ 1,057	2.31 %
Total interest bearing liabilities	$1,164,508	$ 4,286	1.49 %	$1,080,756	$ 2,790	1.05 %
Demand deposits	256,014			234,129		
Other liabilities	15,049			12,892		
Total liabilities	1,435,571			1,327,777		
Stockholders' equity	102,804			90,939		
Total liabilities and stockholders' equity	$1,538,375			$1,418,716		
Net interest income (FTE)		$11,775			$10,941	
Net interest spread			2.95 %			3.09 %
Net interest margin			3.26 %			3.30 %

(1) Interest income and yields are presented on a fully taxable equivalent basis using the federal statutory income tax rate of 21%, net of nondeductible interest expense, for the three months ended March 31, 2019 and 2018 respectively. Such adjustments totaled $146,000 and $187,000 for the three months ended March 31, 2019 and 2018, respectively.

(2) Non-accruing loans are included in the average amounts outstanding.

(3) Average balances based on amortized cost.

(4) Fees and costs on loans are included in interest income.

Rate and Volume Analysis

The following table summarizes the changes in net interest income on a fully taxable equivalent basis, by major category of interest earning assets and interest bearing liabilities, identifying changes related to volumes and rates for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. The change in interest due to the combined rate/volume variance has been allocated to rate and volume changes in proportion to the absolute dollar amounts of change in each.

	Three Months Ended March 31, 2019 vs. 2018		
		Change due to	
(In thousands)	Total Change	Average Volume	Average Rate
Interest income on a fully taxable equivalent basis: (1)			
Loans: (2) (4)			
Commercial	$ 453	$ 188	$ 265
Real estate construction - residential	78	—	78
Real estate construction - commercial	231	95	136
Real estate mortgage - residential	188	(37)	225
Real estate mortgage - commercial	880	635	245
Installment and other consumer	43	(1)	44
Investment securities: (3)			
U.S. Treasury	(47)	(68)	21
U.S. government and federal agency obligations	49	10	39
Obligations of states and political subdivisions	(48)	(34)	(14)
Mortgage-backed securities	(13)	(51)	38
Other debt securities	4	(1)	5
Other investment securities	16	2	14
Federal funds sold and interest bearing deposits in other financial institutions	496	437	59
Total interest income	2,330	1,175	1,155
Interest expense:			
NOW accounts	248	(11)	259
Savings	5	—	5
Interest checking	45	39	6
Money market	334	64	270
Time deposits	722	193	529
Federal funds purchased and securities sold under agreements to repurchase	(138)	(63)	(75)
Federal Home Loan Bank advances and other borrowings	147	9	138
Subordinated notes	133	—	133
Total interest expense	1,496	231	1,265
Net interest income on a fully taxable equivalent basis	$ 834	$ 944	$ (110)

(1) Interest income and yields are presented on a fully taxable equivalent basis using the Federal statutory income tax rate of 21%, net of nondeductible interest expense, for the three months ended March 31, 2019 and 2018, respectively. Such adjustments totaled $146,000 for the three months ended March 31, 2019 compared to $187,000 for the three months ended March 31, 2018.

(2) Non-accruing loans are included in the average amounts outstanding.

(3) Average balances based on amortized cost.

(4) Fees and costs on loans are included in interest income.

Financial results for the quarter ended March 31, 2019 compared to the quarter ended March 31, 2018, reflected an increase in net interest income, on a tax equivalent basis, of $834,000, or 7.62%. Measured as a percentage of average earning assets, the net interest margin (expressed on a fully taxable equivalent basis) decreased to 3.26% for the quarter ended March 31, 2019, compared to 3.30% for the quarter ended March 31, 2018. Although net interest income increased

primarily due to an increase in average earning assets, net interest margin decreased due to the cost of interest bearing liabilities repricing faster than the rate earned on interest bearing assets in the comparative periods presented.

Average interest-earning assets increased $120.9 million, or 8.99%, to $1.47 billion for the three months ended March 31, 2019 compared to $1.34 billion for the three months ended March 31, 2018, and average interest bearing liabilities increased $83.8 million, or 7.75%, to $1.16 billion for the three months ended March 31, 2019 compared to $1.08 billion for the three months ended March 31, 2018.

Total interest income (expressed on a fully taxable equivalent basis) was $16.1 million for the three months ended March 31, 2019 compared to $13.7 million for the three months ended March 31, 2018. The Company's rates earned on interest earning assets were 4.44% for the three months ended March 31, 2019 compared to 4.14% for the three months ended March 31, 2018.

Interest income on loans increased to $14.2 million for the three months ended March 31, 2019 compared to $12.3 million for the three months ended March 31, 2018.

Average loans outstanding increased $73.7 million, or 6.87%, to $1.15 billion for the three months ended March 31, 2019 compared to $1.07 billion for the three months ended March 31, 2018. The average yield on loans receivable increased to 5.02% for the three months ended March 31, 2019 compared to 4.66% for the three months ended March 31, 2018. See the *Lending and Credit Management* section for further discussion of changes in the composition of the lending portfolio.

Total interest expense increased to $4.3 million for the three months ended March 31, 2019 compared to $2.8 million for the three months ended March 31, 2018. The Company's rates paid on interest bearing liabilities was 1.49% for the three months ended March 31, 2019 compared to 1.05% for the three months ended March 31, 2018. See the *Liquidity Management* section for further discussion.

Interest expense on deposits increased to $3.1 million for the three months ended March 31, 2019 compared to $1.7 million for the three months ended March 31, 2018.

Average interest bearing deposits increased $103.9 million, or 11.6%, to $999.1 million for the three months ended March 31, 2019 compared to $895.2 million for the three months ended March 31, 2018. These increases were primarily due to demand deposits, public funds, Missouri Link deposits, and brokered deposits. The average cost of deposits increased to 1.25% for the three months ended March 31, 2019 compared to 0.79% for the three months ended March 31, 2018. The increase was primarily due to generally higher market interest rates quarter over quarter.

Interest expense on borrowings increased to $1.2 million for the three months ended March 31, 2019 compared to $1.1 million for the three months ended March 31, 2018.

Average borrowings decreased to $165.5 million for the three months ended March 31, 2019 compared to $185.6 million for the three months ended March 31, 2018. The decrease in average borrowings was primarily due to the $22.2 million decrease in average repurchase agreements due to a tax initiative involving short sales of a U.S. Treasury security funded by a repurchase agreement during the first quarter ended March 31, 2018. The average cost of borrowings increased to 2.94% for the three months ended March 31, 2019 compared to 2.31% for the three months ended March 31, 2018. The increase in cost of funds primarily resulted from higher market interest rates. See the *Liquidity Management* section for further discussion.

Non-interest Income and Expense

Non-interest income for the periods indicated was as follows:

(In thousands)	Three Months Ended March 31, 2019	2018	$ Change	% Change
Non-interest Income				
Service charges and other fees	$ 862	$ 876	$ (14)	(1.6)%
Bank card income and fees	695	656	39	5.9
Trust department income	293	280	13	4.6
Real estate servicing fees, net	84	221	(137)	(62.0)
Gain on sales of mortgage loans, net	105	146	(41)	(28.1)
Other	52	36	16	44.4
Total non-interest income	$ 2,091	$ 2,215	$ (124)	(5.6)%
Non-interest income as a % of total revenue *	15.2 %	17.1 %		

* Total revenue is calculated as net interest income plus non-interest income.

Total non-interest income decreased $124,000, or 5.6%, to $2.1 million for the quarter ended March 31, 2019 compared to $2.2 million for the quarter ended March 31, 2018.

Real estate servicing fees, net of the change in valuation of mortgage serving rights, (MSRs) decreased $137,000 to $84,000 for the quarter ended March 31, 2019 compared to $221,000 for the quarter ended March 31, 2018 primarily due to a decrease in the change in fair value quarter over quarter. The change in the value of MSRs in the periods presented is primarily the result of market-driven changes in interest rates and prepayment speeds.

Mortgage loan servicing fees earned on loans sold were $178,000 for the three months ended March 31, 2019 compared to $203,000 for the three months ended March 31, 2018. The Company was servicing $275.7 million of mortgage loans at March 31, 2019 compared to $279.9 million and $283.1 million at December 31, 2018 and March 31, 2018, respectively.

Gain on sales of mortgage loans decreased $41,000, or 28.1%, to $105,000 for the quarter ended March 31, 2019 compared to $146,000 for the quarter ended March 31, 2018. The decrease period over period was primarily due to a decrease in other loan origination income, partially offset by an increase in loan origination fees and costs. The Company sold $5.1 million of loans for the three months ended March 31, 2019 compared to $7.6 million for the three months ended March 31, 2018.

Other Income increased $16,000, or 44.4%, to $52,000 for the quarter ended March 31, 2019 compared to $36,000 for the quarter ended March 31, 2018. The increase period over period was primarily due to rental income received on a bank owned building in other real estate owned.

Investment securities gains, net for the periods indicated were as follows:

(in thousands)	Three Months Ended March 31, 2019	2018
Investment securities gains, net		
Available for sale securities:		
Gains realized on sales	$ —	$ 98
Losses realized on sales	—	—
Other-than-temporary impairment recognized	—	—
Other investment securities:		
Fair value adjustments, net	1	—
Investment securities gains, net	**$ 1**	**$ 98**

During the three months ended March 31, 2018, the Company received $25.7 million from proceeds from a series of short-term sales of U.S. Treasury securities purchased with repurchase agreements and recognized gains of $98,000 in order to generate capital gains to offset capital losses that were to expire during 2018 and 2019. During the three months ended March 31, 2019 there were no securities sales.

Gain on branch sale, net

On February 8, 2019, Hawthorn Bank, a wholly-owned subsidiary of Hawthorn Bancshares, Inc., completed the sale of its branch located in Branson, Missouri to Branson Bank, Branson, Missouri. The Company sold the land and building for $3.5 million with a net book value of $1.7 million and transferred approximately $10.6 million in deposits, subject to future adjustments required in the definitive agreement for a deposit premium of 4.1%, or $0.3 million, excluding future contingent adjustments. The sale resulted in a pre-tax gain of approximately $2.1 million, or $1.6 million after tax.

Non-interest expense for the periods indicated was as follows:

	Three Months Ended March 31,			
(In thousands)	2019	2018	$ Change	% Change
Non-interest Expense				
Salaries	$ 3,972	$ 4,552	$ (580)	(12.7)%
Employee benefits	1,466	1,505	(39)	(2.6)
Occupancy expense, net	698	689	9	1.3
Furniture and equipment expense	809	635	174	27.4
Processing expense, network and bank card expense	1,001	859	142	16.5
Legal, examination, and professional fees	329	422	(93)	(22.0)
Advertising and promotion	258	252	6	2.4
Postage, printing, and supplies	210	268	(58)	(21.6)
Other	1,145	1,084	61	5.6
Total non-interest expense	$ 9,888	$ 10,266	$ (378)	(3.7)%
Efficiency ratio*	72.1 %	79.2 %		
Number of full-time equivalent employees	286	339		

* Efficiency ratio is calculated as non-interest expense as a percent of revenue.

Total revenue includes net interest income and non-interest income.

Total non-interest expense decreased $378,000, or 3.7%, to $9.9 million for the quarter ended March 31, 2019 compared to $10.3 million for the quarter ended March 31, 2018.

Salaries decreased $580,000, or 12.7%, to $4.0 million for the quarter ended March 31, 2019 compared to $4.6 million for the quarter ended March 31, 2018. The decrease quarter over quarter was primarily due to a reduction of fifty-three full-time equivalent employees. In addition, a bonus was paid in February 2018 to all eligible full-time and part-time employees resulting from the expected tax savings from the Tax Act.

Employee benefits decreased $39,000, or 2.6%, to $1.5 million for the quarter ended March 31, 2019 compared to $1.5 million for the quarter ended March 31, 2018. The decrease quarter over quarter was primarily due to a decrease in medical plan premiums due to a reduction of employees as mentioned above, and was partially offset by an increase in the employer 401(k) and profit-sharing contributions.

Furniture and equipment expense increased $174,000, or 27.4%, to $809,000 for the quarter ended March 31, 2019 compared to $635,000 for the quarter ended March 31, 2018. The increase quarter over quarter was primarily due to an increase in the monthly cost to maintain the Company's hosted network, and the replacement of several computers below the Company's capitalization threshold during the current quarter.

Processing, network, and bank card expense increased $142,000, or 16.5%, to $1.0 million for the quarter ended March 31, 2019 compared to $859,000 for the quarter ended March 31, 2018. The increase quarter over quarter was primarily due to an increase in debit card processing expenses.

Legal, examination, and professional fees decreased $93,000, or 22.0%, to $329,000 for the quarter ended March 31, 2019 compared to $422,000 for the quarter ended March 31, 2018. The decrease quarter over quarter was primarily related to a decrease in attorney and consulting fees. During 2018 additional fees were incurred related to tax planning initiatives.

Postage, printing, and supplies decreased $58,000, or 21.6%, to $210,000 for the quarter ended March 31, 2019 compared to $268,000 for the quarter ended March 31, 2018. The decrease quarter over quarter was primarily due to bank-wide reduction of costs and timing of supply purchases.

Income taxes

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 18.9% for the three months ended March 31, 2019 compared to 16.4% for the three months ended March 31, 2018. The change in the effective tax rate in the first quarter of 2019 over the first quarter of 2018 is primarily due to an increase in taxable income, which included a $2.1 million pre-taxable gain from the sale of the Branson branch.

The federal corporate income tax rate declined from 34% to 21% effective January 1, 2018 as a result of the Tax Cuts and Jobs Act, (Tax Act). The Company's tax rate is lower than the federal statutory rate for the quarters ending March 31, 2019 and 2018, respectively, primarily due to tax-exempt income and additional tax planning initiatives. The provisional adjustments recorded in the fourth quarter of 2017 related to the enactment of the Tax Act were finalized during the third quarter of 2018 with the filing of the Company's 2017 tax return, within the one-year measurement period provided under Staff Accounting Bulletin No. 118 in regards to the application of FASB's ASC Topic 740, *Income Taxes*.

Lending and Credit Management

Interest earned on the loan portfolio is a primary source of interest income for the Company. Net loans represented 74.3% of total assets as of March 31, 2019 compared to 76.6% as of December 31, 2018.

Lending activities are conducted pursuant to an established loan policy approved by the Bank’s Board of Directors. The Bank’s credit review process is overseen by regional loan committees with established loan approval limits. In addition, a senior loan committee reviews all credit relationships in aggregate over an established dollar amount. The senior loan committee meets weekly and is comprised of senior managers of the Bank.

A summary of loans, by major class within the Company's loan portfolio as of the dates indicated is as follows:

(In thousands)	March 31, 2019	December 31, 2018
Commercial, financial, and agricultural	$ 204,759	$ 207,720
Real estate construction - residential	26,082	28,610
Real estate construction - commercial	109,766	106,784
Real estate mortgage - residential	248,059	241,517
Real estate mortgage - commercial	534,121	529,536
Installment and other consumer	31,865	32,460
Total loans	$ 1,154,652	$ 1,146,627
Percent of categories to total loans:		
Commercial, financial, and agricultural	17.7 %	18.1 %
Real estate construction - residential	2.3	2.5
Real estate construction - commercial	9.5	9.3
Real estate mortgage - residential	21.4	21.1
Real estate mortgage - commercial	46.3	46.2
Installment and other consumer	2.8	2.8
Total	100.0 %	100.0 %

The Company extends credit to its local community market through traditional real estate mortgage products. The Company does not participate in extending credit to sub-prime residential real estate markets. The Company does not lend funds for transactions defined as "highly leveraged" by bank regulatory authorities or for foreign loans. Additionally, the Company does not have any concentrations of loans exceeding 10% of total loans that are not otherwise disclosed in the loan portfolio composition table. The Company does not have any interest-earning assets that would have been included in nonaccrual, past due, or restructured loans if such assets were loans.

The Company generally does not retain long-term fixed rate residential mortgage loans in its portfolio. Fixed rate loans conforming to standards required by the secondary market are offered to qualified borrowers, but are not funded until the Company has a non-recourse purchase commitment from the secondary market at a predetermined price. During the three months ended March 31, 2019, the Company sold approximately $5.1 million of loans to investors, compared to $7.6 million for the three months ended March 31, 2018. At March 31, 2019, the Company was servicing approximately $275.7 million of loans sold to the secondary market compared to $279.9 million at December 31, 2018, and $283.1 million at March 31, 2018.

Risk Elements of the Loan Portfolio

Management, the senior loan committee, and internal loan review, formally review all loans in excess of certain dollar amounts (periodically established) at least annually. Loans in excess of $2.0 million in aggregate and all adversely classified credits identified by management are reviewed by the senior loan committee. In addition, all other loans are reviewed on a risk weighted selection process. The senior loan committee reviews and reports to the board of directors, on a monthly basis, past due, classified, and watch list loans in order to classify or reclassify loans as loans requiring attention, substandard, doubtful, or loss. During this review, management also determines which loans should be considered impaired. Management follows the guidance provided in the FASB's ASC Topic 310-10-35 in identifying and measuring loan impairment. If management determines that it is probable that all amounts due on a loan will not be collected under the original terms of the loan agreement, the loan is considered impaired. These loans are evaluated individually for impairment, and in conjunction with current economic conditions and loss experience, specific reserves are estimated as further discussed below. Loans not individually evaluated are aggregated and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type, delinquencies, current economic conditions, loan risk ratings and industry concentration. Management believes, but there can be no assurance, that these procedures keep management informed of potential problem loans. Based upon these procedures, both the allowance and provision for loan losses are adjusted to maintain the allowance at a level considered necessary by management to provide for probable losses inherent in the loan portfolio.

Non-performing Assets

The following table summarizes non-performing assets at the dates indicated:

(In thousands)	March 31, 2019	December 31, 2018	March 31, 2018
Nonaccrual loans:			
Commercial, financial, and agricultural	$ 1,747	$ 1,857	$ 2,258
Real estate construction - residential	—	—	59
Real estate construction - commercial	151	153	—
Real estate mortgage - residential	2,803	2,720	2,089
Real estate mortgage - commercial	508	474	916
Installment and other consumer	222	210	160
Total	$ 5,431	$ 5,414	$ 5,482
Loans contractually past - due 90 days or more and still accruing:			
Commercial, financial, and agricultural	$ —	$ —	$ —
Real estate construction - residential	—	—	—
Real estate construction - commercial	—	—	—
Real estate mortgage - residential	140	156	—
Real estate mortgage - commercial	—	—	—
Installment and other consumer	5	6	38
Total	$ 145	$ 162	$ 38
Total non-performing loans (a)	5,576	5,576	5,520
Other real estate owned and repossessed assets	13,537	13,691	10,690
Total non-performing assets	$ 19,113	$ 19,267	$ 16,210
Loans (c)	$ 1,153,640	$ 1,146,044	$ 1,083,797
Allowance for loan losses to loans	1.03 %	1.02 %	1.01 %
Non-performing loans to loans (a)	0.48 %	0.49 %	0.51 %
Non-performing assets to loans (b)	1.66 %	1.68 %	1.50 %
Non-performing assets to assets (b)	1.24 %	1.30 %	1.12 %
Allowance for loan losses to non-performing loans	212.43 %	208.97 %	198.32 %

(a) Non-performing loans include loans 90 days past due and accruing, nonaccrual loans, and non-performing TDRs included in nonaccrual loans.

(b) Non-performing assets include non-performing loans and other real estate owned and repossessed assets.

(c) Loan totals do not include loans held for sale.

Total non-performing assets were $19.1 million, or 1.66% of total loans, at March 31, 2019 compared to $19.3 million, or 1.68% of total loans, at December 31, 2018, and $16.2 million, or 1.50% of total loans, at March 31, 2018, respectively. Non-accrual loans included $1.9 million of loans classified as TDRs at March 31, 2019 compared to $2.0 million and $1.7 million at December 31, 2018 and March 31, 2018, respectively.

As of March 31, 2019, approximately $5.3 million compared to $5.2 million and $9.0 million at December 31, 2018 and March 31, 2018, respectively, of loans classified as substandard, which include performing TDRs, and are not included in the nonperforming asset table, were identified as potential problem loans having more than normal risk which raised doubts as to the ability of the borrower to comply with present loan repayment terms. Management believes the general allowance was sufficient to cover the risks and probable losses related to such loans at March 31, 2019 and December 31, 2018, respectively.

Non-accrual loans were consistent at $5.4 million at March 31, 2019 and December 31, 2018, respectively. Loans past due 90 days and still accruing interest at March 31, 2019, were $145,000 compared to $162,000 at December 31, 2018. Other real estate and repossessed assets were $13.5 million at March 31, 2019 compared to $13.7 million at December 31, 2018.

During the three months ended March 31, 2019, $116,000 of nonaccrual loans, net of charge-offs taken, moved to other real estate owned and repossessed assets compared to $278,000 during the three months ended March 31, 2018.

The following table summarizes the Company's TDRs at the dates indicated:

	March 31, 2019			December 31, 2018		
(In thousands)	Number of contracts	Recorded Investment	Specific Reserves	Number of contracts	Recorded Investment	Specific Reserves
Performing TDRs						
Commercial, financial and agricultural	8	$ 629	$ 185	6	$ 570	$ 174
Real estate mortgage - residential	9	2,048	77	9	2,073	72
Real estate mortgage - commercial	2	373	7	2	377	8
Installment and other consumer	3	42	4	3	44	4
Total performing TDRs	22	$ 3,092	$ 273	20	$ 3,064	$ 258
Non-performing TDRs						
Commercial, financial and agricultural	5	$ 1,023	$ 86	5	$ 1,042	$ 94
Real estate mortgage - residential	5	822	144	5	867	182
Real estate mortgage - commercial	—	—	—	—	—	—
Installment and other consumer	2	72	9	2	72	9
Total non-performing TDRs	12	$ 1,917	$ 239	12	$ 1,981	$ 285
Total TDRs	34	$ 5,009	$ 512	32	$ 5,045	$ 543

At March 31, 2019, loans classified as TDRs totaled $5.0 million, with $512,000 of specific reserves, of which $1.9 million were classified as non-performing TDRs and $3.1 million were classified as performing TDRs. This compared to $5.0 million of loans classified as TDRs, with $543,000 of specific reserves, of which $2.0 million were classified as non-performing TDRs and $3.0 million were classified as performing TDRs at December 31, 2018. Both performing and nonperforming TDRs are considered impaired loans. When an individual loan is determined to be a TDR, the amount of impairment is based upon the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral less applicable selling costs if the loan is collateral dependent. The net decrease in total TDRs from December 31, 2018 to March 31, 2019 was primarily due to $117,000 of payments received on TDRs, partially offset by two new TDRs totaling $80,000.

Allowance for Loan Losses and Provision

Allowance for Loan Losses

The following table is a summary of the allocation of the allowance for loan losses:

(In thousands)	March 31, 2019	December 31, 2018
Allocation of allowance for loan losses at end of period:		
Commercial, financial, and agricultural	$ 3,232	$ 3,237
Real estate construction - residential	74	140
Real estate construction - commercial	638	757
Real estate mortgage - residential	1,890	2,071
Real estate mortgage - commercial	5,523	4,914
Installment and other consumer	333	334
Unallocated	155	199
Total	$ 11,845	$ 11,652

The allowance for loan losses (ALL) was $11.8 million, or 1.03%, of loans outstanding at March 31, 2019 compared to $11.7 million, or 1.02%, at December 31, 2018, and $10.9 million, or 1.01%, of loans outstanding at March 31, 2018. The

ratio of the allowance for loan losses to nonperforming loans was 212.43% at March 31, 2019, compared to 208.97% at December 31, 2018, and 198.32% at March 31, 2018.

The following table is a summary of the general and specific allocations of the allowance for loan losses:

(In thousands)	March 31, 2019	December 31, 2018
Allocation of allowance for loan losses:		
Individually evaluated for impairment - specific reserves	$ 1,039	$ 1,194
Collectively evaluated for impairment - general reserves	10,806	10,458
Total	$ 11,845	$ 11,652

The *specific reserve component* applies to loans evaluated individually for impairment. The net carrying value of impaired loans is generally based on the fair values of collateral obtained through independent appraisals and/or internal evaluations, or by discounting the total expected future cash flows. Once the impairment amount is calculated, a specific reserve allocation is recorded. At March 31, 2019, $1.0 million of the Company's ALL was allocated to impaired loans totaling approximately $8.5 million compared to $1.2 million of the Company's ALL allocated to impaired loans totaling approximately $8.5 million at December 31, 2018. Management determined that $2.3 million, or 27%, of total impaired loans required no reserve allocation at March 31, 2019 compared to $2.1 million, or 25%, at December 31, 2018, primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

The *incurred loss component* of the general reserve, or loans collectively evaluated for impairment, is determined by applying loss rates to pools of loans by asset type. Loans not individually evaluated are aggregated by risk characteristics and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type. In the first quarter 2019, management adjusted the look-back period to begin with loss history in the first quarter 2012 as the starting point through the current quarter and it will continue to include this starting point going forward. Management determined that with the extended current economic recovery, the look-back period should be expanded to include the current economic cycle. This increasing look-back period will then be adjusted once a loss producing downturn is recognized by allowing the look-back period to shift forward by eliminating the earliest loss period and replenishing it with losses from the most recent period. Prior to 2019, the Company utilized a five-year look-back period, which was considered a representative historical loss period. The look-back period is consistently evaluated for relevance given the current facts and circumstances.

These historical loss rates for each risk group are used as the starting point to determine loss rates for measurement purposes. The historical loan loss rates are multiplied by loss emergence periods (LEP) which represent the estimated time period between a borrower first experiencing financial difficulty and the recognition of a loss.

The Company's methodology includes qualitative risk factors that allow management to adjust its estimates of losses based on the most recent information available and to address other limitations in the quantitative component that is based on historical loss rates. Such risk factors are generally reviewed and updated quarterly, as appropriate, and are adjusted to reflect changes in national and local economic conditions and developments, the nature, volume and terms of loans in the portfolio, including changes in volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans, loan concentrations, assessment of trends in collateral values, assessment of changes in the quality of the Company's internal loan review department, and changes in lending policies and procedures, including underwriting standards and collections, charge-off and recovery practices.

The specific and general reserve allocations represent management's best estimate of probable losses inherent in the loan portfolio at the evaluation date. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses.

The more significant changes from December 31, 2018 to March 31, 2019 in the allocations of the allowance for loan losses to the loan portfolios listed above included the following:

Real estate mortgage – commercial increased by $609,000 primarily due to higher historical loss rates resulting from extending the look-back period back to the first quarter 2012. Real estate mortgage – residential decreased by $181,000 primarily due to a reduction in the qualitative risk factors associated with this portfolio. Real estate construction – commercial decreased by $119,000 primarily due to a reduction in the qualitative risk factors associated with this portfolio. Real estate construction – residential decreased by $66,000 primarily due to a reduction in the qualitative risk factors associated with this portfolio.

Provision

A $150,000 provision was required for the three months ended March 31, 2019 compared to a $300,000 provision for the three months ended March 31, 2018. The decrease from the prior quarter was primarily due to improved credit quality and economic conditions used in assessing the risk in the portfolio.

The following table summarizes loan loss experience for the periods indicated:

	Three Months Ended March 31,	
(In thousands)	**2019**	**2018**
Analysis of allowance for loan losses:		
Balance beginning of period	$ 11,652	$ 10,852
Charge-offs:		
Commercial, financial, and agricultural	53	110
Real estate construction - residential	—	48
Real estate construction - commercial	—	30
Real estate mortgage - residential	84	20
Real estate mortgage - commercial	8	14
Installment and other consumer	52	57
Total charge-offs	197	279
Recoveries:		
Commercial, financial, and agricultural	$ 108	$ 13
Real estate construction - residential	—	12
Real estate mortgage - residential	99	19
Real estate mortgage - commercial	—	6
Installment and other consumer	33	24
Total recoveries	240	74
Net (recoveries) charge-offs	**(43)**	**205**
Provision for loan losses	150	300
Balance end of period	$ 11,845	$ 10,947

Net Loan (Recoveries) Charge-offs

The Company’s net loan recoveries were ($43,000), or (0.00%), of average loans for the three months ended March 31, 2019 compared to net charge-offs of $205,000, or 0.02%, of average loans for the three months ended March 31, 2018. The decrease in charge-offs for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 primarily related to one commercial loan relationship charge-off during the first quarter of 2018 partially offset by one commercial loan relationship recovery and one real estate mortgage – residential recovery during the first quarter of 2019.

Liquidity and Capital Resources

Liquidity Management

The role of liquidity management is to ensure funds are available to meet depositors' withdrawal and borrowers' credit demands while at the same time maximizing profitability. This is accomplished by balancing changes in demand for funds with changes in the supply of those funds. Liquidity to meet the demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from external sources, principally depositors. Due to the nature of services offered by the Company, management prefers to focus on transaction accounts and full service relationships with customers.

The Company's Asset/Liability Committee (ALCO), primarily made up of senior management, has direct oversight responsibility for the Company's liquidity position and profile. A combination of daily, weekly, and monthly reports provided to management detail the following: internal liquidity metrics, composition and level of the liquid asset portfolio, timing differences in short-term cash flow obligations, available pricing and market access to the financial markets for capital, and exposure to contingent draws on the Company's liquidity.

The Company has a number of sources of funds to meet liquidity needs on a daily basis. The Company's most liquid assets are comprised of available for sale investment securities, not including other debt securities, federal funds sold, and excess reserves held at the Federal Reserve.

(In thousands)	March 31, 2019	December 31, 2018
Federal funds sold and other overnight interest-bearing deposits	$ 75,035	$ 18,396
Certificates of deposit in other banks	12,741	12,247
Available-for-sale investment securities	218,539	218,205
Total	$ 306,315	$ 248,848

Federal funds sold and resale agreements normally have overnight maturities and are used for general daily liquidity purposes. The fair value of the available-for-sale investment portfolio was $218.5 million at March 31, 2019 and included an unrealized net loss of $2.6 million. The portfolio includes projected maturities and mortgage backed securities pay-downs of approximately $22.1 million over the next twelve months, which offer resources to meet either new loan demand or reductions in the Company's deposit base.

The Company pledges portions of its investment securities portfolio to secure public fund deposits, federal funds purchase lines, securities sold under agreements to repurchase, borrowing capacity at the Federal Reserve Bank, and for other purposes required by law. At March 31, 2019 and December 31, 2018, the Company's unpledged securities in the available for sale portfolio totaled approximately $42.6 million and $65.2 million, respectively.

Total investment securities pledged for these purposes were as follows:

(In thousands)	March 31, 2019	December 31, 2018
Investment securities pledged for the purpose of securing:		
Federal Reserve Bank borrowings	$ 9,169	$ 9,397
Federal funds purchased and securities sold under agreements to repurchase	33,651	32,529
Other deposits	133,146	111,090
Total pledged, at fair value	$ 175,966	$ 153,016

Liquidity is available from the Company's base of core customer deposits, defined as demand, interest checking, savings, money market deposit accounts, and time deposits less than $250,000, less all brokered deposits under $250,000. At March 31, 2019, such deposits totaled $1.1 billion and represented 86.5% of the Company's total deposits. These core deposits are normally less volatile and are often tied to other products of the Company through long lasting relationships.

Core deposits at March 31, 2019 and December 31, 2018 were as follows:

(In thousands)	March 31, 2019	December 31, 2018
Core deposit base:		
Non-interest bearing demand	$ 264,218	$ 262,857
Interest checking	245,211	215,432
Savings and money market	360,051	378,484
Other time deposits	211,768	211,715
Total	$ 1,081,248	$ 1,068,488

Time deposits and certificates of deposit of $250,000 and greater at March 31, 2019 and December 31, 2018 were $140.9 million and $104.9 million, respectively. The Company had brokered deposits totaling $40.0 million and $39.8 million at March 31, 2019 and December 31, 2018, respectively.

Other components of liquidity are the level of borrowings from third party sources and the availability of future credit. The Company's outside borrowings are comprised of securities sold under agreements to repurchase, Federal Home Loan Bank advances, and subordinated notes. Federal funds purchased are overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved credit lines. As of March 31, 2019, under agreements with these unaffiliated banks, the Bank may borrow up to $50.0 million in federal funds on an unsecured basis and $16.6 million on a secured basis. There were no federal funds purchased outstanding at March 31, 2019. Securities sold under agreements to repurchase are generally borrowed overnight and are secured by a portion of the Company's investment portfolio. At March 31, 2019, there were $22.1 million in repurchase agreements. The Company may periodically borrow additional short-term funds from the Federal Reserve Bank through the discount window; although no such borrowings were outstanding at March 31, 2019.

The Bank is a member of the Federal Home Loan Bank of Des Moines (FHLB). As a member of the FHLB, the Bank has access to credit products of the FHLB. As of March 31, 2019, the Bank had $95.1 million in outstanding borrowings with the FHLB. In addition, the Company has $49.5 million in outstanding subordinated notes issued to wholly-owned grantor trusts, funded by preferred securities issued by the trusts.

Borrowings outstanding at March 31, 2019 and December 31, 2018 were as follows:

(In thousands)	March 31, 2019	December 31, 2018
Borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	$ 22,097	$ 24,647
Federal Home Loan Bank advances	95,069	95,126
Subordinated notes	49,486	49,486
Other borrowings	27	27
Total	$ 166,679	$ 169,286

The Company pledges certain assets, including loans and investment securities to the Federal Reserve Bank, FHLB, and other correspondent banks as security to establish lines of credit and borrow from these entities. Based on the type and value of collateral pledged, the FHLB establishes a collateral value from which the Company may draw advances against this collateral. This collateral is also used to enable the FHLB to issue letters of credit in favor of public fund depositors of the Company. The Federal Reserve Bank also establishes a collateral value of assets pledged to support borrowings from the discount window. The following table reflects collateral value of assets pledged, borrowings, and letters of credit outstanding, in addition to the estimated future funding capacity available to the Company as follows:

	March 31, 2019				December 31, 2018			
(In thousands)	FHLB	Federal Reserve Bank	Federal Funds Purchased Lines	Total	FHLB	Federal Reserve Bank	Federal Funds Purchased Lines	Total
Advance equivalent	$ 293,849	$ 9,451	$ 57,148	$ 360,448	$ 301,606	$ 9,160	$ 57,235	$ 368,001
Letters of credit	(109,000)	—	—	(109,000)	(80,000)	—	—	(80,000)
Advances outstanding	(95,069)	—	—	(95,069)	(95,126)	—	(8,000)	(103,126)
Total available	$ 89,780	$ 9,451	$ 57,148	$ 156,379	$ 126,480	$ 9,160	$ 49,235	$ 184,875

At March 31, 2019, loans of $159.3 million were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit. At March 31, 2019, investments and certificates of deposits in other banks totaling $19.0 million were pledged to secure federal funds purchase lines and borrowing capacity at the Federal Reserve Bank.

Sources and Uses of Funds

Cash and cash equivalents were $90.7 million at March 31, 2019 compared to $42.1 million at December 31, 2018. The $48.6 million increase resulted from changes in the various cash flows produced by operating, investing, and financing activities of the Company, as shown in the accompanying consolidated statement of cash flows for the three months ended March 31, 2019. Cash flow provided from operating activities consists mainly of net income adjusted for certain non-cash items. Operating activities provided cash flow of $3.7 million for the three months ended March 31, 2019.

Investing activities consisting mainly of purchases, sales and maturities of available-for-sale securities, and changes in the level of the loan portfolio used total cash of $14.5 million. The cash outflow primarily consisted of $7.7 million increase in loans and $12.8 million purchases of investment securities, partially offset by $13.9 million from maturities and calls of investment securities.

Financing activities provided cash of $59.5 million, resulting primarily from a $9.7 increase in demand deposits, a $12.0 million increase in interest bearing transaction accounts, and a $40.9 million increase in time deposits. Future short-term liquidity needs arising from daily operations are not expected to vary significantly during 2019.

In the normal course of business, the Company enters into certain forms of off-balance sheet transactions, including unfunded loan commitments and letters of credit. These transactions are managed through the Company's various risk management processes. Management considers both on-balance sheet and off-balance sheet transactions in its evaluation of the Company's liquidity. The Company had $371.3 million in unused loan commitments and standby letters of credit as of March 31, 2019. Although the Company's current liquidity resources are adequate to fund this commitment level the nature of these commitments is such that the likelihood of such a funding demand is very low.

The Company is a legal entity, separate and distinct from the Bank, which must provide its own liquidity to meet its operating needs. The Company's ongoing liquidity needs primarily include funding its operating expenses and paying cash dividends to its shareholders. The Company paid cash dividends to its shareholders totaling approximately $603,000 and $406,000 for the three months ended March 31, 2019 and 2018, respectively. A large portion of the Company's liquidity is obtained from the Bank in the form of dividends. The Bank declared and paid $1.5 million and $1.0 million in dividends to the Company during the three months ended March 31, 2019 and 2018, respectively. At March 31, 2019 and December 31, 2018, the Company had cash and cash equivalents totaling $1.3 million and $1.3 million, respectively.

Capital Management

The Company and the Bank are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification of the Company and the Bank are subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for the Company began on January 1, 2015. The Federal Reserve System's (FRB) capital adequacy guidelines require that bank holding companies maintain a Common Equity Tier 1 risk-based capital ratio equal to at least 4.5% of its risk-weighted assets, a Tier 1 risk-based capital ratio equal to at least 6% of its risk-weighted assets and a total risk-based capital ratio equal to at least 8% of its risk-weighted assets. In addition, bank holding companies generally are required to maintain a Tier 1 leverage ratio of at least 4%.

In addition, the final rules establish a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement will be phased in over four years beginning in 2016. The capital conservation buffer was phased in from 0.625% of risk-weighted assets beginning January 1, 2016 to 2.5% of risk weighted-assets by January 1, 2019. The capital conservation buffer requirement effectively raises the minimum required risk-based capital ratios to 7% Common Equity Tier 1 Capital, 8.5% Tier 1 Capital and 10.5% Total Capital on a fully phased-in basis. Under the Basel III requirements, at March 31, 2019 and December 31, 2018, the Company met all capital adequacy requirements and had regulatory capital ratios in excess of the levels established for well-capitalized institutions, as shown in the following table as of periods indicated:

	Actual		Required for Capital Adequacy Purposes		Well-Capitalized Standard		Minimum Capital Requirement	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2019								
Total Capital (to risk-weighted assets):								
Company	$169,581	13.39 %	$101,349	8.00 %	$ N.A.	N.A %	$ N.A.	N.A %
Bank	167,965	13.29	101,105	8.00	126,381	10.00	132,700	10.50
Tier 1 Capital (to risk-weighted assets):								
Company	$144,533	11.41 %	$ 76,012	6.00 %	$ N.A.	N.A %	$ N.A.	N.A %
Bank	155,960	12.34	75,829	6.00	101,105	8.00	107,424	8.50
Common Equity Tier 1 Capital (to risk-weighted assets)								
Company	$109,576	8.65 %	$ 57,009	4.50 %	$ N.A.	N.A %	$ N.A.	N.A %
Bank	155,960	12.34	56,871	4.50	82,148	6.50	88,467	7.00
Tier 1 Capital (to adjusted average assets):								
Company	$144,533	9.38 %	$ 61,667	4.00 %	$ N.A.	N.A %	$ N.A.	N.A %
Bank	155,960	10.16	61,394	4.00	76,742	5.00	61,394	4.00
(in thousands)								
December 31, 2018								
Total Capital (to risk-weighted assets):								
Company	$165,325	13.28 %	$ 99,578	8.00 %	$ N.A.	N.A. %	$ N.A.	N.A %
Bank	163,814	13.19	99,327	8.00	124,159	10.00	130,367	10.50
Tier 1 Capital (to risk-weighted assets):								
Company	$139,532	11.21 %	$ 74,683	6.00 %	$ N.A.	N.A. %	$ N.A.	N.A %
Bank	152,002	12.24	74,495	6.00	99,327	8.00	105,535	8.50
Common Equity Tier 1 Capital (to risk-weighted assets)								
Company	$105,513	8.48 %	$ 56,013	4.50 %	$ N.A.	N.A. %	$ N.A.	N.A %
Bank	152,002	12.24	55,872	4.50	80,703	6.50	86,911	7.00
Tier 1 leverage ratio:								
Company	$139,532	9.55 %	$ 58,467	4.00 %	$ N.A.	N.A. %	$ N.A.	N.A %
Bank	152,002	10.43	58,272	4.00	72,839	5.00	58,272	4.00

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Asset/Liability and Interest Rate Risk

Management and the Board of Directors are responsible for managing interest rate risk and employing risk management policies that monitor and limit this exposure. Interest rate risk is measured using net interest income simulations and market value of portfolio equity analyses. These analyses use various assumptions, including the nature and timing of interest rate changes, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment/replacement of asset and liability cash flows.

The principal objective of the Company's asset and liability management function is to evaluate the interest rate risk within the balance sheet and pursue a controlled assumption of interest rate risk while maximizing earnings and preserving

adequate levels of liquidity and capital. The asset and liability management function is under the guidance of the Asset Liability Committee from direction of the Board of Directors. The Asset Liability Committee meets monthly to review, among other things, the sensitivity of the Company's assets and liabilities to interest rate changes, local and national market conditions and rates. The Asset Liability Committee also reviews the liquidity, capital, deposit mix, loan mix and investment positions of the Company.

Instantaneous parallel rate shift scenarios are modeled and utilized to evaluate risk and establish exposure limits for acceptable changes in net interest margin. These scenarios, known as rate shocks, simulate an instantaneous change in interest rates and use various assumptions, including, but not limited to, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment and replacement of asset and liability cash flows.

Management analyzes the economic value of equity as a secondary measure of interest rate risk. This is a complementary measure to net interest income where the calculated value is the result of the market value of assets less the market value of liabilities. The economic value of equity is a longer term view of interest rate risk because it measures the present value of the future cash flows. The impact of changes in interest rates on this calculation is analyzed for the risk to our future earnings and is used in conjunction with the analyses on net interest income.

The table below illustrates the impact of an immediate and sustained 200 and 100 basis point increase and a 200 and 100 basis point decrease in interest rates on net interest income based on the interest rate risk model at March 31, 2019 and December 31, 2018.

	% Change in projected net interest income	
Hypothetical shift in interest rates ***(bps)***	**March 31, 2019**	**December 31, 2018**
200	2.93 %	0.26 %
100	2.90 %	1.17 %
(100)	2.76 %	3.39 %
(200)	2.13 %	4.19 %

The change in our interest rate risk exposure from December 31, 2018 to March 31, 2019 was primarily due to the Company's balance sheet becoming more asset sensitive leading to higher changes in net interest income in a rising rate environment. Conversely, the increased asset sensitivity also led to a lower change in net interest income in a falling rate environment. However, since the change in net interest income in all four of the rate scenarios is relatively the same it indicates that the balance sheet was well balanced between rate sensitive assets and rate sensitive liabilities at March 31, 2019.

Many assumptions are used to calculate the impact of interest rate fluctuations. Actual results may be significantly different than our projections due to several factors, including the timing and frequency of rate changes, market conditions and the shape of the yield curve. The computations of interest rate risk shown above do not include actions that management may undertake to manage the risks in response to anticipated changes in interest rates and actual results may also differ due to any actions taken in response to the changing rates.

Effects of Inflation

The effects of inflation on financial institutions are different from the effects on other commercial enterprises since financial institutions make few significant capital or inventory expenditures, which are directly affected by changing prices. Because bank assets and liabilities are virtually all monetary in nature, inflation does not affect a financial institution as much as do changes in interest rates. The general level of inflation does underlie the general level of most interest rates, but interest rates do not increase at the rate of inflation as do prices of goods and services. Rather, interest rates react more to changes in the expected rate of inflation and to changes in monetary and fiscal policy.

Inflation does have an impact on the growth of total assets in the banking industry, often resulting in a need to increase capital at higher than normal rates to maintain an appropriate capital to asset ratio. In the opinion of management, inflation did not have a significant effect on the Company's operations for the three months ended March 31, 2019.

Item 4. Controls and Procedures

Our Company's management has evaluated, with the participation of our principal executive and principal financial officers, the effectiveness of our disclosure controls and procedures as defined in Rules 13a – 15(e) or 15d – 15(e) of the Securities Exchange Act of 1934 as of March 31, 2019. Based upon and as of the date of that evaluation, our principal executive and principal financial officers concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as and when required. It should be noted that any system of disclosure controls and procedures, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any system of disclosure controls and procedures is based in part upon assumptions about the likelihood of future events. Because of these and other inherent limitations of any such system, there can be no assurance that any design will always succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

There has been no change in our Company's internal control over financial reporting that occurred during the three months ended March 31, 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Impact of New Accounting Standards

Intangibles In August 2018, the FASB issued ASU 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software (Topic 350-40) Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.* This ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). ASU 2018-15 is effective for annual reporting periods beginning after December 15, 2019 and is not expected to have a significant impact on the Company's consolidated financial statements.

Pension In August 2018, the FASB issued ASU 2018-14, *Compensation - Retirement Benefits - Defined Benefit Plans -General (Subtopic 715-20) Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans.* These amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. ASU 2018-14 is effective for annual reporting periods beginning after December 15, 2020 and is not expected to have a significant impact on the Company's consolidated financial statements.

Fair Value Measurement In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820) - Changes to the Disclosure Requirements for Fair Value Measurement.* ASU 2018-13 removes the requirement to disclose the amount of and reasons for transfers between Level 1 and Level 2 fair value measurement methodologies, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements. It also adds a requirement to disclose changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 measurements. For certain unobservable inputs, entities may disclose other quantitative information in lieu of the weighted average if the other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently evaluating the impact of the adoption on the Company's consolidated financial statements and disclosures.

Financial Instruments In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (CECL). The revised accounting guidance will remove all

recognition thresholds and will require a company to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. It also amends the credit loss measurement guidance for available-for-sale debt securities and beneficial interests in securitized financial assets. This new accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2019. While the Company generally expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, the Company has not determined the magnitude of any such one-time adjustment or the overall impact of the new guidance on the Company's consolidated financial statements. The Company has formed a committee and is continuing to evaluate the impact of the ASU's adoption on the Company's consolidated financial statements. Beginning in the first quarter of 2019, the Company began running parallel credit risk models to continue evaluating the results.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The information required by this Item is set forth in *Commitments and Contingencies, Pending Litigation,* in our Company's Notes to Consolidated Financial Statements (*unaudited)* .

Item 1A.	Risk Factors	None
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	None
Item 3.	Defaults Upon Senior Securities	None
Item 4.	Mine Safety Disclosures	None
Item 5.	Other Information	None

Item 6. Exhibits

Exhibit No.	Description
3.1	Restated Articles of Incorporation of the Company (filed as Exhibit 3.1 to the Company's current report on Form 8-K on August 9, 2007 and incorporated herein by reference).
3.2	Amended and Restated Bylaws of the Company (filed as Exhibit 3.1 to the Company's current report on Form 8-K on June 8, 2009 and incorporated herein by reference).
4.1	Specimen certificate representing shares of the Company's $1.00 par value Common Stock (filed as Exhibit 4.1 to the Company's current report on Form 8-K/A on June 23, 2017 and incorporated herein by reference).
31.1	Certificate of the Chief Executive Officer of the Company pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of the Chief Financial Officer of the Company pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of the Chief Executive Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certificate of the Chief Financial Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Changes in Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text and in detail (XBRL).

HAWTHORN BANCSHARES, INC.

INDEX TO EXHIBITS
March 31, 2019 Form 10-Q

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* This information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	HAWTHORN BANCSHARES, INC.
Date	
	/s/ David T. Turner
May 10, 2019	David T. Turner, Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
	/s/ W. Bruce Phelps
May 10, 2019	W. Bruce Phelps, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

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Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

CERTIFICATIONS

I, David T. Turner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Hawthorn Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2019

/s/ David T. Turner
David T. Turner
Chairman of the Board and Chief Executive Officer

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Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

CERTIFICATIONS

I, W. Bruce Phelps, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Hawthorn Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2019

/s/ W. Bruce Phelps
W. Bruce Phelps
Chief Financial Officer

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Section 4: EX-32.1 (EX-32.1)

Exhibit 32.1

Certification of Chief Executive Officer

In connection with the Quarterly Report of Hawthorn Bancshares, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2019 as filed with the Securities and Exchange Commission (the "Report"), I, David T. Turner, Chairman of the Board and Chief Executive Officer of our Company, hereby certify in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(a) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(b) The information contained in the Report fairly presents, in all material aspects, the financial condition and results of operations of the Company.

Dated: May 10, 2019

/s/ David T. Turner
David T. Turner
Chairman of the Board and Chief Executive Officer

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Section 5: EX-32.2 (EX-32.2)

Exhibit 32.2

Certification of Chief Financial Officer

In connection with the Quarterly Report of Hawthorn Bancshares, Inc. (the “Company”) on Form 10-Q for the period ended March 31, 2019 as filed with the Securities and Exchange Commission (the “Report”), I, W. Bruce Phelps, Chief Financial Officer of our Company, hereby certify in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(a) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(b) The information contained in the Report fairly presents, in all material aspects, the financial condition and results of operations of the Company.

Dated: May 10, 2019

/s/ W. Bruce Phelps
W. Bruce Phelps
Chief Financial Officer

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