

2011
ANNUAL REPORT
TO
SHAREHOLDERS

HAWTHORN BANCSHARES, INC.

Lee's Summit, Missouri

A WORD CONCERNING 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 our Company 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 our 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 Hawthorn and its acquisition targets may be greater than expected,
- legislative or regulatory changes may adversely affect the business in which Hawthorn and its subsidiaries are engaged, and
- changes may occur in the securities markets.

We have described under the caption "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011, and in other reports that we file 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 we have not 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.

HAWTHORN BANCSHARES, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Through the branch network of its subsidiary bank, our Company, Hawthorn Bancshares, Inc., provides a broad range of commercial and personal banking services, including certificates of deposit, individual retirement and other time deposit accounts, checking and other demand deposit accounts, interest checking accounts, savings accounts, and money

Overview

Through the branch network of its subsidiary bank, our Company, Hawthorn Bancshares, Inc., provides a broad

SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents selected consolidated financial information for our Company as of and for each of the years in the five-year period ended December 31, 2011. The selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements of our Company, including the related notes, presented elsewhere herein.

Income Statement Data

(In thousands, except per share data)	2011	2010	2009	2008	2007
Interest income	\$ 53,468	\$ 58,739	\$ 63,562	\$ 69,715	\$ 74,207
Interest expense	10,853	15,753	22,974	31,599	37,175
Net interest income	42,615	42,986	40,588	38,116	37,032
Provision for loan losses	11,523	15,255	8,354	8,211	1,154
Net interest income after provision for loan losses	31,092	27,731	32,234	29,905	35,878
Non-interest income	9,200	10,481	10,702	9,294	10,223
Security gains, net	-	-	606	3	(2)
Total non-interest income	9,200	10,481	11,308	9,297	10,221
Non-interest expense	36,844	44,851	36,730	75,975	35,054
Income (loss) before income taxes	3,448	(6,639)	6,812	(36,773)	11,045
Income tax expense (benefit)	591	(3,087)	1,856	(6,146)	3,245
Net income (loss)	2,857	(3,552)	4,956	(30,627)	7,800
Less: preferred stock dividends and accretion of discount on preferred stock	1,513	1,513	1,517	50	-
	476	476	477	16	-
Net income (loss) available to common shareholders	\$ 868	\$ (5,541)	\$ 2,962	\$ (30,693)	\$ 7,800

Dividends on Common Stock

Declared	\$ 913	\$ 1,136	\$ 2,270	\$ 3,486	\$ 3,504
Paid	904	1,385	2,666	3,486	3,504
Ratio of total dividends declared to net income	105.18%	N.M.	76.64%	N.M.	44.92%

Per Share Data

Basic earnings (loss) per common share	\$ 0.19	\$ (1.19)	\$ 0.64	\$ (6.47)	\$ 1.67
Diluted earnings (loss) per common	0.19	(1.19)	0.64	(6.47)	1.65
Basic weighted average shares of common stock outstanding	4,652,994	4,652,994	4,652,994	4,674,645	4,674,645
Diluted weighted average shares of common stock outstanding	4,652,994	4,652,994	4,652,994	4,674,645	4,715,509

N.M. - not meaningful

(In thousands, except per share data)

	2011	2010	2009	2008	2007
Balance Sheet Data (at period end)					
Total assets	\$ 1,171,161	\$ 1,200,172	\$ 1,236,471	\$ 1,279,699	\$ 1,195,804
Loans	842,931	898,472	991,614	1,009,104	911,278
Investment securities	213,806	178,978	152,927	149,401	151,742
Total deposits	958,224	946,663	956,323	955,296	921,257
Subordinated notes	49,486	49,486	49,486	49,486	49,486
Other borrowed money	28,410	66,986	79,317	129,057	77,915
Common stockholders' equity	73,258	72,647	79,406	78,530	111,199
Total stockholders' equity	102,576	101,488	107,771	106,418	111,199
Balance Sheet Data (average balances)					
Total assets	\$ 1,187,410	\$ 1,236,841	\$ 1,258,381	\$ 1,251,496	\$ 1,156,500
Loans	865,214	949,457	1,002,830	963,252	848,771
Investment securities	209,077	165,213	151,907	156,870	171,179
Total deposits	957,965	967,970	977,826	914,218	921,257
Subordinated notes	49,486	49,486	49,486	49,486	49,486
Other borrowed money	42,230	70,456	78,626	124,025	53,626
Common stockholders' equity	75,390	80,735	79,828	112,307	108,052
Total stockholders' equity	104,455	109,323	107,938	113,375	108,052
Key Ratios					
Earnings Ratios					
Return (loss) on average total assets	0.24 %	(0.29) %	0.39 %	(2.45) %	0.67 %
Return (loss) on average common stockholders' equity	1.15	(6.86)	3.71	(27.33)	7.22
Efficiency ratio (3)	71.11	83.89	71.61	160.25	74.18
Asset Quality Ratios					
Allowance for loan losses to loans	1.64	1.62	1.49	1.26	1.02
Nonperforming loans to loans (1)	6.37	6.27	4.27	2.46	0.67

Nonperforming loans to loans (1)	6.37	6.27	4.27	2.46	0.67
Allowance for loan losses to nonperforming loans (1)	25.73	25.87	34.94	50.94	152.54
Nonperforming assets to loans					

CRITICAL ACCOUNTING POLICIES

The following accounting policies are considered most critical to the understanding of our 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 our critical accounting policies on our business operations is discussed throughout “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 to our Company’s consolidated financial statements.

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Allowance for Loan Losses

RESULTS OF OPERATIONS ANALYSIS

Our 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, our 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

Net Interest Income

Net interest income is the largest source of revenue resulting from our 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.

Average Balance Sheets

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 years in the three year period ended December 31, 2011.

(Dollars in thousands)

2011

2010

2009

(Dollars in thousands)

2011

2010

2009

Average
BalanceInterest
Income/
Expense(1)Rate
Earned/
Paid(1)Average
BalanceInterest
Income/
Expense(1)Rate
Earned/
Paid(1)Average
BalanceInterest
Income/
Expense(1)Rate
Earned/
Paid(1)

ASSETS

Loans: (2) (4)

Commercial

\$	127,572	\$	6,952	5.45 %	\$	139,679	\$	7,739	5.54 %	\$	149,695	\$	8,151	5.45 %
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Real estate mortgage - residential	203,587	11,619	5.71	221,545	12,672	5.72	222,798	14,197	6.37
Real estate mortgage - commercial	423,682	22,884	5.40	440,285	25,309	5.75	494,703	26,813	5.42
Consumer	29,828	2,057	6.90	34,787	2,626	7.55	34,456	2,606	7.56
Total Loans	\$ 865,214	\$ 47,471	5.49 %	\$ 949,457	\$ 53,209	5.60 %	\$ 1,002,830	\$ 57,514	5.74 %
Investment in securities: (3)									
U.S. treasury	\$ 1,754	\$ 29	1.65 %	\$ 790	\$ 15	1.90 %	\$ -	\$ -	- %
Government sponsored enterprises	63,089	1,240	1.97	47,914	1,242	2.59	47,958	1,800	3.75
Asset backed securities	111,859	3,551	3.17	83,237	2,918	3.51	64,133	2,617	4.08
State and municipal	32,375	1,573	4.86	33,272	1,764	5.30	39,816	2,166	5.44
Total Investment securities	\$ 209,077	\$ 6,393	3.06 %	\$ 165,213	\$ 5,939	3.59 %	\$ 151,907	\$ 6,583	4.33 %
Restricted investments	5,091	156	3.06	6,356	176	2.77	8,817	164	1.86
Federal funds sold	117	-	-	187	-	-	309	-	-
Interest bearing deposits									
in other financial institutions	22,245	58	0.26	34,680	86	0.25	18,807	53	0.28
Total interest earning assets	\$ 1,101,744	\$ 54,078	4.91 %	\$ 1,155,893	\$ 59,410	5.14 %	\$ 1,182,670	\$ 64,314	5.44 %
All other assets	99,216			94,802			89,108		
Allowance for loan losses	(13,550)			(13,854)			(13,397)		
Total assets	\$ 1,187,410			\$ 1,236,841			\$ 1,258,381		
LIABILITIES AND									
STOCKHOLDERS' EQUITY									
NOW accounts	\$ 175,347	\$ 911	0.52 %	\$ 167,303	\$ 960	0.57 %	\$ 138,456	\$ 1,131	0.82 %
Savings	60,582	125	0.21	52,605	131	0.25	46,464	139	0.30
Money market	152,670	609	0.40	162,040	1,000	0.62	175,894	1,747	0.99

Financial results for 2011 compared to 2010 included a decrease in net interest income, on a tax equivalent basis, of \$432,000, or 1.0%. Average interest-earning assets decreased \$54,149,000, or 4.7% to \$1,101,744,000 at December 31, 2011 compared to \$1,155,893,000 at December 31, 2010 and average interest bearing liabilities decreased \$57,227,000, or 5.8%, to \$931,970,000 at December 31, 2011 compared to \$989,197,000 at December 31, 2010.

Average time deposits decreased \$23,914,000 to \$812,618,000 at December 31, 2011 compared to \$836,532,000 at December 31, 2010. Average borrowings decreased \$33,313,000 to \$119,352,000 at December 31, 2011 compared to \$152,665,000 at December 31, 2010. The decrease in average borrowings primarily reflects a net decrease in Federal Home Loan Bank advances. See the *Liquidity Management* section for further discussion.

Financial results for 2010 compared to 2009 included an increase in net interest income—on a tax equivalent

Financial results for 2010 compared to 2009 included an increase in net interest income, on a tax equivalent

Non-interest Income and Expense

Non-interest income for the years ended December 31, 2011, 2010, and 2009 were as follows:

					<u>\$ Change</u>		<u>% Change</u>	
(Dollars in thousands)	2011	2010	2009	'11-'10	'10-'09	'11-'10	'10-'09	
Non-interest Income								
Service charges on deposit accounts \$	5,566	\$ 5,554	\$ 5,864	\$ 12	\$ (310)	0.2 %	(5.3) %	
Trust department income	898	803	815	95	(12)	11.8	(1.5)	
Gain on sales of mortgage loans	1,649	2,493	2,974	(844)	(481)	(33.9)	(16.2)	
Other	1,087	1,631	1,049	(544)	582	(33.4)	55.5	
Total non-interest income	\$ 9,200	\$ 10,481	\$ 10,702	\$ (1,281)	\$ (221)	(12.2) %	(2.1) %	
Investment securities								
gains (losses), net	\$ -	\$ -	\$ 606	\$ -	\$ (606)	- %	NM %	
Non-interest income as a								
% of total revenue *	17.8 %	19.6 %	20.9 %					
Total revenue per full time								
equivalent employee	\$ 153.8	\$ 157.3	\$ 147.4					

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

Years Ended December 31, 2011 and 2010

Noninterest income decreased \$1,281,000 or 12.2% to \$9,200,000 for 2011 compared to \$10,481,000 for 2010. The decrease was primarily the result of a \$844,000 decrease in the gains on sales of mortgage loans and a \$544,000 decrease in other income. Our Company's loans sold decreased from \$106,547,000 for 2010 to \$74,983,000 for 2011. A decrease in refinancing activity impacted both the volume of loans sold and gains recognized. Our Company was servicing \$307,016,000 of mortgage loans at December 31, 2011 compared to \$298,325,000 at December 31, 2010. The decrease in other noninterest income was primarily due to a \$268,000 refund of prior year's processing fees received in 2010 and a \$139,000 decrease in credit card income. Our Company had no sales of debt securities during 2011 or 2010.

Years Ended December 31, 2010 and 2009

Noninterest income decreased \$221,000 or 2.1% to \$10,481,000 for 2010 compared to \$10,702,000 for 2009. The decrease was primarily the result of a \$481,000 decrease in the gains on sales of mortgage loans and a \$310,000 decrease in service charges on deposit accounts. Although refinancing activity substantially increased during the last half of 2010, our Company experienced more refinancing activity throughout 2009, impacting both volumes of loans sold and gains recognized. Our Company was servicing \$298,325,000 of mortgage loans at December 31, 2010 compared to \$269,475,000 at December 31, 2009. The decrease in noninterest income was partially offset by an increase in other income that included a \$268,000 refund of prior year's processing fees and a \$227,000 increase in credit card income, of which \$167,000 was due to a nonmaterial correction. Our Company recognized \$606,000 in gain on sales and calls of debt securities during 2009. Our Company had no sales of debt securities during 2010.

Non-interest expense for the years ended December 31, 2011, 2010, and 2009 were as follows:

(Dollars in thousands)	2011	2010	2009	\$ Change		% Change	
				'11-'10	'10-'09	'11-'10	'10-'09
Non-interest Expense							
Salaries	\$ 13,760	\$ 13,904	\$ 13,253	\$ (144)	\$ 651	(1.0) %	4.9 %
Employee benefits	4,222	3,995	4,204	227	(209)	5.7	(5.0)
Occupancy expense, net	2,701	2,532	2,335	169	197	6.7	8.4
Furniture and equipment expense	2,019	1,997	2,286	22	(289)	1.1	(12.6)
FDIC insurance assessment	1,107	1,651	2,519	(544)	(868)	(32.9)	(34.5)
Legal, examination, and professional	1,332	1,441	1,222	(109)	219	(7.6)	17.9
Advertising and promotion	1,103	1,256	1,272	(153)	(16)	(12.2)	(1.3)
Postage, printing, and supplies	1,158	1,201	1,168	(43)	33	(3.6)	2.8
Processing expense	3,193	3,353	3,420	(160)	(67)	(4.8)	(2.0)
Other real estate expense	2,736	9,804	1,189	(7,068)	8,615	(72.1)	724.6
Other	3,513	3,717	3,862	(204)	(145)	(5.5)	(3.8)
Total non-interest expense	\$ 36,844	\$ 44,851	\$ 36,730	\$ (8,007)	\$ 8,121	(17.9) %	22.1 %
Efficiency ratio	71.1 %	83.9 %	71.6 %				
Salaries and benefits as a % of total non-interest expense	48.8 %	39.9 %	47.5 %				
Number of full-time equivalent employees	337	340	348				

Years Ended December 31, 2011 and 2010

Noninterest expense decreased \$8,007,000, or 17.9%, to \$36,844,000 for 2011 compared to \$44,851,000 for 2010. The decrease primarily resulted from a \$7,068,000, or 72.1%, decrease in other real estate expense, a \$544,000, or 32.9%, decrease in Federal Deposit Insurance Corporation (FDIC) insurance assessment, and an \$144,000, or 1.0% decrease in salary expense. These decreases were partially offset by a \$227,000, or 5.7%, increase in employee benefits expense. Our Company recorded a \$1,252,000 provision for other real estate owned, included in other real estate expense on foreclosed property for the year ended December 31, 2011 compared to \$6,158,000 for the year ended December 31, 2010. Our Company recognized \$18,000 in losses on sales on foreclosed properties for the year ended December 31, 2011 compared to \$2,071,000 in losses for the year ended December 31, 2010. The decrease in FDIC insurance assessments was due to amendments made by the FDIC effective for the third quarter of 2011 to implement revisions to the Federal Deposit Insurance Act made by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The last six months of 2011 reflect a new assessment base using assets and tier one capital in the assessment calculation. A slight decrease in the number of employees for 2011 compared to 2010 primarily resulted in the decrease in salary expense that was offset by an increase in employee benefits primarily due to an increase in medical insurance premiums.

Years Ended December 31, 2010 and 2009

Noninterest expense increased \$8,121,000, or 22.1%, to \$44,851,000 for 2010 compared to \$36,730,000 for 2009. Other real estate expense increased \$8,615,000, or 724.6%, legal, examination, and professional fees increased \$219,000, or 17.9%, partially offset by a decrease in Federal Deposit Insurance Corporation (FDIC) insurance assessment of \$868,000, or 34.5%. The increase in other real estate expense reflects expenses incurred related to the increase in our Company's foreclosed property for 2010. \$6,158,000 of this expense was incurred for the fourth quarter when our Company recorded a provision to the valuation allowance for other real estate owned based on current appraisals received on two commercial real estate properties. The increase in legal, examination, and professional fees primarily resulted in an increase in accrued expenses representing our Company's estimated obligation in a suit filed against Hawthorn Bank found in favor of the customer. See Note 17 *Commitments and Contingencies* for further explanation in the consolidated financial statements. The decrease in the FDIC insurance assessment is a result of a decrease in the estimated expense accrued for 2010 in comparison to 2009 and an increase in special assessments for 2009.

Fourth Quarter Results for 2011

Comparing fourth quarter 2011 to third quarter 2011:

Our Company's net loss of (\$1,522,000) for the fourth quarter ended December 31, 2011 decreased \$2,540,000, compared to net income of \$1,018,000 for the third quarter ended September 30, 2011. Net interest income decreased to \$10,548,000 from \$10,804,000 over the same period. This decrease was primarily the result of a decrease in average interest earning assets from \$1,092,000 for the third quarter ended September 30, 2011 to \$1,082,000 for the fourth quarter ended December 31, 2011.

The fourth quarter 2011 provision for loan losses of \$5,880,000 was \$3,870,000 higher than third quarter 2011's provision of \$2,010,000 and was based upon management's determination of the loan loss reserve required to cover probable losses in the loan portfolio at year-end.

Noninterest income of \$2,612,000 for fourth quarter 2011 increased \$254,000 from third quarter 2011's noninterest income of \$2,358,000. This increase was primarily a result of gains on sales of mortgages increased \$325,000 to \$756,000 for the fourth quarter of 2011 from \$431,000 in the third quarter of 2011. Our Company's loans sold were \$31,491,000 for three months ended December 31, 2011 compared to \$22,543,000 for the three months ended September 30, 2011.

Noninterest expense of \$9,533,000 for fourth quarter 2011 increased by \$608,000 from third quarter 2011's noninterest expense of \$8,925,000. This increase primarily resulted from a \$647,000 increase in other real estate expenses from \$524,000 for the three months ended September 30, 2011 to \$1,171,000 for the three months ended December 31, 2011. Included in this increase was a \$370,000 increase to the provision for the valuation allowance for other real estate owned. Partially offsetting this increase was a \$277,000 decrease in the FDIC insurance assessment calculated for the fourth quarter of 2011 using the results from the third quarter call report.

Comparing fourth quarter 2011 to fourth quarter 2010:

Our Company's net loss of (\$1,522,000) for the fourth quarter ended December 31, 2011 decreased \$5,230,000, compared to a net loss of (\$6,752,000) for the fourth quarter ended December 31, 2010. Net interest income of \$10,548,000 decreased \$154,000 in the fourth quarter of 2011 compared to the fourth quarter of 2010. This decrease was primarily the result of a decrease in average interest earning assets from \$1,132,000 for the fourth quarter ended December 31, 2010 to \$1,082,000 for the fourth quarter ended December 31, 2011.

The fourth quarter 2011 provision for loan losses of \$5,880,000 was \$2,270,000 less than the fourth quarter 2010 provision of \$8,150,000 and was based upon management's determination of the loan loss reserve required to cover probable losses in the loan portfolio at year-end.

Noninterest income of \$2,612,000 for the fourth quarter 2011 decreased by \$503,000 from noninterest income of \$3,115,000 for the fourth quarter 2010. This decrease was a result of \$756,000 in gains on sales of mortgages for the three months ended December 31, 2011 compared to \$960,000 for the three months ended December 31, 2010. Our Company's loans sold were \$38,001,000 for the three months ended December 31, 2010 compared to \$31,491,000 for three months ended December 31, 2011. The decrease in noninterest income was also a result of our Company receiving a \$268,000 refund of prior year's processing fees during the fourth quarter of 2010.

Noninterest expense of \$9,533,000 for the fourth quarter 2011 decreased \$6,501,000 from the fourth quarter 2010 noninterest expense of \$16,035,000. This decrease primarily resulted from a \$6,158,000 provision to the valuation allowance for other real estate owned based on current appraisals received on two commercial real estate properties for the three months ended December 31, 2010.

Income taxes (benefit)

Income taxes as a percentage of earnings (loss) before income taxes as reported in the consolidated financial statements were 17.2% for 2011, compared to 46.5% for 2010, and 27.3% for 2009. The decrease in the effective tax rate for 2011 in comparison to 2010 was due to the recognition of tax benefits during the fourth quarter of 2011 as a result of the expiration of the statute of limitation on our Company's 2007 state tax return. The increase in the effective tax rate for 2010 in comparison to 2009 is primarily the result of tax exempt income and other tax benefits increasing the overall income tax benefit related to the pre-tax loss. As a result, these calculated tax benefits increase the statutory tax rate in a year where our Company has a pre-tax loss versus a decrease in the statutory tax rate in years with positive pre-tax income. In addition, 2009 tax expense reflects the recognition of tax benefits as a result of the expiration of the statute of limitations on our Company's 2005 state tax return during the fourth quarter of 2009.

Lending and Credit Management

Interest earned on the loan portfolio is a primary source of interest income for our Company. Net loans represented 70.8% of total assets as of December 31, 2011 compared to 73.7% as of December 31, 2010.

Lending activities are conducted pursuant to an established loan policy approved by our Bank's Board of Directors. The Bank's credit review process is comprised of a regional loan committee with an established approval limit. 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 our Company's loan portfolio as of the dates indicated are as follows:

<i>(In thousands)</i>	Balance at December 31,				
	2011	2010	2009	2008	2007
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
Commercial, financial, and agricultural	\$ 128,555	\$ 131,382	\$ 151,399	\$ 153,386	\$ 151,488
Real estate construction - residential	30,201	31,834	38,841	49,623	-
Real estate construction - commercial	47,697	56,053	77,937	80,016	147,432
Real estate mortgage - residential	203,454	207,835	232,332	235,834	210,458
Real estate mortgage - commercial	402,960	439,069	453,975	456,696	365,094
Installment loans to individuals	29,884	32,132	36,966	33,404	36,738
Deferred fees and costs, net	179	167	164	144	68
Total loans	\$ 842,930	\$ 898,472	\$ 991,614	\$ 1,009,103	\$ 911,278

Our Company's loan portfolio decreased \$55,542,000, or 6.2%, from 2010 to 2011, primarily due to repayments, charge-offs and transfers to other real estate owned. Due to reduced loan demand during the year 2011, loan repayments exceeded new originations. This reduction in demand was seen throughout our Company's loan portfolio. Contributing to the decline of our loan portfolio were gross loans charged-off in the amount of \$13,206,000 and \$10,904,000 of assets transferred from loans to other real estate owned and repossessed assets.

Our Company's loan portfolio decreased \$93,142,000, or 9.4% from 2009 to 2010. This decrease was primarily a result of a decrease in commercial loans of \$20,017,000, or 13.2%, a decrease in real estate mortgage – residential loans of \$24,498,000, or 10.5%, a decrease in real estate mortgage – commercial loans of \$14,907,000, or 3.3%, and a decrease in real estate construction – commercial loans of \$21,884,000, or 28.1%. The decrease in commercial loans and real estate mortgage loans primarily reflects the payoff of four large commercial credits and three large real estate mortgage loans. The decrease in individual consumer loans reflects the payoff of one large consumer loan which was secured by a Bank certificate of deposit. Also contributing to the decrease in total loans were gross charge-offs of \$16,190,000 and \$23,677,000 of assets transferred from loans to other real estate owned and repossessed assets.

The contractual maturities of loan categories at December 31, 2011, and the break down of those loans between fixed rate and floating rate loans are as follows:

	Principal Payments Due				Total
	One Year Or Less	Over One Year Through Five Years	Over Five Years		
Commercial, financial, and agricultural	\$ 88,437	\$ 37,383	\$ 2,735	\$	128,555
Real estate construction - residential	20,281	9,920	-		30,201
Real estate construction - commercial	30,284	16,188	1,225		47,697
Real estate mortgage - residential	45,603	97,594	60,257		203,454
Real estate mortgage - commercial	154,448	247,091	1,421		402,960
Installment loans to individuals	13,638	15,864	561		30,063
Total loans net of unearned income	\$ 352,691	\$ 424,040	\$ 66,199	\$	842,930
Loans with fixed rates	291,734	393,268	21,461		706,463
Loans with floating rates	60,957	30,772	44,738		136,467
Total loans net of unearned income	\$ 352,691	\$ 424,040	\$ 66,199	\$	842,930

Our 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 our Company has a non-recourse purchase commitment from the secondary market at a predetermined price. For the year ended December 31, 2011 our Company sold \$74,983,000 loans to investors. At December 31, 2011 our Company was servicing approximately \$307,016,000 of loans sold to the secondary market.

Real estate mortgage loans retained in our Company's portfolio generally include provisions for rate adjustments at one to three year intervals. Commercial loans and real estate construction loans generally have maturities of less than one year. Installment loans to individuals are primarily fixed rate loans with maturities from one to five years.

Management along with the senior loan committee, and internal loan review, formally review all loans in excess of certain dollar amounts (periodically established) at least annually. Currently, loans in excess of \$2,000,000 in aggregate and all adversely classified credits identified by management as containing more than usual risk are reviewed. In addition, loans below the above scope are reviewed on a sample basis. On a monthly basis, the senior loan committee reviews and reports to the Board of Directors 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, *Accounting by Creditors for Impairment of a Loan*, 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 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

Nonperforming Assets

The following table summarizes our Company's nonperforming assets at the dates indicated:

(Dollars in thousands)	Years Ended December 31,				
	2011	2010	2009	2008	2007
Nonaccrual loans:					
Commercial, financial, and agricultural	\$ 2,068	\$ 3,532	\$ 2,067	\$ 2,071	\$ 2,332
Real estate construction - residential	1,147	3,586	2,678	2,775	-
Real estate construction - commercial	7,867	10,067	9,277	7,572	866
Real estate mortgage - residential	4,153	5,672	6,692	4,345	658
Real estate mortgage - commercial	31,000	27,604	13,161	3,505	651
Installment loans to individuals	168	126	279	119	32
Total nonaccrual loans	46,403	50,587	34,154	20,387	4,539
Loans contractually past - due 90 days or more and still accruing:					
Commercial, financial, and agricultural	-	-	2	140	265
Real estate construction - residential	-	-	-	-	-
Real estate construction - commercial	8	-	-	52	158
Real estate mortgage - residential	9	-	-	-	864
Real estate mortgage - commercial	36	-	-	547	189
Installment loans to individuals	1	33	-	4	70
Total loans contractually past -due 90 days or more and still accruing	54	33	2	743	1,546
Troubled debt restructurings - accruing	7,217	5,683	8,191	3,736	-
Total nonperforming loans	53,674	56,303	42,347	24,866	6,085
Other real estate	15,741	13,393	8,452	7,828	2,337
Repossessions	279	616	39	-	-
Total nonperforming assets	\$ 69,694	\$ 70,312	\$ 50,838	\$ 32,694	\$ 8,422

Allowance for loan losses to loans	1.64 %	1.62 %	1.49 %	1.26 %	1.02 %
Nonperforming loans to loans	6.37 %	6.27 %	4.27 %	2.46 %	0.67 %
Allowance for loan losses to nonperforming loans	25.73 %	25.87 %	34.94 %	50.94 %	152.54 %
Nonperforming assets to loans and foreclosed assets	8.11 %	7.71 %	5.08 %	3.21 %	0.92 %

Nonperforming loans, defined as loans on nonaccrual status, loans 90 days or more past due and still accruing, and restructured loans totaled \$53,674,000 or 6.37% of total loans at December 31, 2011 compared to \$56,303,000 or 6.27% of total loans at December 31, 2010.

It is our Company's policy to discontinue the accrual of interest income on loans when management believes that the borrower's financial condition, after consideration of business conditions and collection efforts, is such that the collection of interest is doubtful or upon which principal or interest has been in default for a period of 90 days or more.

probable losses in the loan portfolio. The allowance for loan losses decreased to \$13,809,000 or 1.6% of loans outstanding at December 31, 2011 compared to \$14,565,000 or 1.6% of loans outstanding at December 31, 2010. Charge-offs taken

at December 31, 2011 compared to \$14,565,000 or 1.6% of loans outstanding at December 31, 2010. Charge-offs taken during 2011 and 2010 contributed to the decrease in the allowance for loan losses without being fully offset by gains.

The allowance for loan losses is available to absorb probable loan losses regardless of the category of loans to be charged off. The allowance for loan losses consists of asset-specific reserves, and general reserves based on expected loss estimates and unallocated reserves.

The asset-specific reserve component applies to loans evaluated individually for impairment and is primarily based on management's best estimate of proceeds from liquidating collateral. The majority of our nonperforming loans are secured by real estate collateral. The actual timing and amount of repayments and the ultimate realizable value of the collateral may differ from management's estimate.

The general reserve component is determined by applying percentages to pools of loans by asset type. These

percentages are determined by using historical loss percentages. These expected loss estimates are sensitive to changes in

collateral may differ from management's estimate.

Debt securities classified as held-to-maturity are carried at amortized cost, while debt and equity securities classified as available-for-sale are carried at estimated market value. Unrealized holding gains and losses from available-for-sale securities are excluded from earnings and reported, net of applicable taxes, as a separate component of stockholders' equity until realized.

Our Company does not engage in trading activities and accordingly does not have any debt or equity securities classified as trading securities. Historically our Company's practice had been to purchase and hold debt instruments until maturity unless special circumstances exist. However, since the investment portfolio's major function is to provide liquidity and to balance our Company's interest rate sensitivity position, all debt securities are classified as available-for-sale.

At December 31, 2011, our investment portfolio classified as available-for-sale represented 18.3% of total consolidated assets. Future levels of held-to-maturity and available-for-sale investment securities can be expected to vary depending upon liquidity and interest sensitivity needs as well as other factors.

The following table presents the composition of the investment portfolio by major category for the periods presented:

<i>(In thousands)</i>	December 31,	
	2011	2010
U.S. treasury	\$ 2,054	\$ 1,028
Government sponsored enterprises	70,314	53,342
Asset-backed securities	107,329	90,176
Obligations of states and political subdivisions	34,109	34,432
Total available for sale debt securities	\$ 213,806	\$ 178,978

As of December 31, 2011 the maturity of debt securities in the investment portfolio was as follows:

<i>(In thousands)</i>	One Year Or Less	Over One Through Five Years	Over Five Through Ten Years	Over Ten Years	Total	Weighted Average Yield (1)
U.S. treasury	\$ -	\$ 2,054	\$ -	\$ -	\$ 2,054	1.64 %
Government sponsored enterprises	-	70,314	-	-	70,314	1.67
Asset-backed (2)	7,069	86,686	13,574	-	107,329	3.22
States and political subdivisions (3)	2,452	10,181	19,682	1,794	34,109	4.59
Total available-for-sale debt	\$ 9,521	\$ 169,235	\$ 33,256	\$ 1,794	\$ 213,806	2.89 %
Weighted average yield (1)	3.58 %	2.68 %	3.81 %	4.65 %	2.89 %	

(1) Weighted average yield is based on amortized cost.

(2) Asset-backed securities have been included using historic repayment speeds. Repayment speeds were determined from actual portfolio experience during the twelve months ended December 31, 2011 calculated separately for each mortgage-backed security. These repayment speeds are not necessarily indicative of future repayment speeds and are subject to change based on changing mortgage interest rates.

(3) Rates on obligations of states and political subdivisions have been adjusted to fully taxable equivalent rates using the statutory Federal income tax rate of 34%.

At December 31, 2011 \$131,000 of debt securities classified as available-for-sale in the table above had variable rate provisions with adjustment periods ranging from one week to twelve months.

The following non-marketable securities are restricted securities which, lacking a market, are carried at cost. These securities are reported in other assets. At December 31, 2011, \$2,738,000 of the total included Federal Home Loan Bank (Des Moines) stock held by the Bank in accordance with debt and regulatory requirements. Other non-marketable securities include an \$1,486,000 equity investment in our Company's unconsolidated Exchange Statutory Trusts. (See Note 8 to our Company's consolidated financials for further explanation on the Exchange Statutory Trusts.)

<i>(In thousands)</i>	December 31,	
	2011	2010
Federal Home Loan Bank of Des Moines Stock	\$ 2,738	\$ 4,495
Midwest Independent Bank Stock	151	151
Federal Agricultural Mortgage Corporation	10	10
Investment in unconsolidated trusts	1,486	1,486
Total non-marketable investment securities	\$ 4,385	\$ 6,142

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 our Company, management prefers to focus on transaction accounts and full service relationships with customers. Management believes it has the ability to increase deposits at any time by offering rates slightly higher than the market rate.

Our Company's Asset/Liability Committee (ALCO), primarily made up of senior management, has direct

Liquidity is available from our Company's base of core customer deposits, defined as demand, interest, checking, savings, and money market deposit accounts. At December 31, 2011, such deposits totaled \$543,786,000 and represented 56.7% of our Company's total deposits. These core deposits are normally less volatile and are often tied to other products of our Company through long lasting relationships. Time deposits and certificates of deposit of \$100,000 and over totaled \$414,438,000 at December 31, 2011. These accounts are normally considered more volatile and higher costing representing 43.3% of total deposits at December 31, 2011.

(dollars in thousands)	December 31,	
	2011	2010
Core deposit base:		
Non-interest bearing demand	\$ 159,187	\$ 137,750
Interest checking	169,452	160,225
Savings and money market	215,147	218,912
Total	\$ 543,786	\$ 516,887

Other components of liquidity are the level of borrowings from third party sources and the availability of future credit. Our Company's outside borrowings are comprised of securities sold under agreements to repurchase, FHLB advances, and subordinated notes as follows:

(dollars in thousands)	December 31,	
	2011	2010
Borrowings:		
Securities sold under agreements to repurchase	\$ 24,516	\$ 30,068
FHLB advances	28,410	66,986
Subordinated notes	49,486	49,486
Total	\$ 102,412	\$ 146,540

Federal funds purchased are overnight borrowings obtained mainly from upstream correspondent banks with which our Company maintains approved credit lines. As of December 31, 2011, under agreements with these unaffiliated banks, the Bank may borrow up to \$15,000,000 in federal funds on an unsecured basis and \$19,918,000 on a secured basis. There were no federal funds purchased outstanding at December 31, 2011. Securities sold under agreements to repurchase are generally borrowed overnight and are secured by a portion of our Company's investment portfolio. At December 31, 2011 there was \$24,516,000 in repurchase agreements. Our Company may periodically borrow additional short-term funds from the Federal Reserve Bank through the discount window; although no such borrowings were outstanding at the year end. 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 December 31, 2011, the Bank had \$28,410,000 in outstanding borrowings with the FHLB. In addition, our Company has \$49,486,000 in outstanding subordinated notes issued to wholly-owned grantor trusts, funded by preferred securities issued by the trusts.

Our 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

Sources and Uses of Funds

As loan demand has declined and overnight borrowing rates remain at historic lows, management has expanded our investment portfolio to keep excess cash minimized. A deposit reclassification program was implemented in January of 2011 that lowered the Federal Reserve account requirement, improving liquidity, and enabling our Company to lower cash balances maintained at the Federal Reserve and invest in higher yielding investment securities.

Cash and cash equivalents were \$43,210,000 at December 31, 2011 compared to \$50,980,000 at December 31, 2010. The \$7,770,000 decrease resulted from changes in the various cash flows produced by operating, investing, and financing activities of our Company, as shown in the accompanying consolidated statement of cash flows for the year ended December 31, 2011. Cash flow provided from operating activities consists mainly of net income adjusted for certain non-cash items. Operating activities provided cash flow of \$20,832,000 for the year ended 2011.

certain non-cash items. Operating activities provided cash flow of \$20,832,000 for the year ended 2011.

Investing activities consisting mainly of purchases, sales and maturities of available for sale securities, and changes in the level of the loan portfolio, provided cash flow of \$6,281,000. The cash inflow primarily consisted of

securities, and \$7,435,000 in proceeds from sales of other real estate owned and repossessions, partially offset by \$122,871,000 purchases of investment securities and \$3,393,00 purchases of premises and equipment.

Financing activities used total cash of \$34,983,000, resulting primarily from a \$38,576,000 net repayment of

	2011	2010	2009	Well-Capitalized Regulatory Guidelines
Risk-based capital ratios:				
Total capital	18.03 %	17.05 %	16.49 %	10.00 %
Tier I capital	15.16	14.25	14.01	6.00
Leverage ratio	11.52	11.00	11.35	5.00

Commitments, Contractual Obligations, and Off-Balance Sheet Arrangements

The required payments of time deposits and other borrowed money, not including interest, at December 31, 2011 are as follows:

		Payments due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
<i>(Dollars in thousands)</i>	Total				
Time deposits	\$ 414,439	\$ 266,517	\$ 127,939	\$ 19,983	\$ -
Other borrowed money	28,410	8,284	10,126	-	10,000

In the normal course of business, our Company is party to activities that contain credit, market and operational risk that are not reflected in whole or in part in our Company's consolidated financial statements. Such activities include traditional off-balance sheet credit related financial instruments.

Our Company provides customers with off-balance sheet credit support through loan commitments and standby letters of credit. Summarized credit-related financial instruments, including both commitments to extend credit and letters of credit at December 31, 2011 are as follows:

		Amount of Commitment Expiration per Period			
		Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
<i>(Dollars in thousands)</i>	Total				
Unused loan commitments	\$ 117,171	\$ 94,255	\$ 13,932	\$ 2,083	\$ 6,901
Standby letters of credit	2,992	2,693	60	217	22

Since many of the unused commitments are expected to expire or be only partially used, the total amount of

commitments in the preceding table does not necessarily represent future cash requirements.

Quantitative and Qualitative Disclosures About Market Risk

<i>(Dollars in thousands)</i>	Year 1	Year 2	Year 3	Year 4	Year 5	Over 5 years or no stated Maturity	Total
ASSETS							
Interest-bearing deposits	\$ 50,620	\$ 20,502	\$ 60,212	\$ 29,992	\$ 16,779	\$ 26,700	\$ 212,806

Interest-bearing deposits	20,267	-	-	-	-	-	20,267
Other restricted investments	4,385	-	-	-	-	-	4,385
Federal funds sold and securities purchased under agreements to resell	75	-	-	-	-	-	75
Loans	439,572	172,399	147,966	22,885	33,362	26,746	842,930
Total	\$ 514,938	\$ 192,992	\$ 208,179	\$ 61,768	\$ 50,140	\$ 53,446	\$ 1,081,463

LIABILITIES

Savings, Now deposits	\$ -	\$ -	\$ 154,807	\$ -	\$ -	\$ -	\$ 154,807
Rewards checking, Super Now, money market deposits	229,792	-	-	-	-	-	229,792
Time deposits	266,517	93,209	34,730	8,811	11,172	-	414,439
Federal funds purchased and securities sold under agreements to repurchase	24,516	-	-	-	-	-	24,516
Subordinated notes	49,486	-	-	-	-	-	49,486
Other borrowed money	18,305	10,105	-	-	-	-	28,410
Total	\$ 588,616	\$ 103,314	\$ 189,537	\$ 8,811	\$ 11,172	\$ -	\$ 901,450

Interest-sensitivity GAP							
Periodic GAP	\$ (73,678)	\$ 89,678	\$ 18,642	\$ 52,957	\$ 38,968	\$ 53,446	\$ 180,013
Cumulative GAP	\$ (73,678)	\$ 16,000	\$ 34,642	\$ 87,599	\$ 126,567	\$ 180,013	\$ 180,013

Ratio of interest-earnings assets to interest-bearing liabilities							
Periodic GAP	0.87	1.87	1.10	7.01	4.49	NM	1.20
Cumulative GAP	0.87	1.02	1.04	1.10	1.14	1.20	1.20

Impact of New Accounting Standards

Other Comprehensive Income In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05, *Presentation of Comprehensive Income*, which revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in ASC 220 and requires entities to report components of comprehensive income in either a continuous statement

fair value measurement guidance ASC 820, *Fair Value Measurement*, and includes several new fair value disclosure requirements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 is not expected to have a material impact on our Company's consolidated financial statements.

Repurchase Agreements In April 2011, the FASB issued ASU 2011-03, *Consideration of Effective Control on Repurchase Agreements*, which deals with the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 changes the rules for determining when these transactions should be accounted for as financings, as opposed to sales. The guidance in ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The adoption of ASU 2011-03 is not expected to have a material impact on our Company's consolidated financial statements.

Troubled Debt Restructurings In April 2011, the FASB issued ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. The provisions of ASU No. 2011-02 provide a creditor additional guidance in determining whether a restructuring constitutes a troubled debt restructuring by concluding that both the following conditions exist (1) a creditor has granted a concession, and (2) the borrower is experiencing financial difficulties. A provision in ASU No. 2011-02 also ends the FASB's deferral of the additional disclosures about troubled debt restructurings as required by ASU No. 2010-20. The provisions of ASU No. 2011-02 were adopted for our Company's reporting period ending September 30, 2011 and required retrospective application to all restructurings occurring during 2011 along with additional required disclosures. Under the guidance for identifying TDR's provided in the ASU, our Company identified 10 additional loans as a result of the adoption. See Note 2 for further discussion.

Credit Quality of Financing Receivables and the Allowance for Credit Losses In July 2010, the FASB issued ASU No. 2010-20 – *Receivables (ASC Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. This ASU requires expanded credit risk disclosures intended to provide investors with greater transparency regarding the allowance for credit losses and the credit quality of financing receivables. Under this ASU, companies are required to provide more information about the credit quality of their financing receivables in the disclosures to financial statements, such as aging information, credit quality indicators, changes in the allowance for credit losses, and the nature and extent of troubled debt restructurings and their effect on the allowance for credit losses. Both new and existing disclosures must be disaggregated by portfolio segment or class based on the level of disaggregation that management uses when assessing its allowance for credit losses and managing its credit exposure. The disclosures as of the end of a reporting period are effective for annual periods ending on or after December 15, 2010. The disclosures about activities that occur during a reporting period are effective for annual reporting periods beginning on or after December 15, 2010. The disclosures required by this update are reported in the notes to our Company's consolidated financial statements.

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 our Company's operations for the three years ended December 31, 2011.

CONSOLIDATED FINANCIAL STATEMENTS

The following consolidated financial statements of our Company and report of our Company's independent auditors appear on the pages indicated.

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Consolidated Statements of Operations for each of the years ended December 31, 2011, 2010 and 2009.	33
Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for each of the years ended December 31, 2011, 2010 and 2009.	34
Consolidated Statements of Cash Flows for each of the years ended December 31, 2011, 2010 and 2009.	35-36
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KPMG LLP
Suite 900
10 South Broadway
St. Louis, MO 63102-1761

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Hawthorn Bancshares, Inc.:

We have audited the accompanying consolidated balance sheets of Hawthorn Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight

Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hawthorn Bancshares, Inc. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31,	
	2011	2010
ASSETS		
Loans	\$ 842,930,548	\$ 898,472,463
Allowances for loan losses	(13,809,224)	(14,564,867)
Net loans	829,121,324	883,907,596
Investment in available-for-sale securities at fair value	213,806,001	178,977,550

Federal funds sold and securities purchased under agreements to resell	75,000	125,815
Cash and due from banks	43,134,530	50,853,985
Premises and equipment - net	37,953,372	36,980,503
Other real estate owned and repossessed assets - net	16,020,023	14,009,017
Accrued interest receivable	5,240,610	5,722,694

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Operations

	Years ended December 31,		
	2011	2010	2009

	Years ended December 31,		
	2011	2010	2009
INTEREST INCOME			
Interest and fees on loans	\$ 47,360,717	\$ 53,088,943	\$ 57,409,274
Interest on debt securities:			
Taxable	4,864,256	4,214,192	4,495,259
Nontaxable	1,029,473	1,173,805	1,441,418

Dividends on other securities	155,937	175,634	163,533
Total interest income	53,468,347	58,738,680	63,562,618
INTEREST EXPENSE			
Interest on deposits:			
Savings, interest checking and money market	1,644,328	2,170,718	3,017,488
Time deposit accounts \$100,000 and over	1,663,147	2,484,929	3,862,075
Other time deposit accounts	5,122,927	7,211,251	10,542,476
Interest on federal funds purchased and securities sold under agreements to repurchase	47,033	75,402	88,573
Interest on subordinated notes	1,301,178	1,525,553	2,446,742
Interest on Federal Home Loan Bank advances	1,074,232	2,284,649	3,016,872
Total interest expense	10,852,845	15,752,502	22,974,226
Net interest income	42,615,502	42,986,178	40,588,392
Provision for loan losses	11,523,338	15,255,000	8,354,000
Net interest income after provision for loan losses	31,092,164	27,731,178	32,234,392
NON-INTEREST INCOME			

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated other Comprehensive Income (Loss)	Treasury Stock	Total Stock - holders' Equity
Balance, December 31, 2008	\$ 27,888,294	\$ 4,298,353	\$ 25,144,323	\$ 51,598,678	\$ 1,005,553	\$ (3,516,818)	\$ 106,418,383
Net income	—	—	—	4,955,757	—	—	4,955,757
Change in unrealized gain (loss) on securities:							
Unrealized loss on debt securities available-for-sale, net of tax	—	—	—	—	(277,903)	—	(277,903)
Adjustment on sales and calls of debt securities, net of tax	—	—	—	—	(369,487)	—	(369,487)
Defined benefit pension plans:							
Net gain arising during the year, net of tax	—	—	—	—	511,634	—	511,634
Amortization of prior service cost included in net periodic pension cost, net of tax	—	—	—	—	42,427	—	42,427
Total other comprehensive loss							(93,329)
Total comprehensive income							4,862,428
Stock based compensation expense	—	—	130,459	—	—	—	130,459
Accretion of preferred stock discount	476,474	—	—	(476,474)	—	—	—
Stock dividend	—	165,460	1,695,963	(1,861,423)	—	—	—
Cash dividends declared, preferred stock	—	—	—	(1,369,879)	—	—	(1,369,879)
Cash dividends declared, common stock	—	—	—	(2,270,108)	—	—	(2,270,108)
Balance, December 31, 2009	\$ 28,364,768	\$ 4,463,813	\$ 26,970,745	\$ 50,576,551	\$ 912,224	\$ (3,516,818)	\$ 107,771,283
Net loss	—	—	—	(3,551,740)	—	—	(3,551,740)
Change in unrealized gain (loss) on securities:							
Unrealized loss on debt securities available-for-sale, net of tax	—	—	—	—	(389,428)	—	(389,428)
Defined benefit pension plans:							
Net gain arising during the year, net of tax	—	—	—	—	171,388	—	171,388
Amortization of prior service cost included in net periodic pension cost, net of tax	—	—	—	—	47,965	—	47,965
Total other comprehensive loss							(170,075)
Total comprehensive loss							(3,721,815)
Stock based compensation expense	—	—	87,310	—	—	—	87,310
Accretion of preferred stock discount	476,474	—	—	(476,474)	—	—	—
Stock dividend	—	172,078	1,870,490	(2,042,568)	—	—	—
Cash dividends declared, preferred stock	—	—	—	(1,512,750)	—	—	(1,512,750)
Cash dividends declared, common stock	—	—	—	(1,135,712)	—	—	(1,135,712)

Accretion of preferred stock discount	476,474	—	—	(476,474)	—	—	—
Stock dividend	—	172,078	1,870,490	(2,042,568)	—	—	—
Cash dividends declared, preferred stock	—	—	—	(1,512,750)	—	—	(1,512,750)
Net income	—	—	—	2,857,270	—	—	2,857,270
Change in unrealized gain on securities:							
Unrealized gain on debt securities available-for-sale, net of tax	—	—	—	—	2,380,142	—	2,380,142
Defined benefit pension plans:							
Net loss arising during the year, net of tax	—	—	—	—	(1,830,335)	—	(1,830,335)
Amortization of prior service cost included in net periodic pension cost, net of tax	—	—	—	—	47,963	—	47,963
Total other comprehensive income							597,770
Total comprehensive income							3,455,040
Stock based compensation expense	—	—	57,874	—	—	—	57,874
Accretion of preferred stock discount	476,474	—	—	(476,474)	—	—	—
Stock dividend	—	178,961	1,279,573	(1,458,534)	—	—	—
Cash dividends declared, preferred stock	—	—	—	(1,512,750)	—	—	(1,512,750)
Cash dividends declared, common stock	—	—	—	(912,702)	—	—	(912,702)

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

	Years ended December 31,		
	2011	2010	2009
Cash flows from operating activities:			
Net income (loss)	\$ 2,857,270	\$ (3,551,740)	\$ 4,955,757
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	11,523,338	15,255,000	8,354,000
Depreciation expense	1,940,319	1,963,842	2,044,257
Net amortization (accretion) of debt securities, premiums, and discounts	836,955	698,420	524,639
Amortization of intangible assets	434,763	526,477	626,111
Stock based compensation expense	57,874	87,310	130,459
(Gain) loss on sales and dispositions of premises and equipment	(12,633)	59,716	137,209
Loss (gain) on sales and dispositions of other real estate owned and repossessions	206,337	2,310,734	(27,158)
Provision for other real estate owned	1,251,466	6,158,433	—
Decrease in accrued interest receivable	393,074	891,873	850,536
Increase in cash surrender value -life insurance	(62,487)	(72,055)	(77,008)
Decrease (increase) in other assets	1,042,111	(124,729)	(4,419,959)
Decrease in accrued interest payable	(437,301)	(946,618)	(1,400,394)

Decrease in accrued interest receivable	393,074	891,873	850,536
Increase in cash surrender value -life insurance	(62,487)	(72,055)	(77,008)

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

	Years ended December 31,		
	2011	2010	2009
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 11,290,146	\$ 16,699,120	\$ 24,383,520
Income taxes	\$ 665,000	\$ 800,000	\$ 1,487,000
Supplemental schedule of noncash investing and financing activities:			
Other real estate and repossessions acquired in settlement of loans	\$ 10,903,813	\$ 23,676,706	\$ 6,982,125

See accompanying notes to consolidated financial statements.

**HAWTHORN BANCSHARES, INC.
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Notes to the Consolidated Financial Statements

December 31, 2011, 2010, and 2009

(1) Summary of Significant Accounting Policies

Hawthorn Bancshares, Inc. (the Company) provides a broad range of banking services to individual and corporate customers located within the communities in and surrounding Jefferson City, Clinton, Warsaw, Springfield, Branson and Lee's Summit, Missouri. 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 consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting (U.S. GAAP) principles and conform to predominant practices within the banking industry. The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions, including the determination of the allowance for loan losses, value of

**HAWTHORN BANCSHARES, INC.
AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

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asset totals. TDR's are measured for impairment loss by using fair values of the underlying collateral obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows.

Impaired Loans

A loan is considered impaired when it is probable the Company will be unable to collect all amounts due, both principal and interest, according to the contractual terms of the loan agreement. Included in impaired loans are all non-accrual loans and loans whose terms have been modified in a troubled debt restructuring. Impaired loans are individually evaluated for impairment based on fair values of the underlying collateral, obtained through independent appraisals or internal valuations for a collateral dependent loan, or by discounting the total expected future cash flows.

Loans Held for Sale

The Bank originates certain loans which are sold in the secondary mortgage market. These long-term, fixed-rate loans are typically classified as held for sale upon origination based upon management's intent to sell. For loans with servicing rights retained, immediately upon locking in an interest rate, the Company enters into an agreement to sell

servicing rights retained, immediately upon locking in an interest rate, the Company enters into an agreement to sell the mortgage loan without recourse. At December 31, 2011 there were no mortgage loans that were held for sale in comparison to \$62,000 at December 31, 2010.

**HAWTHORN BANCSHARES, INC.
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Notes to the Consolidated Financial Statements

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existing conditions), collateral values, specific industry conditions within portfolio segments, bank regulatory examination results, and findings of the internal loan review department.

The underlying assumptions, estimates and assessments used by management to determine these components are continually evaluated and updated to reflect management's current view of overall economic conditions and relevant factors impacting credit quality and inherent losses. Changes in such estimates could significantly impact the allowance and provision for credit losses. The Company could experience credit losses that are different from the current estimates made by management.

Loans, or portions of loans, are charged off to the extent deemed uncollectible. Loan charge-offs reduce the allowance for loan losses, and recoveries of loans previously charged off are added back to the allowance. Once the fair value for a collateral dependent loan has been determined, any impaired amount is typically charged off unless the loan has other income streams to support repayment. For impaired loans which have other income streams to support repayment, a specific reserve is established for the amount determined to be impaired.

Investment in Debt and Equity Securities

At the time of purchase, debt securities are classified into one of two categories: available-for-sale or held-to-maturity. Held-to-maturity securities are those securities which the Company has the positive intent and ability to hold until maturity. All debt securities not classified as held-to-maturity are classified as available-for-sale. The Company's securities are classified as available-for-sale and are carried at fair value. Changes in fair value, excluding certain losses associated with other-than-temporary impairment, are reported in other comprehensive income, net of taxes, a component of stockholders' equity. Securities are periodically evaluated for other-than-temporary impairment in accordance with guidance provided in the FASB ASC Topic 320, *Investments – Debt and Equity Securities*. For those securities with other-than-temporary impairment, the entire loss in fair value is required to be recognized in current earnings if the Company intends to sell the securities or believes it more likely than not that it will be required to sell the security before the anticipated recovery. If neither condition is met, but the Company does not expect to recover the amortized cost basis, the Company determines whether a credit loss has occurred, which is then recognized in current earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

Premiums and discounts are amortized using the interest method over the lives of the respective securities, with consideration of historical and estimated cash flows for securities held as investments or as a direct investment to hold

**HAWTHORN BANCSHARES, INC.
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Notes to the Consolidated Financial Statements

December 31, 2011, 2010, and 2009

Intangible Assets

Intangible assets that have indefinite useful lives are not amortized, but tested annually for impairment. Intangible assets that have finite useful lives, such as core deposit intangibles and mortgage servicing rights, are amortized over their estimated useful lives. Core deposit intangibles are amortized over periods of 7 to 8 years representing their estimated lives using straight line and accelerated methods. Mortgage servicing rights are amortized using straight line over the shorter of 7 years or the life of the loan.

When facts and circumstances indicate potential impairment of amortizable intangible assets, the Company evaluates the recoverability of the carrying value based upon future cash flows expected to result from the use of the underlying asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying value of the underlying asset, the Company recognizes an impairment loss. The impairment loss recognized represents the amount by which the carrying value of the underlying asset exceeds the fair value of the underlying asset.

Other Real Estate Owned and Repossessed Assets

Other real estate owned and repossessed assets consist of loan collateral which 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. Other real estate owned assets are initially recorded as held for sale at the lower of the loan balance or fair value of the collateral less estimated selling costs. Any adjustment is recorded as a charge-off against the allowance for loan losses. The Company relies on external appraisals and assessment of property values by internal staff. In the case of non-real estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgment based on experience and expertise of internal specialists. Subsequent to foreclosure, valuations are updated periodically, and the assets may be written down to reflect a new cost basis. The write-downs are recorded as other real estate expense. The Company establishes a valuation allowance related to other real estate owned on an asset-by-asset basis. The valuation allowance is created during the holding period when the fair value less cost to sell is lower than the "cost" of a parcel of other real estate.

Pension Plan

The Company provides a noncontributory defined benefit pension plan for all full-time employees. The benefits are based on age, years of service and the level of compensation during the employees highest ten years of compensation before retirement. Net periodic costs are recognized as employees render the services necessary to earn the retirement benefits. The Company records annual amounts relating to its pension plan based on calculations that incorporate various actuarial and other assumptions including discount rates, mortality, assumed rates of return, compensation increases and turnover rates. The Company reviews its assumptions on an annual basis and may make modifications to the assumptions based on current rates and trends when it is appropriate to do so. The Company believes that the assumptions utilized in recording its obligations under its plan are reasonable based on its experience and market conditions.

The Company follows authoritative guidance included in the FASB ASC Topic 715, *Compensation—Retirement Plans* under the subtopic *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. ASC Topic 715 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its consolidated balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income. This guidance also requires an employer to measure the funded status of a plan as of the date of its fiscal year-end, with limited exceptions. Additional disclosures are required to provide users with an understanding of how investment allocation decisions are made, major categories of plan assets, and fair value measurement of plan assets as defined in ASC Topic 820, *Fair Value Measurements and Disclosures*.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

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Income Taxes

Income taxes are accounted for under the asset / liability method by recognizing the amount of taxes payable or refundable for the current period and deferred tax assets and liabilities for future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in addressing the Company's future tax consequences of events that have been recognized in the consolidated financial statements or tax returns such as realization of the effects of temporary differences, net operating loss carry forwards and changes in tax laws or interpretations thereof. A valuation allowance is established when in the judgment of management, it is more likely than not that such deferred tax assets will not become realizable. In this case, the Company would adjust the recorded value of our deferred tax asset, which would result in a direct charge to income tax expense in the period that the determination was made. Likewise, the Company would reverse the valuation allowance when the realization of the deferred tax asset is more likely than not. In addition, the Company is subject to the continuous examination of its tax returns by the Internal Revenue Service and other taxing authorities. The Company accrues for penalties and interest related to income taxes in income tax expense. At December 31, 2010, total accrued interest was \$31,000 and total interest expense recognized for the year ended 2010 was \$24,000. As of December 31, 2011, the Company released \$28,000 of interest accrued related to the release of \$221,000 of uncertain tax provisions.

Trust Department

Property held by the Bank in a fiduciary or agency capacity for customers is not included in the accompanying consolidated balance sheets, since such items are not assets of the Company. Trust department income is recognized on the accrual basis.

Consolidated Statements of Cash Flows

For the purpose of the consolidated statements of cash flows, cash and cash equivalents consist of short-term federal funds sold and securities sold or purchased under agreements to resell, interest earning deposits with banks, cash, and due from banks.

Stock-Based Compensation

The Company's stock-based employee compensation plan is described in Note 11, Stock Compensation. In accordance with FASB ASC Topic 718, *Compensation – Stock Compensation*, the Company measures the cost of the stock-based compensation based on the grant-date fair value of the award, recognizing the cost over the requisite service period. The fair value of an award is estimated using the Black-Scholes option-pricing model. The expense recognized is based on an estimation of the number of awards for which the requisite service is expected to be rendered, and is included in salaries and employee benefits in the accompanying consolidated statements of operations. The standard also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows.

Treasury Stock

The purchase of the Company's common stock is recorded at cost. Purchases of the stock are made both in the open market and through negotiated private purchases based on market prices. At the date of subsequent reissue, the treasury stock account is reduced by the cost associated with such stock on a first-in-first-out basis.

Comprehensive Income

The Company reports comprehensive income (loss) in the consolidated statements of stockholders' equity and comprehensive income (loss).

**HAWTHORN BANCSHARES, INC.
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Notes to the Consolidated Financial Statements

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Reclassifications

Certain prior year information has been reclassified to conform to the current year presentation.

Impact of New Accounting Standards

Other Comprehensive Income In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05, *Presentation of Comprehensive Income*, which revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in ASC 220 and requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. ASU 2011-05 does not change the items that must be reported in other comprehensive income. ASU 2011-05 is effective for periods beginning January 1, 2012 and requires retrospective application. The ASU does not change the components of other comprehensive income, the timing of items reclassified to net income, or the net income basis for income per share calculations.

In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting in Accounting Standards Update No. 2011-05 (Topic 220)*, which defers the requirement within ASU No. 2011-05 to present the reclassification amounts from other comprehensive income to net income as a separate component on the income statement. Until the FASB has reached a resolution, entities are required to report reclassification out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05.

Fair Value Measurements In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, to substantially converge the guidance in U.S. GAAP and IFRS on fair value measurements and disclosures. The amended guidance changes several aspects of the fair value measurement guidance ASC 820, *Fair Value Measurement*, and includes several new fair value disclosure requirements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 is not expected to have a material impact on the Company's consolidated financial statements.

Repurchase Agreements In April 2011, the FASB issued ASU 2011-03, *Consideration of Effective Control on Repurchase Agreements*, which deals with the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 changes the rules for determining when these transactions should be accounted for as financings, as opposed to sales. The guidance in ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The adoption of ASU 2011-03 is not expected to have a material impact on the Company's consolidated financial statements.

Troubled Debt Restructurings In April 2011, the FASB issued ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. The provisions of ASU No. 2011-02 provide a creditor additional guidance in determining whether a restructuring constitutes a troubled debt restructuring by concluding that both the following conditions exist (1) a creditor has granted a concession, and (2) the borrower is experiencing financial difficulties. A provision in ASU No. 2011-02 also ends the FASB's deferral of the additional disclosures about troubled debt restructurings as required by ASU No. 2010-20. The provisions of ASU No. 2011-02 were adopted for the Company's reporting period ending September 30, 2011 and required retrospective application to all restructurings occurring during 2011 along with additional required disclosures. Under the guidance for identifying TDR's provided in the ASU, the Company identified 10 additional loans as a result of the adoption. See Note 2 for further discussion.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2011, 2010, and 2009

Credit Quality of Financing Receivables and the Allowance for Credit Losses In July 2010, the FASB issued ASU No. 2010-20 – *Receivables (ASC Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. This ASU requires expanded credit risk disclosures intended to provide investors with greater transparency regarding the allowance for credit losses and the credit quality of financing receivables. Under this ASU, companies are required to provide more information about the credit quality of their financing receivables in the disclosures to financial statements, such as aging information, credit quality indicators, changes in the allowance for credit losses, and the nature and extent of troubled debt restructurings and their effect on the allowance for credit losses. Both new and existing disclosures must be disaggregated by portfolio segment or class based on the level of disaggregation that management uses when assessing its allowance for credit losses and managing its credit exposure. The disclosures as of the end of a reporting period are effective for annual periods ending on or after December 15, 2010. The disclosures about activity that occur during a reporting period are effective for annual reporting periods beginning on or after December 15, 2010. The disclosures required by this update are reported in the notes to the Company's consolidated financial statements.

(2) Loans and Allowance for Loan Losses

A summary of loans, by major class within the Company's loan portfolio, at December 31, 2011 and 2010 are as follows:

	2011	2010
Commercial, financial, and agricultural	\$ 128,555,173	\$ 131,382,467
Real estate construction - residential	30,201,198	31,834,174
Real estate construction - commercial	47,696,759	56,052,910
Real estate mortgage - residential	203,454,204	207,834,488
Real estate mortgage - commercial	402,960,327	439,068,622
Installment and other consumer	29,883,986	32,132,336
Unamortized loan origination fees and costs, net	178,901	167,466
Total loans	\$ 842,930,548	\$ 898,472,463

The Bank grants real estate, commercial, installment, and other consumer loans to customers located within the communities surrounding Jefferson City, Clinton, Warsaw, Springfield, Branson and Lee's Summit, Missouri. As such, the Bank is susceptible to changes in the economic environment in these communities. The Bank does not have a concentration of credit in any one economic sector. Installment and other consumer loans consist primarily of the financing of vehicles. At December 31, 2011, loans with a carrying value of \$432,478,000 were pledged at Federal Home Loan Bank as collateral for borrowings and letters of credit.

The following is a summary of activity in 2011 of loans made by the Bank to executive officers and directors or to entities in which such individuals had a beneficial interest. Such loans were made in the normal course of business on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the same time for comparable transactions with other persons, and did not involve more than the normal risk of collectability or present unfavorable features.

Balance at December 31, 2010	\$ 2,263,065
New loans	1,585,721
Amounts collected	(658,749)
Balance at December 31, 2011	\$ 3,190,037

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

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Allowance for loan losses

The following is a summary of the allowance for loan losses for the years ended December 31, 2011, 2010 and 2009 is as follows:

<i>(in thousands)</i>	Commercial, Financial, and Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment Loans to Individuals	Unallocated	Total
Allowance for loan losses:								
Balance, 12-31-08	\$ 1,712	\$ 1,355	\$ 1,135	\$ 2,931	\$ 3,640	\$ 391	\$ 1,503	\$ 12,667
Additions:								
Provision for loan losses	2,252	—	1,055	3,169	1,777	229	(128)	8,354
Deductions:								
Loans charged off	1,404	1,012	450	2,673	728	534	—	6,801
Less recoveries on loans	(213)	(5)	—	(61)	(4)	(294)	—	(577)
Net loans charged off	1,191	1,007	450	2,612	724	240	—	6,224
Balance, 12-31-09	\$ 2,773	\$ 348	\$ 1,740	\$ 3,488	\$ 4,693	\$ 380	\$ 1,375	\$ 14,797
Additions:								
Provision for loan losses	1,908	2,622	4,133	4,740	2,577	32	(758)	15,254
Deductions:								
Loans charged off	1,903	933	4,556	4,534	3,841	422	—	16,189
Less recoveries on loans	(153)	(30)	(22)	(228)	(29)	(241)	—	(703)
Net loans charged off	1,750	903	4,534	4,306	3,812	181	—	15,486
Balance, 12-31-10	\$ 2,931	\$ 2,067	\$ 1,339	\$ 3,922	\$ 3,458	\$ 231	\$ 617	\$ 14,565
Additions:								
Provision for loan losses	837	914	485	1,104	8,593	204	(614)	11,523
Deductions:								
Loans charged off	2,157	1,858	512	1,883	6,420	376	—	13,206
Less recoveries on loans	(193)	(65)	(250)	(108)	(103)	(208)	—	(927)
Net loans charged off	1,964	1,793	262	1,775	6,317	168	—	12,279
Balance, 12/31/11	\$ 1,804	\$ 1,188	\$ 1,562	\$ 3,251	\$ 5,734	\$ 267	\$ 3	\$ 13,809

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

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The following table provides the balance in the allowance for loan losses at December 31, 2011 and 2010, and the related loan balance by impairment methodology. Loans evaluated under ASC 310-10-35 include loans on non-accrual status, which are individually evaluated for impairment, troubled debt restructurings, and other impaired loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment under ASC 450-20. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb credit losses.

For the Year Ended December 31, 2011								
(in thousands)	Commercial, Financial, and Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment Loans to Individuals	Unallocated	Total
Allowance for loan losses:								
Individually evaluated for impairment	\$ 239	\$ 166	\$ 380	\$ 653	\$ 2,309	\$ -	\$ -	3,747
Collectively evaluated for impairment	1,565	1,022	1,182	2,598	3,425	267	3	10,062
Total	\$ 1,804	\$ 1,188	\$ 1,562	\$ 3,251	\$ 5,734	\$ 267	\$ 3	\$ 13,809
Loans outstanding:								
Individually evaluated for impairment	\$ 4,428	\$ 1,147	\$ 7,867	\$ 6,569	\$ 33,440	\$ -	\$ -	53,451
Collectively evaluated for impairment	124,127	29,054	39,830	196,885	369,520	30,063	-	789,479
Total	\$ 128,555	\$ 30,201	\$ 47,697	\$ 203,454	\$ 402,960	\$ 30,063	\$ -	\$ 842,930

For the Year Ended December 31, 2010								
(in thousands)	Commercial, Financial, and Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment Loans to Individuals	Unallocated	Total
Allowance for loan losses:								
Individually evaluated for impairment	\$ 1,737	\$ 1,553	\$ 201	\$ 1,117	\$ 1,768	\$ -	\$ -	6,376
Collectively evaluated for impairment	1,194	514	1,138	2,805	1,690	231	617	8,189
Total	\$ 2,931	\$ 2,067	\$ 1,339	\$ 3,922	\$ 3,458	\$ 231	\$ 617	\$ 14,565
Loans outstanding:								
Individually evaluated for impairment	\$ 3,660	\$ 3,586	\$ 11,783	\$ 8,040	\$ 29,076	\$ -	\$ -	56,145
Collectively evaluated for impairment	127,722	28,248	44,270	199,795	409,993	32,299	-	842,327
Total	\$ 131,382	\$ 31,834	\$ 56,053	\$ 207,835	\$ 439,069	\$ 32,299	\$ -	\$ 898,472

Loans, or portions of loans, are charged off to the extent deemed uncollectible. Loan charge-offs reduce the allowance for loan losses, and recoveries of loans previously charged off are added back to the allowance. Once the fair value for a collateral dependent loan has been determined, any impaired amount is typically charged off unless the loan has other income streams to support repayment. For impaired loans which have other income streams to support repayment, a specific reserve is established for the amount determined to be impaired.

Impaired loans

Impaired loans totaled \$53,619,534 and \$56,270,543 at December 31, 2011 and 2010 respectively, and are comprised of loans on non-accrual status and loans which have been classified as troubled debt restructurings.

The categories of impaired loans at December 31, 2011 and 2010 are as follows:

	2011	2010
Non-accrual loans	\$ 46,402,747	\$ 50,586,887
Troubled debt restructurings continuing to accrue interest	7,216,787	5,683,656
Total impaired loans	\$ 53,619,534	\$ 56,270,543

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The following table provides additional information about impaired loans at December 31, 2011 and 2010, respectively, segregated between loans for which an allowance has been provided and loans for which no allowance has been provided:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Recognized For the Year Ended 12/31/2011
At December 31, 2011					
With no related allowance recorded:					
Commercial, financial and					
Agricultural	\$ 3,546,088	\$ 3,625,113	\$ -	\$ 3,510,156	\$ 51,893
Real estate - construction residential	584,034	788,152	-	1,272,564	-
Real estate - construction commercial	1,458,346	1,755,248	-	3,567,873	-
Real estate - residential	2,315,344	2,653,979	-	3,596,694	25,774
Real estate - commercial	15,150,920	21,189,966	-	18,269,985	73,601
Consumer	168,257	177,332	-	189,722	3,622
Total	\$ 23,222,989	\$ 30,189,790	\$ -	\$ 30,406,994	\$ 154,890
With an allowance recorded:					
Commercial, financial and					
Agricultural	\$ 881,585	\$ 904,168	\$ 238,840	\$ 654,874	\$ 17,285
Real estate - construction residential	562,760	562,760	166,300	46,897	-
Real estate - construction commercial	6,408,713	6,448,100	379,921	5,805,604	-
Real estate - residential	4,254,023	4,265,660	653,279	3,202,511	112,932
Real estate - commercial	18,289,464	18,779,725	2,309,226	12,723,918	-
Total	\$ 30,396,545	\$ 30,960,413	\$ 3,747,566	\$ 22,433,804	\$ 130,217
Total impaired loans	\$ 53,619,534	\$ 61,150,203	\$ 3,747,566	\$ 52,840,798	\$ 285,107
At December 31, 2010					
With no related allowance recorded:					
Commercial, financial and					
Agricultural	\$ 441,861	\$ 629,296	\$ -	\$ 1,250,446	\$ 1,293
Real estate - construction residential	1,769,622	2,355,936	-	2,533,863	2,003
Real estate - construction commercial	8,297,388	9,393,368	-	15,889,842	475
Real estate - residential	2,463,735	2,950,560	-	5,269,211	13,480
Real estate - commercial	12,939,973	14,869,833	-	24,373,677	476,932
Consumer	125,858	132,688	-	149,971	4,219
Total	\$ 26,038,437	\$ 30,331,681	\$ -	\$ 49,467,010	\$ 498,402
With an allowance recorded:					
Commercial, financial and					
Agricultural	\$ 3,217,995	\$ 3,260,009	\$ 1,737,159	\$ 1,243,084	\$ 19,544
Real estate - construction residential	1,816,276	1,848,593	1,552,406	460,869	-
Real estate - construction commercial	3,485,517	4,740,517	201,147	4,363,077	42,824
Real estate - residential	5,576,292	5,669,041	1,117,141	3,662,862	115,609
Real estate - commercial	16,136,025	16,215,862	1,767,893	4,554,688	8,325
Total	\$ 30,232,106	\$ 31,734,022	\$ 6,375,746	\$ 14,284,580	\$ 186,302
Total impaired loans	\$ 56,270,543	\$ 62,065,703	\$ 6,375,746	\$ 63,751,590	\$ 684,704

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Interest income recognized on loans in non-accrual status and contractual interest that would have been recorded had the loans performed in accordance with their original contractual terms is as follows:

	2011	2010	2009
Contractual interest due on non-accrual loans	\$ 1,962,972	\$ 2,551,645	\$ 1,726,395
Interest income recognized on loans in non-accrual status	10,588	22,356	158,124
Net reduction in interest income	\$ 1,952,384	\$ 2,529,289	\$ 1,568,271

The specific reserve component of the Company's allowance for loan losses at December 31, 2011 and 2010 was determined by using fair values of the underlying collateral obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows. 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 \$274,519, \$662,348, and \$436,787, for the years ended December 31, 2011, 2010, and 2009, respectively. The average recorded investment in impaired loans is calculated on a monthly basis during the years 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 when payments become 30 days or more past due. The following table provides aging information for the

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quality and administration. Loans are placed on *watch* status when (1) one or more weaknesses which could jeopardize timely liquidation exits; or (2) the margin or liquidity of an asset is sufficiently tenuous that adverse trends could result in a collection problem. 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. It is the Company's policy to discontinue the accrual of interest income on loans when management believes such that the collection of interest or principal is doubtful. Loans are placed on *non-accrual* status when (1) deterioration in the financial condition of the borrower exists for which payment of full principal and interest is not

placed on (2) when which principal or interest has been 100% of the original amount and the asset is not held

well secured and in the process of collection. Subsequent interest payments received on such 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.

Real Estate
Construction -

Real Estate
Construction -

Real Estate
Mortgage -

Real Estate
Mortgage -

Installment
and other

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The following table summarizes loans that were modified as TDRs during the year ended December 31, 2011:

	The Year Ended December 31, 2011		
	Recorded Investment (1)		
	Number of Contracts	Pre- Modification	Post- Modification
Troubled Debt Restructurings			
Commercial, financial and agricultural	9	\$ 3,500,192	\$ 3,485,661
Real estate construction - commercial	8	6,616,223	6,227,302
Real estate mortgage- residential	7	1,157,063	1,009,716
Real estate mortgage - commercial	9	9,552,474	9,215,406
Total	33	\$ 20,825,952	\$ 19,938,085

(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.

According to guidance provided in ASC subtopic 310-40, *Troubled Debt Restructurings by Creditors*, a loan restructuring or modification of terms is a TDR if the creditor for economic or legal reasons related to the borrowers financial difficulties grants a concession to the borrower that it would not otherwise consider. The Company's portfolio of loans classified as TDRs include concessions such as interest rates below the current market rate, deferring principal payments, and extending maturity dates. Once a loan becomes a TDR, it will continue to be reported as a TDR until it is ultimately repaid in full, charged-off, or foreclosed and sold. The Company considers a loan in TDR status in default when the borrowers payment according to the

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Activity in the valuation allowance for other real estate owned in settlement of loans for the years ended December 31, 2011, 2010, and 2009, respectively, is summarized as follows:

	The Year Ended December 31,		
	2011	2010	2,009
Balance, beginning of period	\$ 6,158,433	\$ —	\$ —
Provision for other real estate owned	1,251,466	6,158,433	—
Charge-offs	(432,914)	—	—
Balance, end of period	\$ 6,976,985	\$ 6,158,433	\$ —

(4) Investment Securities

A summary of investment securities by major category, at fair value, consisted of the following at December 31, 2011 and 2010.

	2011	2010
U.S. treasury	\$ 2,054,102	\$ 1,027,891
Government sponsored enterprises	70,313,978	53,341,551
Asset-backed securities	107,328,618	90,176,241
Obligations of states and political subdivisions	34,109,303	34,431,867

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The amortized cost and fair value of debt securities classified as available-for-sale at December 31, 2011 and 2010 are as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2011				
U.S. Treasury	\$ 1,999,643	\$ 54,459	\$ —	\$ 2,054,102
Government sponsored enterprises	69,703,105	628,888	18,015	70,313,978
Asset-backed securities	103,805,717	3,546,712	23,811	107,328,618
Obligations of states and political subdivisions	32,716,023	1,393,874	594	34,109,303
Total available for sale securities	\$ 208,224,488	\$ 5,623,933	\$ 42,420	\$ 213,806,001
Weighted average yield at end of period	2.89%			

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2010				
U.S. Treasury	\$ 999,823	\$ 28,068	\$ —	\$ 1,027,891
Government sponsored enterprises	53,516,545	327,051	502,045	53,341,551
Asset-backed securities	88,634,760	1,905,377	363,896	90,176,241
Obligations of states and political subdivisions	34,146,782	555,240	270,155	34,431,867

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Debt securities with carrying values aggregating approximately \$172,447,000 and \$148,099,000 at December 31, 2011 and 2010, respectively, were pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

	2011		2010		2009	
Proceeds from sales	\$	—	\$	—	\$	12,546,609
Gains		—		—		605,716
Losses		—		—		—
Net gains	\$	—	\$	—	\$	605,716

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 December 31, 2011 and 2010, were as follows:

	Less than 12 months		12 months or more		Number of Investment Positions	Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		Fair Value	Unrealized Losses
At December 31, 2011							
Government sponsored enterprises	\$ 13,250,239	\$ (18,015)	\$ -	\$ -	13	\$ 13,250,239	(18,015)
Asset-backed securities	4,591,075	(23,811)	-	-	5	4,591,075	(23,811)

Obligations of states and political subdivisions	229,089	(300)	150,279	(294)	2	379,368	(594)
	\$ 18,070,403	\$ (42,126)	\$ 150,279	\$ (294)	20	\$ 18,220,682	\$ (42,420)

	Less than 12 months		12 months or more		Number of Investment Positions	Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		Fair Value	Unrealized Losses
At December 31, 2010							
Government sponsored enterprises	\$ 20,504,526	\$ (502,045)	\$ -	\$ -	19	\$ 20,504,526	(502,045)
Asset-backed securities	21,177,793	(363,896)	-	-	20	21,177,793	(363,896)
Obligations of states and political subdivisions	8,038,946	(270,155)	-	-	29	8,038,946	(270,155)
	\$ 49,721,265	\$ (1,136,096)	\$ -	\$ -	68	\$ 49,721,265	\$ (1,136,096)

The Company's available for sale portfolio consisted of approximately 365 securities at December 31, 2011. One of these securities with an unrealized loss of \$294 had been in the loss position for 12 months or longer. The \$42,000 unrealized loss included in other comprehensive income at December 31, 2011 was caused by interest rate fluctuations. The Company's available for sale portfolio consisted of approximately 333 securities at December 31, 2010. None of these securities had been in the loss position for 12 months or longer. The \$1,136,000 unrealized loss included in other comprehensive income at December 31, 2010 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 December 31, 2011 and 2010.

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(5) Premises and Equipment

A summary of premises and equipment at December 31, 2011 and 2010 is as follows:

	2011	2010
Land and land improvements	\$ 10,120,668	\$ 10,324,154
Buildings and improvements	33,652,171	32,209,975
Furniture and equipment	12,013,172	10,992,544
Construction in progress	277,031	207,880
Total	56,063,042	53,734,553
Less accumulated depreciation	18,109,670	16,754,050
Net premises and equipment	\$ 37,953,372	\$ 36,980,503

Depreciation expense for the past three years is as follows:

	For the Years Ended December 31,		
	2011	2010	2009
Depreciation expense	\$ 1,940,319	\$ 1,963,842	\$ 2,044,257

(6) Other Intangible Assets

A summary of other intangible assets at and for the years ended December 31, 2011 and 2010 is as follows:

	For the Years Ended December 31,					
	2011			2010		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortizable intangible assets:						
Core deposit intangible	\$ 4,795,224	\$ (4,252,478)	\$ 542,746	\$ 7,060,224	\$ (6,082,715)	\$ 977,509
Mortgage servicing rights	3,170,639	(862,262)	2,308,377	3,067,368	(711,378)	2,355,990
Total intangible assets	\$ 7,965,863	\$ (5,114,740)	\$ 2,851,123	\$ 10,127,592	\$ (6,794,093)	\$ 3,333,499

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Changes in the net carrying amount of other intangible assets for the years ended December 31, 2011 and 2010 are shown in the following table:

	Core Deposit Intangible Asset	Mortgage Servicing Rights
Balance at December 31, 2009	\$ 1,503,986	\$ 2,020,964
Additions	—	1,168,701
Amortization	(526,477)	(833,675)
Balance at December 31, 2010	977,509	2,355,990
Additions	—	760,322
Amortization	(434,763)	(807,935)
Balance at December 31, 2011	\$ 542,746	\$ 2,308,377

Mortgage servicing rights (MSRs) are amortized over the shorter of 7 years or the life of the loan. They are periodically reviewed for impairment and if impairment is indicated, recorded at fair value. At December 31, 2011 and 2010, no temporary impairment was recognized. The fair value of MSRs is based on the present value of expected cash flows, as further discussed in *Fair Value of Financial Instruments*. Mortgage loans serviced for others totaled approximately \$307,016,000 and \$298,325,000 at December 31, 2011 and 2010, respectively. Included in other noninterest income were real estate servicing fees for the years ended December 31, 2011, 2010 and 2009 of \$863,000, \$927,000, and \$888,000, respectively.

The Company's amortization expense on intangible assets in any given period may be different from the estimated amounts depending upon the acquisition of intangible assets, changes in mortgage interest rates, prepayment rates and other market conditions. The following table shows the estimated future amortization expense based on existing asset balances and the interest rate environment as of December 31, 2011 for the next five years:

	Core Deposit Intangible Asset	Mortgage Servicing Rights
2012	\$ 408,062	\$ 487,000
2013	134,684	412,000
2014	-	349,000
2015	-	295,000
2016	-	249,000

The aggregate amortization expense of intangible assets subject to amortization for the past three years is as follows:

	For the Years Ended December 31,		
Aggregate amortization expense	2011	2010	2009
Core deposit intangible asset	\$ 434,763	\$ 526,477	\$ 626,111
Mortgage servicing rights	807,935	833,675	916,093

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(7) Deposits

The scheduled maturities of total time deposits are as follows:

	2011	2010
Due within:		
One year	\$ 266,516,536	\$ 304,221,827
Two years	93,209,127	58,226,647
Three years	34,729,677	54,968,145
Four years	8,811,088	5,196,284
Five years	11,172,178	7,162,643
Thereafter	—	—
	<u>\$ 414,438,606</u>	<u>\$ 429,775,546</u>

At December 31, 2011 and 2010, the Company had certificates and other time deposits in denominations of \$100,000 or more which mature as follows:

	2011	2010
Due within:		
Three months or less	\$ 52,273,804	\$ 19,997,962
Over three months through six months	16,016,986	35,685,505
Over six months through twelve months	32,291,758	37,901,059
Over twelve months	38,922,100	30,982,234
	<u>\$ 139,504,648</u>	<u>\$ 124,566,760</u>

The Federal Reserve Bank required the Bank to maintain cash or balances of \$1,335,000 and \$23,564,000 at

December 31, 2011 and 2010, respectively, to satisfy reserve requirements.

Average compensating balances held at correspondent banks were \$489,000 and \$667,000 at December 31, 2011 and 2010, respectively. The Bank maintains such compensating balances with correspondent banks to offset charges for services rendered by those banks.

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(8) Borrowings

Federal Funds Purchased and Securities Sold Under Agreements to Repurchase (repurchase agreements)

Information relating to federal funds purchased and repurchase agreements is as follows:

	Year End Weighted Rate		Average Weighted Rate		Average Balance Outstanding		Maximum Outstanding at any Month End		Balance at December 31,
2011									
Federal funds purchased	—	%	0.3	%	\$ 2,225	\$	-	\$	-
Short-term repurchase agreements	0.1		0.2		27,634,019		30,227,375		24,516,277
Total									24,516,277
2010									
Federal funds purchased	—	%	1.0	%	\$ 425,805	\$	-	\$	-
Short-term repurchase agreements	0.2		0.2		32,297,375		35,168,836		30,068,453
Total									30,068,453
2009									
Federal funds purchased	0.9	%	0.9	%	\$ 1,507,904	\$	7,175,000	\$	4,980,000
Short-term repurchase agreements	0.2		0.2		32,414,635		32,489,362		31,665,434
Total									36,645,434

The securities underlying the agreements to repurchase are under the control of the Bank. All securities sold under agreements to repurchase are secured by a portion of the Company's investment portfolio.

Under agreements with unaffiliated banks, the Bank may borrow federal funds up to \$15,000,000 on an unsecured basis and \$19,918,000 on a secured basis at December 31, 2011.

Subordinated Notes and Other Borrowings

Other borrowings of the Company consisted of the following:

		2011			2010		
	Borrower	Maturity Date	Year End Balance	Year End Weighted Rate	Year End Balance	Year End Weighted Rate	
FHLB advances	Subsidiary bank	2012	\$ 8,283,528	1.6%	\$ 38,575,989	3.6%	

2013	10,126,461	1.5%	8,283,528	1.6%
2014	-	na	10,126,461	1.6%

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on collateral type) of the outstanding advance balance, to secure amounts borrowed by the Bank. The outstanding balance of \$28,410,000 includes \$10,000,000 which the FHLB may call for early payment within the next year. The FHLB has also issued letters of credit totaling \$206,000 at December 31, 2011. Based upon the collateral pledged to the Federal Home Loan Bank of Des Moines at December 31, 2010, the Bank could borrow up to an additional \$230,465,000 under the agreement.

On March 17, 2005, Exchange Statutory Trust II, a business trust issued \$23,000,000 of 30-year floating rate Trust Preferred Securities (TPS) to a TPS Pool. The floating rate is equal to a three-month LIBOR rate plus 1.83% and reprices quarterly (2.39% at December 31, 2011). The TPS can be prepaid without penalty at any time after five years from the issuance date.

The TPS represent preferred interests in the trust. The Company invested approximately \$712,000 in common interests in the trust and the purchaser in the private placement purchased \$23,000,000 in preferred interests. The proceeds were used by the trust to purchase from the Company its 30-year deeply subordinated debentures whose terms mirror those stated above for the TPS. The debentures are guaranteed by the Company pursuant to a subordinated guarantee. Distributions on the TPS are payable quarterly on March 17, June 17, September 17, and December 17 of each year that the TPS are outstanding. The trustee for the TPS holders is U.S. Bank, N.A.. The trustee does not have the power to take enforcement action in the event of a default under the TPS for five years from the date of default. In the event of default, however, the Company would be precluded from paying dividends until the default is cured.

On March 17, 2004, Exchange Statutory Trust I, a Delaware business trust and subsidiary of the Company issued \$25,000,000 of floating TPS to a TPS Pool. The floating rate is equal to the three-month LIBOR rate plus 2.70% and reprices quarterly (3.26% at December 31, 2011). The TPS are fully, irrevocably, and unconditionally guaranteed on a

reprices quarterly (3.26% at December 31, 2011). The TPS are fully, irrevocably, and unconditionally guaranteed on a subordinated basis by the Company. The proceeds of the TPS were invested in junior subordinated debentures of the

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Applicable income tax (benefit) expense for financial reporting purposes differ from the amount computed by applying the statutory Federal income tax rate for the reasons noted in the table below:

	2011			2010			2009	
	Amount	%		Amount	%		Amount	%
Income (loss) before provision for income tax (benefit) expense	\$ 3,448,414			\$ (6,638,553)			\$ 6,811,877	
Tax at statutory Federal income tax rate	\$ 1,172,461	34.00	%	\$ (2,257,108)	34.00	%	\$ 2,316,038	34.00
Tax-exempt income	(404,001)	(11.72)		(445,020)	6.70		(508,002)	(7.46)
State income tax, net of Federal tax benefit	(111,421)	(3.23)		(105,184)	1.58		191,087	2.81
Other, net	(65,895)	(1.91)		(279,501)	4.22		(143,003)	(2.10)
Provision for income tax (benefit) expense	\$ 591,144	17.14	%	\$ (3,086,813)	46.50	%	\$ 1,856,120	27.25

The components of deferred tax assets and deferred tax liabilities at December 31, 2011 and 2010 are as follows:

	2011	2010
Deferred tax assets:		
Allowance for loan losses	\$ 5,247,505	\$ 5,680,298
Nonaccrual loan interest	1,033,195	1,208,665
Core deposit intangible	882,583	873,017
Goodwill	2,831,425	3,263,670
Impairment of other real estate owned	2,734,539	2,547,425
Deferred compensation	26,879	46,878
Deferred taxes on pension	1,379,898	240,349
Pension	276,331	—
Other	548,980	447,485
Total deferred tax assets	14,961,335	14,307,787
Deferred tax liabilities:		
Premises and equipment	960,245	999,943
Mortgage servicing rights	791,037	789,759
FHLB stock dividend	100,282	102,921
Assets held for sale	108,735	—
Available-for-sale securities	2,176,790	655,060
Pension	—	118,265
Other	1,892	6,345
Total deferred tax liabilities	4,138,981	2,672,293
Net deferred tax asset	\$ 10,822,354	\$ 11,635,494

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income 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 strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the

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deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these temporary differences at December 31, 2011 and, therefore, has not established a valuation reserve.

At December 31, 2011, the accumulation of prior years' earnings representing tax bad debt deductions of the Bank was \$2,931,503. If these tax bad debt reserves were charged for losses other than bad debt losses, the Bank would be required to recognize taxable income in the amount of the charge. It is not contemplated that such tax-restricted retained earnings will be used in a manner that would create federal income tax liabilities.

The Company follows ASC Topic 740, *Income Taxes*, which addresses the accounting for uncertain tax positions. As a result of the lapse of the statute of limitations for the 2007 tax year, the Company recognized \$340,351 of gross unrecognized tax benefits and \$30,969 of accrued interest. This resulted in a decrease of the effective tax rate for the year-ended December 31, 2011 compared to December 31, 2010. As of December 31, 2011, the Company did not have any uncertain tax provisions.

A reconciliation of the beginning and ending amount of the unrecognized tax benefits is as follows:

	2011	2010	2009
Unrecognized tax benefits as of January 1,	\$ 340,351	\$ 562,076	\$ 748,942
Gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during prior years	—	—	—
Gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during year	—	—	—
The amount of decreases in unrecognized tax benefits relating to settlements with taxing authorities	—	—	—
Reductions to unrecognized benefits as a result of a lapse of the applicable statute of limitations	(340,351)	(221,725)	(186,866)
Unrecognized tax benefits as of December 31,	\$ —	\$ 340,351	\$ 562,076

(10) Employee Benefit Plans

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

	2011	2010	2009
Payroll taxes	\$ 1,098,110	\$ 1,105,599	\$ 1,096,793
Medical plans	1,676,494	1,544,670	1,494,166
401k match	290,665	318,518	306,042
Pension plan	907,455	864,871	890,692
Profit-sharing	-	2	282,904
Other	249,671	161,210	133,803
Total employee benefits	\$ 4,222,395	\$ 3,994,870	\$ 4,204,400

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 years shown. In addition, employees were able to make additional tax-deferred contributions.

Pension

The Company also provides a noncontributory defined benefit pension plan for all full-time employees.

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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 \$1,243,000 contribution to the defined benefit plan through March 30, 2012, of which \$310,000 relates to the 2010 plan year and \$933,000 relates to the 2011 plan year. The minimum required contribution for the 2012 plan year is estimated to be \$1,048,000. The Company has not determined whether it will make any contributions other than the minimum required funding contribution for 2012.

Obligations and Funded Status at December 31

	2011	2010
Change in projected benefit obligation:		
Balance, January 1	\$ 10,655,180	\$ 9,400,952
Service cost	930,691	844,178
Interest cost	603,903	556,047
Actuarial loss	2,240,500	59,386
Benefits paid	(213,069)	(205,383)
Balance, December 31	14,217,205	10,655,180
Change in plan assets:		
Fair value, January 1	9,296,645	7,993,695
Actual gain (loss) return on plan assets	(54,282)	954,332
Employer contribution	1,005,000	554,000
Benefits paid	(213,069)	(205,382)
Fair value, December 31	10,034,294	9,296,645
Funded status at end of year	\$ (4,182,911)	\$ (1,358,535)
Accumulated benefit obligation	\$ 10,762,152	\$ 8,172,291

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 years ended December 31, 2011, 2010 and 2009:

	2011	2010	2009
Service cost—benefits earned during the year	\$ 930,691	\$ 844,178	\$ 850,940
Interest costs on projected benefit obligations	603,903	556,047	509,482
Expected return on plan assets	(705,767)	(613,982)	(539,283)

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Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income (loss) at December 31, 2011 and 2010 are shown below, including amounts recognized in other comprehensive income during the periods. All amounts are shown on a pre-tax basis.

	2011	2010
Prior service costs	\$ (678,812)	\$ (757,440)
Net accumulated actuarial net (loss) gain	(2,776,911)	223,639
Accumulated other comprehensive loss	(3,455,723)	(533,801)
Net periodic benefit cost in excess of cumulative employer contributions	(727,188)	(824,734)
Net amount recognized at December 31, balance sheet	\$ (4,182,911)	\$ (1,358,535)
Net loss (gain) arising during period	\$ 3,000,549	\$ (280,964)
Prior service cost amortization	(78,628)	(78,628)
Amortization of net actuarial gain / (loss)	-	-
Total recognized in other comprehensive income	\$ 2,921,921	\$ (359,592)

Total recognized in other comprehensive income	\$ 2,921,921	\$ (359,592)
Total recognized in net periodic pension cost and other comprehensive income	\$ 3,829,376	\$ 505,279

The estimated prior service cost for the defined benefit pension plan that will be amortized from accumulated other

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Plan Assets

The investment policy of the pension plan is designed for growth in value while minimizing risk to the overall portfolio. The Company diversifies the assets through investments in domestic and international fixed income securities and domestic and international equity securities. The assets are readily marketable and can be sold to fund benefit payment obligations as they become payable. The Company's long-term investment target mix for the plan is 70% equity securities and 30% fixed income. The Company regularly reviews its policies on the investment mix and may make changes depending on economic conditions and perceived investment mix.

The fair value of the Company's pension plan assets at December 31, 2011 and 2010 by asset category are as follows:

Description	Fair Value Measurements At December 31, 2011 Using			
	Fair Value December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 1,790,943	\$ 1,790,943	\$ -	\$ -
Equity securities:				
U.S. large-cap (a)	3,820,667	3,820,667	-	-
U.S. mid-cap (b)	502,246	502,246	-	-
U.S. small-cap (c)	595,027	595,027	-	-
International (d)	1,277,798	1,277,798	-	-
Real Estate (e)	203,000	203,000	-	-
Commodities (f)	198,253	198,253	-	-
Fixed income securities:				
U.S. Gov't Agency Obligations (g)	841,083	-	841,083	-
Corporate investment grade (g)	653,144	-	653,144	-
Corporate non-investment grade (g)	152,133	-	152,133	-
Total	\$ 10,034,294	\$ 8,387,934	\$ 1,646,360	\$ -

- (a) This category is comprised of low-cost equity index funds not actively managed that track the S&P 500.
- (b) This category is comprised of low-cost equity index funds not actively managed that track the MSCI U.S. mid-cap 450.
- (c) This is comprised of actively managed mutual funds.
- (d) 37% of this category is comprised of low-cost equity index funds not actively managed that track the MSCI EAFE.
- (e) This category comprised low-cost real estate index exchange traded funds.
- (f) This category is comprised of exchange traded funds investing agricultural and energy commodities.
- (g) This category is comprised of individual bonds.

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		Fair Value Measurements		
		Fair Value Measurements At December 31, 2010 Using		
		Quoted Prices in Active Markets for Identical	Other Observable	Significant Unobservable
Description	2010	(Level 1)	(Level 2)	(Level 3)
Cash equivalents	\$ 1,123,265	\$ 1,123,265	\$ -	\$ -
Equity securities:				
U.S. large-cap (a)	3,364,627	3,364,627	-	-
U.S. mid-cap (b)	1,138,036	1,138,036	-	-
U.S. small-cap (c)	445,318	445,318	-	-
International (d)	1,276,752	1,276,752	-	-
Fixed income securities:				
U.S. Govt Agency Obligations (e)	993,464	-	993,464	-
Corporate investment grade (e)	682,715	-	682,715	-
Corporate non-investment grade (e)	272,468	-	272,468	-
Total	\$ 9,296,645	\$ 7,347,998	\$ 1,948,647	\$ -

(a) This category is comprised of low-cost equity index funds not actively managed that track the S&P 500.

(b) This category is comprised of low-cost equity index funds not actively managed that track the MSCI U.S. mid-cap 450.

(c) This is comprised of actively managed mutual funds.

(d) 44% of this category is comprised of low-cost equity index funds not actively managed that track the MSCI EAFE.

(e) This category is comprised of individual bonds.

The following future benefit payments are expected to be paid:

Year	Pension benefits
2012	\$ 326,953
2013	335,437
2014	413,817
2015	429,802
2016	432,330
2017 to 2021	2,793,297

(11) Stock Compensation

The Company's stock option plan provides for the grant of options to purchase up to 506,188 shares of the Company's common stock to officers and other key employees of the Company and its subsidiaries. All options have been granted at exercise prices equal to fair value and vest over periods ranging from four to five years, except 10,705 options issued in 2008 to acquire shares that vested immediately.

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The following table summarizes the Company's stock option activity:

	Number of shares			Weighted average		
	December 31			exercise price		
	2011	2010	2009	2011	2010	2009
Outstanding, beginning of year	260,466	298,382	299,988	\$ 24.44	\$ 23.18	\$ 23.21
Granted	—	—	—	—	—	—
Exercised	—	—	—	—	—	—

The following table summarizes the Company's stock option activity:

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more quarterly periods, whether or not consecutive. Under such circumstances, the Treasury will be entitled to vote to elect two directors to the board until all unpaid dividends have been paid or declared and set apart for payment. The Company is prohibited from paying any dividends with respect to shares of common stock unless all accrued and unpaid dividends are paid in full on the senior preferred stock for all past dividend periods. The Treasury Department may also transfer the senior preferred stock to a third party at any time.

The common stock warrant is exercisable immediately with a ten year term, in whole or in part, at an exercise price of \$16.44 per share. The preferred stock and warrant are classified as stockholders' equity in the consolidated balance sheet and qualify, for regulatory capital purposes, as Tier I capital. For the year ended December 31, 2011, the Company had declared and paid \$1,513,000 of dividends and amortized \$476,000 of accretion of the discount on preferred stock.

(13) Earnings (loss) per Share

Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings (loss) per share gives effect to all dilutive potential common shares that were outstanding during the year. The calculations of basic and diluted earnings

(13) Earnings (loss) per Share

Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings (loss) per share gives effect to all dilutive potential common shares that were outstanding during the year. The calculations of basic and diluted earnings

	2011	2010	2009
Basic earnings (loss) per common share:			
Net income (loss)	\$ 2,857,270	\$ (3,551,740)	\$ 4,955,757
Less:			
Preferred stock dividends	1,512,750	1,512,750	1,516,952
Accretion of discount on preferred stock	476,474	476,474	476,474
Net income (loss) available to common shareholders	\$ 868,046	\$ (5,540,964)	\$ 2,962,331
Basic (loss) earnings per share	\$ 0.19	\$ (1.19)	\$ 0.64
Diluted earnings (loss) per common share:			
Net income (loss)	\$ 2,857,270	\$ (3,551,740)	\$ 4,955,757
Less:			
Preferred stock dividends	1,512,750	1,512,750	1,516,952
Accretion of discount on preferred stock	476,474	476,474	476,474
Net income (loss) available to common shareholders	\$ 868,046	\$ (5,540,964)	\$ 2,962,331
Average shares outstanding	4,652,994	4,652,994	4,652,994

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The following options to purchase shares during the fiscal years ended 2011, 2010, and 2009 were not included in the

with the effect of the unamortized compensation expense, was greater than the average market price of the common shares and were considered anti-dilutive.

	Years Ended December 31,		
	2011	2010	2009
Anti-dilutive shares - option shares	260,274	260,466	298,382
Anti-dilutive shares - warrant shares	276,090	276,090	276,090

(14) Capital Requirements

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.

Quantitative measures established by regulations to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital to risk-weighted assets, and of Tier I capital to adjusted-average assets. Management believes, as of December 31, 2011 and 2010, the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2011, the most recent notification from the regulatory authorities categorized the bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are

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The actual and required capital amounts and ratios for the Company and the Bank as of December 31, 2011 and 2010 are as follows (dollars in thousands):

	<u>Actual</u>		<u>Minimum Capital requirements</u>		<u>Well-Capitalized Capital Requirements</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
December 31, 2011						
Total capital (to risk-weighted assets):						
Company	\$ 159,768	18.03 %	\$ 70,905	8.00 %	—	—
Hawthorn Bank	130,361	14.18	73,548	8.00	\$ 91,834	10.00 %
Tier I capital (to adjusted average assets):						
Company	\$ 134,391	11.52 %	\$ 34,993	3.00 %	—	—
Hawthorn Bank	119,498	10.45	34,309	3.00	\$ 57,181	5.00 %
December 31, 2010						
Total capital (to risk-weighted assets):						
Company	\$ 159,510	17.05 %	\$ 74,863	8.00 %	—	—
Hawthorn Bank	130,361	14.18	73,548	8.00	\$ 91,834	10.00 %
Tier I capital (to risk-weighted assets):						
Company	\$ 133,349	14.25 %	\$ 37,431	4.00 %	—	—
Hawthorn Bank	118,837	12.93	36,774	4.00	\$ 55,161	6.00 %
Tier I capital (to adjusted average assets):						
Company	\$ 133,349	11.00 %	\$ 36,360	3.00 %	—	—
Hawthorn Bank	118,837	9.99	35,685	3.00	\$ 59,475	5.00 %

(15) Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain financial and nonfinancial assets and liabilities. The FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The standard applies whenever other standards require (permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, FASB clarified the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. As of December 31, 2011 and 2010, there were no transfers into or out of Level 2.

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Description	Fair Value December 31, 2011	Fair Value Measurements At December 31, 2011 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. treasury	\$ 2,054,102	\$ -	\$ 2,054,102	\$ -
Government sponsored enterprises	70,313,978	-	70,313,978	-
Asset-backed securities	107,328,618	-	107,328,618	-
Obligations of states and political subdivisions	34,109,303	-	34,109,303	-
Total	\$ 213,806,001		\$ 213,806,001	\$ -

Description	Fair Value December 31, 2010	Fair Value Measurements At December 31, 2010 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. treasury	\$ 1,027,891	\$ -	\$ 1,027,891	\$ -
Government sponsored enterprises	53,341,551	-	53,341,551	-
Asset-backed securities	90,176,241	-	90,176,241	-
Obligations of states and political subdivisions	34,431,867	-	34,431,867	-
Total	\$ 178,977,550		\$ 178,977,550	\$ -

Valuation methods for instruments 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:

Impaired Loans

The Company does not record loans at fair value on a recurring basis other than loans that are considered impaired. The net carrying value of impaired loans is generally based on fair values of the underlying collateral obtained through independent appraisals or internal evaluations, or by discounting the total expected future cash flows. Once the fair value of the collateral has been determined and any impairment amount calculated, a specific reserve allocation is made. Because many of these inputs are not observable, the measurements are classified as Level 3. As of December 31, 2011, the Company identified \$30.4 million in impaired loans that had specific allowances for losses aggregating \$3.7 million. Related to these loans, there was \$11.3 million in charge-offs recorded during 2011.

Other Real Estate Owned and Repossessed Assets

Other real estate owned and repossessed assets consist of loan collateral which 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. Other real estate owned assets are recorded as held for sale initially at the lower of the cost or fair value. Subsequent to initial recognition, the assets are carried at the lower of cost or fair value. The fair value is determined by the Company's management, based on the best available information. The fair value is determined by the Company's management, based on the best available information. The fair value is determined by the Company's management, based on the best available information.

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estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgment based on experience and expertise of internal specialists. Subsequent to foreclosure, 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.

Description	Fair Value December 31, 2011	Fair Value Measurements Using			Total Gains (Losses)*
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Impaired loans:					
Commercial, financial, & agricultural	\$ 642,745	\$ -	\$ -	\$ 642,745	\$ (2,135,996)
Real estate construction - residential	396,460	-	-	396,460	(1,556,738)
Real estate construction - commercial	6,028,792	-	-	6,028,792	(279,088)
Real estate mortgage - residential	3,600,744	-	-	3,600,744	(1,509,328)
Real estate mortgage - commercial	15,980,238	-	-	15,980,238	(5,841,988)
Total	\$ 26,648,979	\$ -	\$ -	\$ 26,648,979	\$ (11,323,138)
Other real estate owned and repossessed assets	\$ 16,020,023	\$ -	\$ -	\$ 16,020,023	\$ (2,111,929)

Description	Fair Value December 31, 2010	Fair Value Measurements Using			Total Gains (Losses)*
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Impaired loans:					
Commercial, financial, & agricultural	\$ 1,480,836	\$ -	\$ -	\$ 1,480,836	\$ (1,634,544)
Real estate construction - residential	263,870	-	-	263,870	(863,399)
Real estate construction - commercial	3,284,371	-	-	3,284,371	(4,496,156)
Real estate mortgage - residential	4,459,151	-	-	4,459,151	(3,971,927)
Real estate mortgage - commercial	14,368,132	-	-	14,368,132	(3,626,892)
Total	\$ 23,856,360	\$ -	\$ -	\$ 23,856,360	\$ (14,592,918)
Other real estate owned and repossessed assets	\$ 14,009,017	\$ -	\$ -	\$ 14,009,017	\$ (3,528,011)

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

(16) 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:

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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*.

Federal Funds Sold, Cash, and Due from Banks

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

Mortgage Servicing Rights

The fair value of mortgage servicing rights is based on the discounted value of contractual cash flows utilizing servicing rate, constant prepayment rate, servicing cost, and discount rate factors. Accordingly, the fair value is estimated based on a valuation model which calculates the present value of estimated future net servicing income. The model

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A summary of the carrying amounts and fair values of the Company's financial instruments at December 31, 2011 and 2010 is as follows:

	2011		2010	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets:				
Loans	\$ 829,121,324	\$ 830,077,000	\$ 883,907,596	\$ 889,291,000
Investment in debt securities	213,806,001	213,806,001	178,977,550	178,977,550
Federal fund sold and securities purchased under agreements to resell	75,000	75,000	125,815	125,815
Cash and due from banks	43,134,530	43,134,530	50,853,985	50,853,985
Federal fund sold and securities purchased under agreements to resell	75,000	75,000	125,815	125,815
Cash and due from banks	43,134,530	43,134,530	50,853,985	50,853,985
Mortgage servicing rights	2,308,377	2,512,000	2,355,990	3,027,000
Liabilities:				
Deposits:				
Demand	\$ 159,186,859	\$ 159,186,859	\$ 137,749,571	\$ 137,749,571
NOW	169,451,594	169,451,594	160,225,356	160,225,356
Savings	62,075,470	62,075,470	54,722,129	54,722,129
Money market	153,071,624	153,071,624	164,190,054	164,190,054
Time	414,438,606	421,687,000	429,775,546	437,996,000
Federal funds purchased and securities sold under agreements to repurchase	24,516,277	24,516,277	30,068,453	30,068,453
Subordinated notes	49,486,000	22,082,000	49,486,000	21,105,000
Other borrowings	28,409,989	29,525,000	66,985,978	69,329,000
Accrued interest payable	1,054,202	1,054,202	1,491,503	1,491,503
	\$ 1,061,690,621	\$ 1,042,650,026	\$ 1,094,694,590	\$ 1,076,877,066

Off-Balance Sheet Financial Instruments

The fair value of commitments to extend credit and standby letters of credit are 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, which are competitive in the markets in which it operates. See Note 17 for further discussion.

Limitations

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On December 17, 2009, a suit was filed against Hawthorn Bank (the Bank) in Circuit Court of Jackson County for the Eastern Division of Missouri state court by a customer alleging that the Bank had not followed through on its commitment to fund a loan request. A jury found in favor of the customer and awarded \$620,000 in damages to the

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plaintiffs, including \$200,000 in punitive damages. After hearing post-judgment motions, the trial court struck the punitive damage award and entered an amended judgment for a total of \$510,000 against the Bank. As of December 31, 2011, the Company carried a liability of \$161,000 with respect to this matter. The Company is in the early stages of the appeals process and the probable outcome is presently not determinable.

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(18) Condensed Financial Information of the Parent Company Only

Following are the condensed financial statements of Hawthorn Bancshares, Inc. (Parent only) as of and for the years indicated:

Condensed Balance Sheets

	December 31,	
	2011	2010
Assets		
Cash and due from bank subsidiaries	\$ 13,281,671	\$ 12,448,772
Investment in equity securities	1,486,000	1,486,000
Investment in subsidiaries	140,361,330	138,677,199
Premises and equipment	1,611	3,662
Deferred tax asset	1,610,808	166,349
Other assets	9,921	21,430
Total assets	\$ 156,751,341	\$ 152,803,412
Liabilities and Stockholders' Equity		
Subordinated notes	\$ 49,486,000	\$ 49,486,000
Other liabilities	4,689,568	1,829,101
Stockholders' equity	102,575,773	101,488,311
Total liabilities and stockholders' equity	\$ 156,751,341	\$ 152,803,412

Condensed Statements of Operations

	For the Years Ended December 31,		
	2011	2010	2009
Income			
Interest and dividends received from subsidiaries	\$ 5,191,614	\$ 4,405,349	\$ 247,842
Total income	5,191,614	4,405,349	247,842
Expenses			
Interest on subordinated notes	1,301,178	1,525,553	2,446,742
Other	2,605,082	2,904,355	3,057,108
Total expenses	3,906,260	4,429,908	5,503,850
Income (loss) before income tax benefit and equity in undistributed income of subsidiaries	1,285,354	(24,559)	(5,256,008)
Income tax benefit	1,367,927	1,449,929	1,918,880
Income (loss) before income tax benefit and equity in undistributed income of subsidiaries	2,653,281	1,425,370	(3,337,128)

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Condensed Statements of Cash Flows			
	2011	2010	2009
Cash flows from operating activities:			
Net income (loss)	\$ 2,857,270	\$ (3,551,740)	\$ 4,955,757
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	2,051	2,441	3,404
Equity in undistributed (income) losses of subsidiaries	(203,989)	4,977,110	(8,292,885)
Stock based compensation expense	57,874	87,310	130,459
(Increase) decrease in deferred tax asset	(274,245)	(37,876)	120,281
Other, net	(89,557)	381,702	(109,419)
Net cash provided by (used in) operating activities	2,349,404	1,858,947	(3,192,403)
Cash flows from investing activities:			
Purchase of premise and equipment	—	—	(3,052)
Proceeds from sale premise and equipment	—	—	500
Investment in subsidiary	900,000	(1,250,000)	(8,000,000)
Net cash provided by (used in) investing activities	900,000	(1,250,000)	(8,002,552)
Cash flows from financing activities:			
Proceeds from issuance of preferred stock and warrant	—	—	—
Purchase of treasury stock	—	—	—
Cash dividends paid - preferred stock	(1,512,750)	(1,512,750)	(1,369,879)
Cash dividends paid - common stock	(903,755)	(1,385,230)	(2,665,557)
Net cash used in financing activities	(2,416,505)	(2,897,980)	(4,035,436)
Net increase (decrease) in cash and due from banks	832,899	(2,289,033)	(15,230,391)
Cash and due from banks at beginning of year	12,448,772	14,737,805	29,968,196
Cash and due from banks at end of year	\$ 13,281,671	\$ 12,448,772	\$ 14,737,805

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(19) Quarterly Financial Information (Unaudited)

Year Ended December 31, 2011

<i>(In thousands except per share data)</i>	First quarter	Second quarter	Third quarter	Fourth quarter	Year to Date
Interest income	\$ 13,583	\$ 13,640	\$ 13,384	\$ 12,861	\$ 53,468
Interest expense	3,102	2,858	2,580	2,313	10,853
Net interest income	10,481	10,782	10,804	10,548	42,615
Provision for loan losses	1,750	1,883	2,010	5,880	11,523
Noninterest income	2,052	2,178	2,358	2,612	9,200
Noninterest expense	9,378	9,008	8,925	9,533	36,844
Income tax (benefit) expense	451	661	711	(1,232)	591
Net income (loss)	\$ 954	\$ 1,408	\$ 1,516	\$ (1,021)	\$ 2,857
Preferred stock dividends	370	382	379	382	1,513
Accretion of discount on preferred stock	119	119	119	119	476
Net income (loss) available to common stockholders	\$ 465	\$ 907	\$ 1,018	\$ (1,522)	\$ 868
Net income (loss) per share:					
Basic earnings (loss) per share	\$ 0.10	\$ 0.19	\$ 0.22	\$ (0.33)	\$ 0.19
Diluted earnings (loss) per share	0.10	0.19	0.22	(0.33)	0.19

Year Ended December 31, 2010

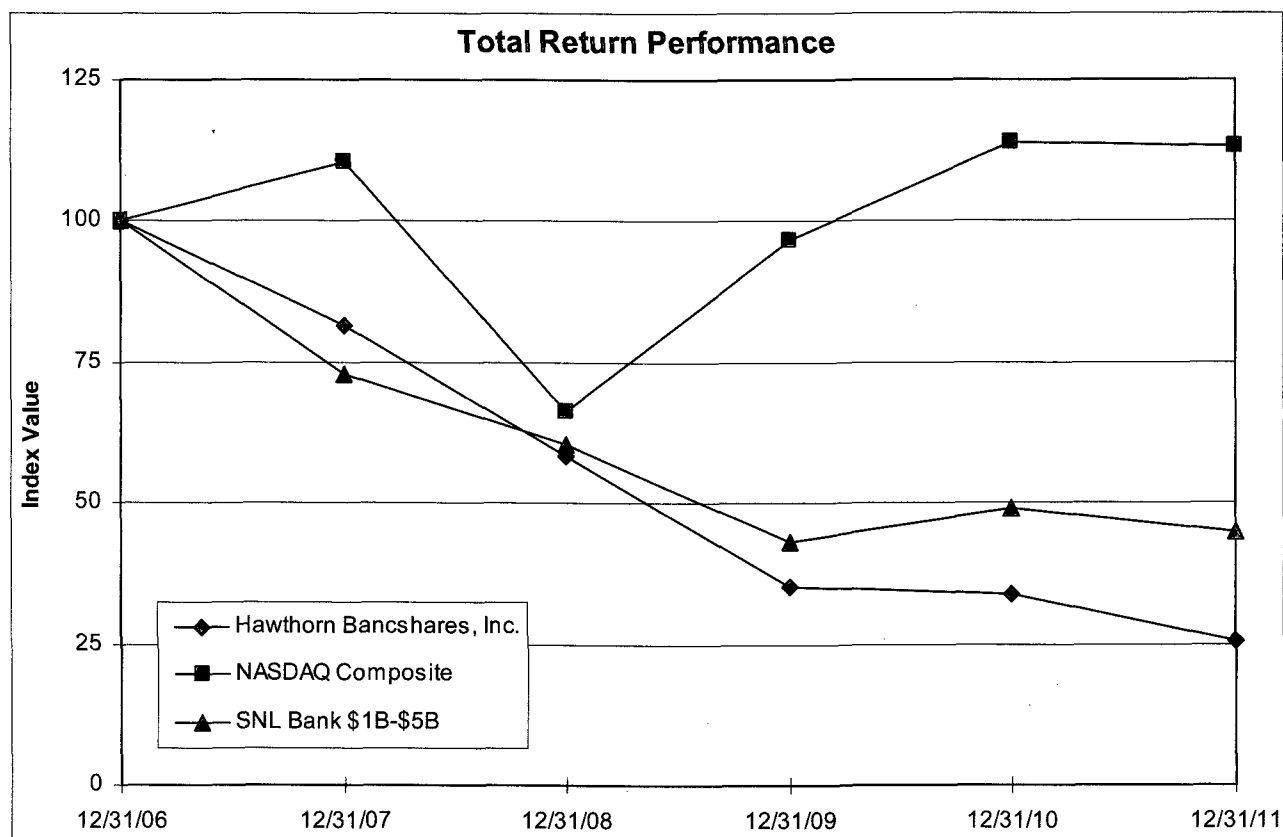
<i>(In thousands except per share data)</i>	First quarter	Second quarter	Third quarter	Fourth quarter	Year to Date
Interest income	\$ 14,873	\$ 15,103	\$ 14,625	\$ 14,138	\$ 58,739
Interest expense	4,562	3,989	3,766	3,436	15,753
Net interest income	10,311	11,114	10,859	10,702	42,986
Provision for loan losses	2,505	2,150	2,450	8,150	15,255
Noninterest income	2,006	2,450	2,910	3,115	10,481
Noninterest expense	9,131	10,320	9,365	16,035	44,851
Income tax (benefit) expense	187	312	531	(4,117)	(3,087)
Net income (loss)	\$ 494	\$ 782	\$ 1,423	\$ (6,251)	\$ (3,552)
Preferred stock dividends	370	382	379	382	1,513
Accretion of discount on preferred stock	119	119	119	119	476
Net income (loss) available to common stockholders	\$ 5	\$ 281	\$ 925	\$ (6,752)	\$ (5,541)

MARKET PRICE OF AND DIVIDENDS ON EQUITY SECURITIES AND RELATED MATTERS

of "HWBK." The following table sets forth the range of high and low bid prices of our Company's common stock by quarter for each quarter in 2011 and 2010 in which the stock was traded.

2011	High	Low
First Quarter	\$ 9.33	\$ 8.06

assumes that the value of an investment in our common stock and each index was \$100 at December 31, 2006 and that all dividends were reinvested. The information presented in the performance graph is historical in nature and is not intended to represent or guarantee future returns.



The comparison of cumulative total returns presented in the above graph was plotted using the following index values and common stock price values:

	<u>12/31/06</u>	<u>12/31/07</u>	<u>12/31/08</u>	<u>12/31/09</u>	<u>12/31/10</u>	<u>12/31/11</u>
Hawthorn Bancshares, Inc.	\$100.00	\$81.56	\$58.41	\$35.36	\$33.94	\$25.52
Nasdaq Composite (U.S. Companies)	\$100.00	\$110.66	\$66.42	\$96.54	\$114.06	\$113.16
Index of financial institutions (\$1 billion to \$5 billion)	\$100.00	\$72.84	\$60.42	\$43.31	\$49.09	\$44.77

DIRECTORS AND EXECUTIVE OFFICERS OF OUR COMPANY

<u>Name</u>	<u>Position with Our Company</u>	<u>Position with Subsidiary Bank</u>	<u>Principal Occupation</u>
David T. Turner	Chairman, Chief Executive Officer, President and Director	Chairman, Chief Executive Officer, President and Director	Position with Hawthorn Bancshares and Hawthorn Bank
	Officer, President and Director -Class III	Officer, President and Director	Bancshares and Hawthorn Bank
Charles G. Dudenhoefter, Jr.	Director-Class II	Director	Retired
Philip D. Freeman	Director-Class I	Director	Owner/Manager, Freeman Mortuary, Jefferson City, Missouri
Kathleen L. Bruegenhemke	Senior Vice President, Chief Risk Officer and Corporate Secretary	Senior Vice President and Chief Risk Officer	Position with Hawthorn Bancshares and Hawthorn Bank
James E. Smith	Director-Class I	Director	Retired
Gus S. Wetzel, II	Director-Class II	Director	Physician, Wetzel Clinic, Clinton, Missouri
W. Bruce Phelps	Chief Financial Officer	Senior Vice President and Chief Financial Officer	Position with Hawthorn Bancshares and Hawthorn Bank
Kathleen L. Bruegenhemke	Senior Vice President, Chief Risk Officer and Corporate Secretary	Senior Vice President and Chief Risk Officer	Position with Hawthorn Bancshares and Hawthorn Bank
Richard G. Rose	Former Chief Financial Officer - Retired 1-30-12	Senior Vice President	Position with Hawthorn Bank

ANNUAL REPORT ON FORM 10-K

A copy of our Company's Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission, excluding exhibits, will be furnished without charge to shareholders entitled to vote at the 2012 annual meeting of shareholders upon written request to Kathleen L. Bruegenhemke, Secretary, Hawthorn Bancshares, Inc., 132 East High Street, Jefferson City, Missouri 65101. Our Company will provide a copy of any exhibit to the Form 10-K to any such person upon written request and the payment of our Company's reasonable expenses in furnishing such exhibits.

