UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

**FORM 10-K**

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2020

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _________________ to ________________.

Commission file number: 0-23636

**HAWTHORN BANCSHARES, INC.**
*(Exact name of registrant as specified in its charter)*

| **Missouri** | **43-1626350** |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**132 East High Street, Box 688, Jefferson City, Missouri 65102**
*(Address of principal executive offices)* *(Zip Code)*

**(573) 761-6100**
*(Registrant's telephone number, including area code)*

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

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

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:**

Common Stock, par value $1.00 per share
*(Title of Class)*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | |
|---|---|---|
| Large accelerated filer ☐ | Accelerated filer ☐ | Non-accelerated filer ☒ |
| Smaller reporting company ☒ | Emerging growth company ☐ | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the 5,805,361 shares of voting and non-voting common equity of the registrant held by non-affiliates computed by reference to the $19.69 closing price of such common equity on June 30, 2020, the last business day of the registrant's most recently completed second fiscal quarter, was $114,307,556. Aggregate market value excludes an aggregate of 680,287 shares of common stock held by officers and directors and by each person known by the registrant to own 5% or more of the outstanding common stock on such date. Exclusion of shares held by any of these persons should not be construed to indicate that such person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the registrant, or that such person is controlled by or under common control with the registrant. As of March 12, 2021, the registrant had 6,769,322 shares of common stock, par value $1.00 per share, issued and 6,362,476 shares outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the following documents are incorporated by reference into the indicated parts of this report: (1) 2020 Annual Report to Shareholders - Part II and (2) definitive Proxy Statement for the 2021 Annual Meeting of Shareholders to be filed with the Commission pursuant to Regulation 14A - Part III.

**PART I**

**Item 1. Business.**

This report and the documents incorporated by reference herein contain forward-looking statements, which are inherently subject to risks and uncertainties. See "Forward Looking Statements" under Item 7 of this report.

**General**

The Company, Hawthorn Bancshares, Inc., is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. Hawthorn Bancshares, Inc. was incorporated under the laws of the State of Missouri on October 23, 1992 as Exchange National Bancshares, Inc. and changed its name to Hawthorn Bancshares, Inc. in August 2007. The Company owns all of the issued and outstanding capital stock of Union State Bancshares, Inc., which in turn owns all of the issued and outstanding capital stock of Hawthorn Bank. The Company and Union State Bancshares each received approval from the Federal Reserve and elected to become a financial holding company on October 21, 2001.

The Company acquired Hawthorn Bank and its constituent predecessor banks, as well as Union State Bancshares, in a series of transactions that are summarized as follows:

- On April 7, 1993 the Company acquired all of the issued and outstanding capital stock of The Exchange National Bank of Jefferson City, a national banking association, pursuant to a corporate reorganization involving an exchange of shares;
- On November 3, 1997, the Company acquired Union State Bancshares, Inc., and Union's wholly-owned subsidiary, Union State Bank and Trust of Clinton;
- On January 3, 2000, the Company acquired Osage Valley Bank;
- Following the May 4, 2000 acquisition of Citizens State Bank of Calhoun by Union State Bank, Citizens State Bank merged into Union State Bank to form Citizens Union State Bank & Trust;
- On June 16, 2000, the Company acquired City National Savings Bank, FSB, which was then merged into Exchange National Bank; and
- On May 2, 2005, the Company acquired all of the issued and outstanding capital stock of Bank 10, a Missouri state bank.

On December 1, 2006, the Company announced its development of a strategic plan in which, among other things, Exchange National Bank, Citizens Union State Bank, Osage Valley Bank and Bank 10 would be consolidated into a single bank under a Missouri state trust charter. This consolidation was completed in October 2007, and the subsidiary bank is now known as Hawthorn Bank.

Except as otherwise provided herein, references herein to the "Company" or "Hawthorn" include Hawthorn Bancshares, Inc. and its consolidated subsidiaries, and references herein to the "Bank" refers to Hawthorn Bank and its constituent predecessors.

**Description of Business**

**Company.** The Company is a bank holding company registered under the Bank Holding Company Act that has elected to become a financial holding company. The Company's activities currently are limited to ownership, indirectly through its subsidiary (Union State Bancshares, Inc.), of the outstanding capital stock of Hawthorn Bank. In addition to ownership of its subsidiaries, the Company may seek expansion through acquisition and may engage in those activities (such as investments in banks or operations that are financial in nature) in which it is permitted to engage under applicable law. It is not currently anticipated that the Company will engage in any business other than that directly related to its ownership of its banking subsidiary or other financial institutions.

**Union.** Union State Bancshares, Inc. is a bank holding company registered under the Bank Holding Company Act that has elected to become a financial holding company. Union's activities currently are limited to ownership of the outstanding capital stock of Hawthorn Bank. It is not currently anticipated that Union will engage in any business other than that directly related to its ownership of Hawthorn Bank.

**Hawthorn Bank**. Hawthorn Bank was founded in 1932 as a Missouri bank and converted to a Missouri trust company on August 16, 1989. However, its predecessors trace their lineage back to the founding of Exchange National Bank in 1865. Hawthorn Bank has 23 banking offices, including its principal office at 132 East High Street in Jefferson City's central business district. See "Item 2. Properties".

Hawthorn Bank is a full service bank conducting a general banking and trust business, offering its customers checking and savings accounts, internet banking, debit cards, certificates of deposit, trust services, brokerage services, safety deposit boxes and a wide range of lending services, including commercial and industrial loans, single payment personal loans, installment loans and commercial and residential real estate loans.

Hawthorn Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation (the "FDIC") to the extent provided by law. Hawthorn Bank's operations are supervised and regulated by the FDIC and the Missouri Division of Finance. Periodic examinations of Hawthorn Bank are conducted by representatives of the FDIC and the Missouri Division of Finance. Such regulations, supervision and examinations are principally for the benefit of depositors, rather than for the benefit of the holders of Hawthorn Bank's common stock. See "Regulation Applicable to Bank Holding Companies" and "Regulation Applicable to the Bank".

**Hawthorn Real Estate**. Hawthorn Real Estate, LLC, a non-bank subsidiary of the Company, was formed in December 2008 in order to purchase and hold various nonperforming assets of Hawthorn Bank. The purpose for holding these nonperforming assets in Hawthorn Real Estate is to allow for the orderly disposition of these assets and strengthen Hawthorn Bank's financial position.

**HB Realty, LLC.** HB Realty, LLC, a Missouri limited liability company ("HB Realty"), was formed in February 2018 and commenced operations in April 2018. HB Realty is intended to qualify as a "real estate investment trust" under the Internal Revenue Code of 1986, as amended (the "IRC"). HB Realty was formed in order to hold certain mortgage loans and participation interests contributed to it by Hawthorn Bank. HB Realty was initially capitalized with mortgage loans and participation interests having an approximate aggregate book value of $404,665,296. As of December 31, 2020, the approximate aggregate book value of the mortgage loans and participation interests held by HB Realty was $464,631,531.

Initially, Hawthorn Bank was the sole common member and the sole preferred member of HB Realty, owning all 1,000 common shares and all 1,000 preferred shares. On April 1, 2018, Hawthorn Bank contributed all 1,000 common shares and 850 preferred shares to Jefferson City IHC, LLC, a Missouri limited liability company that is wholly owned by Hawthorn Bank ("JCIHC"). Under the IRC, a real estate investment trust must have at least one hundred (100) owners. Pursuant to a newly established Hawthorn Bank Real Estate Investment Trust Ownership Plan, Hawthorn Bank made available to certain employees of Hawthorn Bank, as an employee benefit, up to a total of 150 preferred shares of HB Realty. Each selected employee was given the opportunity to own one preferred share of HB Realty. These preferred shares were transferred to employees beginning in January 2019. Each preferred share is generally entitled to an annual dividend of thirty dollars ($30) and a liquidation amount of $500. Although dividends are not guaranteed, it is expected that HB Realty will pay dividends in December of each year. By virtue of its ownership of JCIHC, Hawthorn Bank indirectly owns the remaining economic interest associated with membership interests in HB Realty.

Through its ownership of JCIHC, Hawthorn Bank is, indirectly, the controlling member of HB Realty and is entitled to control the appointment of managers of HB Realty. The Board of Managers of HB Realty, which is responsible for the management of the business and affairs of HB Realty, is currently comprised of David T. Turner, Kathleen L. Bruegenhemke, Gregg A. Bexten and Stephen E. Guthrie.

On December 7$^{th}$, 2020 Hawthorn Bank was informed that certain mortgage loans and participation interests contributed to HB Realty from Hawthorn Bank would no longer be eligible as collateral at the Federal Home Loan Bank

(“FHLB”), where Hawthorn Bank maintains credit facilities. The FHLB has implemented a 5 year run-off period for the affected collateral pledged as of September 30, 2020 and Hawthorn Bank continues to investigate alternative solutions for maintaining the borrowing capacity relative to the affected collateral.

**Hawthorn Risk Management, Inc.,** a non-bank subsidiary of the Company, which was formed and began operations on December 28, 2017, is a Missouri-based captive insurance company which provides property and casualty insurance coverage to the Company and the Bank for which insurance may not be currently available or economically feasible in today's insurance marketplace. Hawthorn Risk Management, Inc. pools resources with several other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves. Hawthorn Risk Management, Inc. is subject to the regulations of the State of Missouri and undergoes periodic examinations by the Missouri Division of Insurance**.**

**Employees**

As of December 31, 2020, Hawthorn and its subsidiaries had approximately 290 full-time and 16 part-time employees. None of its employees is presently represented by any union or collective bargaining group, and the Company considers its employee relations to be satisfactory.

**Competition**

Bank holding companies and their subsidiaries and affiliates encounter intense competition from nonbanking as well as banking sources in all of their activities. The Bank's competitors include other commercial banks, thrifts, savings banks, credit unions, and money market mutual funds. Thrifts and credit unions now have the authority to offer checking accounts and to make corporate and agricultural loans and were granted expanded investment authority by recent federal regulations. In addition, large national and multinational corporations have in recent years become increasingly visible in offering a broad range of financial services to all types of commercial and consumer customers. In the Bank's service areas, new competitors, as well as the expanding operations of existing competitors, have had, and are expected to continue to have, an adverse impact on the Bank's market share of deposits and loans in such service areas.

The Bank experiences substantial competition for deposits and loans within both its primary service areas of Jefferson City, Columbia, Clinton, Lee's Summit, Warsaw, and Springfield, Missouri and its secondary service area of the nearby communities in Cole, Boone, Henry, Cass, Benton, and Greene counties of Missouri. Hawthorn Bank's principal competition for deposits and loans comes from other banks within its primary service areas and, to an increasing extent, other banks in nearby communities. Based on publicly available information, management believes that Hawthorn Bank is the third largest (in terms of deposits) of the twelve banks within Cole county, the tenth largest (in terms of deposits) of thirty-one banks within Boone county, the largest (in terms of deposits) of the eight banks within Henry county, the third largest (in terms of deposits) of the eighteen banks within Cass county, and the second largest (in terms of deposits) of the five banks within Benton county. The main competition for Hawthorn Bank's trust services is from other commercial banks, including those of the Kansas City metropolitan area.

**Regulation Applicable to Bank Holding Companies**

**General.** As a registered bank holding company and a financial holding company under the Bank Holding Company Act (the "BHC Act") and the Gramm-Leach-Bliley Act (the "GLB Act"), Hawthorn is subject to supervision and examination by the Board of Governors of the Federal Reserve System (the "FRB"). The FRB has authority to issue cease and desist orders against bank holding companies if it determines that their actions represent unsafe and unsound practices or violations of law. In addition, the FRB is empowered to impose civil money penalties for violations of banking statutes and regulations. Regulation by the FRB is intended to protect depositors of the Bank, not the shareholders of Hawthorn. Hawthorn also is subject to a number of restrictions and requirements imposed by the Sarbanes-Oxley Act of 2002 relating to internal controls over financial reporting, disclosure controls and procedures, loans to directors or executive officers of the Hawthorn and its subsidiaries, the preparation and certification of Hawthorn's consolidated financial statements, the duties of Hawthorn's audit committee, relations with and functions performed by Hawthorn's independent registered public accounting firm, and various accounting and corporate governance matters.

**Limitation on Activities.** The activities of bank holding companies are generally limited to the business of banking, managing or controlling banks, and other activities that the FRB has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In addition, under the GLB Act, a bank holding company, all of whose controlled depository institutions are "well capitalized" and "well managed" (as defined in federal banking regulations) with "satisfactory" Community Reinvestment Act ratings, may declare itself to be a "financial holding company" and engage in a broader range of activities. As noted above, Hawthorn is registered as a financial holding company.

A financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. "Financial in nature" activities include:

- securities underwriting, dealing and market making;
- sponsoring mutual funds and investment companies;
- insurance underwriting and insurance agency activities;
- merchant banking; and
- activities that the FRB determines to be financial in nature or incidental to a financial activity or which is complementary to a financial activity and does not pose a safety and soundness risk.

A financial holding company that desires to engage in activities that are financial in nature or incidental to a financial activity but not previously authorized by the FRB must obtain approval from the FRB before engaging in such activity. Also, a financial holding company may seek FRB approval to engage in an activity that is complementary to a financial activity, if it shows, among other things, that the activity does not pose a substantial risk to the safety and soundness of its insured depository institutions or the financial system.

A financial holding company generally may acquire a company (other than a bank holding company, bank or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature without prior approval from the FRB. Prior FRB approval is required, however, before the financial holding company may acquire control of more than 5% of the voting shares or substantially all of the assets of a bank holding company, bank or savings association. In addition, under the FRB's merchant banking regulations, a financial holding company is authorized to invest in companies that engage in activities that are not financial in nature, as long as the financial holding company makes its investment with the intention of limiting the duration of the investment, does not manage the company on a day-to-day basis, and the company does not cross-market its products or services with any of the financial holding company's controlled depository institutions.

If any subsidiary bank of a financial holding company ceases to be "well-capitalized" or "well-managed" and fails to correct its condition within the time period that the FRB specifies, the FRB has authority to order the financial holding company to divest its subsidiary banks. Alternatively, the financial holding company may elect to limit its activities and the activities of its subsidiaries to those permissible for a bank holding company that is not a financial holding company. If any subsidiary bank of a financial holding company receives a rating under the Community Reinvestment Act (the "CRA") of less than "satisfactory", then the financial holding company is prohibited from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations until the rating is raised to "satisfactory" or better.

**Limitation on Acquisitions**. The BHC Act requires a bank holding company to obtain prior approval of the FRB before:

- taking any action that causes a bank to become a controlled subsidiary of the bank holding company;
- acquiring direct or indirect ownership or control of voting shares of any bank or bank holding company, if the acquisition results in the acquiring bank holding company having control of more than 5% of the

outstanding shares of any class of voting securities of such bank or bank holding company, and such bank or bank holding company is not majority-owned by the acquiring bank holding company prior to the acquisition;

- acquiring substantially all of the assets of a bank; or
- merging or consolidating with another bank holding company.

**Regulatory Capital Requirements.** The FRB has issued risk-based and leverage capital guidelines applicable to United States banking organizations. If a bank holding company's capital falls below minimum required levels, then the bank holding company must implement a plan to increase its capital, and its ability to pay dividends and make acquisitions of new bank subsidiaries may be restricted or prohibited. The risk-based capital guidelines that applied to us and our subsidiary bank prior to January 1, 2015 were based on the 1988 capital accord, referred to as Basel I, of the International Basel Committee on Banking Supervision (which we refer to as the "Basel Committee"), a committee of central banks and bank supervisors, as implemented by federal bank regulators. In 2008, the bank regulatory agencies began to phase-in capital standards based on a second capital accord issued by the Basel Committee, referred to as Basel II, for large or "core" international banks (generally defined for U.S. purposes as having total assets of $250 billion or more or consolidated foreign exposures of $10 billion or more). Because we do not anticipate controlling any large or "core" international bank in the foreseeable future, Basel II presently does not apply to us. On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee, announced agreement on the calibration and phase-in arrangements for a strengthened set of capital requirements, known as Basel III. In July 2013, the federal banking agencies announced new risk-based capital and leverage ratios to conform to the Basel III framework and address provisions of the Dodd-Frank Act. With respect to the Company and the Bank, these requirements become effective on January 1, 2015.

The Basel III Rules established three components of regulatory capital: (1) common equity tier 1 capital (“CET1”), (2) additional tier 1 capital, and (3) tier 2 capital. CET1 capital generally includes common stock instruments and related surplus (net of treasury stock), retained earnings, and, subject to certain adjustments, minority common equity interests in subsidiaries, less goodwill and certain other adjustments. Tier 1 Capital generally includes CET1 Capital plus Additional Tier 1 Capital elements, such as non-cumulative perpetual preferred stock and similar instruments meeting specified criteria and minority interests in subsidiaries that do not satisfy the requirements for Common Equity Tier 1 Capital treatment. Cumulative preferred stock (other than cumulative preferred stock issued to the U.S. Treasury under the Capital Purchase Program or the Small Business Lending Fund) does not qualify as Additional Tier 1 Capital. Trust preferred securities and other non-qualifying capital instruments issued prior to May 19, 2010 by bank and savings and loan holding companies with less than $15 billion in assets as of December 31, 2009 or by mutual holding companies may continue to be included in Tier 1 Capital but will be phased out over 10 years beginning in 2016 for all other banking organizations. These non-qualifying capital instruments, however, may be included in Tier 2 Capital. Tier 2 Capital may also include certain qualifying debt and the allowance for credit losses up to 1.25% of risk-weighted assets and other adjustments.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and investments in the capital of unconsolidated financial institutions be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Beginning April 1, 2020, this framework for regulatory capital deductions to CET1 will be simplified by increasing the deduction threshold to 25% at the individual level for each of the aforementioned categories. Pursuant to the Basel III Rules, the effects of certain accumulated other comprehensive income or loss (“AOCI”) items are not excluded; however, “non-advanced approaches banking organizations,” including the Company and the Bank, could make a one-time permanent election to continue to exclude these items. The Company made its one-time, permanent election to continue to exclude AOCI from capital in its filing with the Federal Reserve Board for the quarter ended March 31, 2015. If the Company would not have made this election, unrealized gains and losses would have been included in the calculation of its regulatory capital.

The sum of the three tiers of capital less investments in unconsolidated subsidiaries represents the total capital. The risk-based capital ratios are calculated by dividing Common Equity Tier 1, Tier 1 and total capital by risk-weighted assets (including certain off-balance sheet activities). Under the Basel III Rules, the minimum capital ratios effective as of January 1, 2015 are:

- Common Equity Tier 1 risk-based capital ratio equal to at least 4.5% of its risk-weighted assets;
- Tier 1 risk-based capital ratio equal to at least 6% of its risk-weighted assets;
- Total risk-based capital ratio equal to at least 8% of its risk-weighted assets; and
- Tier 1 capital to average consolidated assets (leverage ratio) of at least 4%.

In addition to the higher requirements, the Basel III Rules established bank holding companies are required to maintain a common equity Tier 1 capital conservation buffer of at least 2.5% of risk-weighted assets over and above the minimum risk-based capital requirements. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement began being phased in over four years beginning in 2016. On January 1, 2016, the first phase of the requirement went into effect at 0.625% of risk-weighted assets, and increased each subsequent year by an additional 0.625 percentage points, to reach its final level of 2.5% of risk weighted assets on January 1, 2019. At December 31, 2019, the capital conservation buffer requirement of 2.5%, effectively raised the minimum required risk-based capital ratios to 7% Common Equity Tier 1 Capital, 8.5% Tier 1 Capital and 10.5% Total Capital on a fully phased-in basis.

On December 31, 2020, the Company was in compliance with the FRB's capital adequacy guidelines. The Company's capital ratios calculated under the Basel III Rules (minimum plus a 2.5% capital conservation buffer) on December 31, 2020 are as follows:

| **Tier 1 Leverage Ratio (4%) (min requirement)** | **Common Equity Tier 1 Risk-Based Capital Ratio (7.0%) (min requirement plus buffer)** | **Tier 1 Risk-Based Capital Ratio (8.5%) (min requirement plus buffer)** | **Total Risk-Based Capital Ratio (10.5%) (min requirement plus buffer)** |
|---|---|---|---|
| 10.19 % | 10.00 % | 13.37 % | 14.97 % |

The Economic Growth, Regulatory Relief, and Consumer Protection Act (the "EGRRCPA") directs the federal banking agencies to develop a specified Community Bank Leverage Ratio, or CBLR, (that is, the ratio of a bank's equity capital to its consolidated assets) of not less than 8% and not more than 10%. On November 4, 2019, federal regulators issued final rules that provide certain banks and their holding companies with the option to elect out of complying with the Basel III Capital Rules. Under this new rule, a qualifying community banking organization is eligible to elect the community bank leverage ratio framework if it has a community bank leverage ratio, or CBLR, greater than 9% at the time of election.

A qualifying community banking organization, or QCBO, is defined as a bank, a savings association, a bank holding company or a savings and loan holding company with:

- a CBLR greater than 9%;
- total consolidated assets of less than $10 billion;
- total off-balance sheet exposures (excluding derivatives other than credit derivatives and unconditionally cancelable commitments) of 25% or less of total consolidated assets; and
- total trading assets and trading liabilities of 5% or less of total consolidated assets.

A QCBO may elect out of complying with the Basel III Capital Rules if, at the time of the election, the QCBO has a CBLR above 9%. The CBLR is generally calculated in accordance with the regulations for calculating the Tier 1 leverage ratio under the regulatory capital framework discussed above and below, with certain specified exceptions. As of December 31, 2020, the Company and the Bank each qualified to elect the community bank leverage ratio framework because they had a CBLR of greater than 9% and satisfied the other requirements. The Company does not have immediate plans to elect to use the community bank leverage ratio framework but may make such an election in the future.

Implementing Section 4012 of The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), federal banking agencies issued final rules that, effective October 1, 2020, temporarily lower the community bank leverage ratio

threshold and provide a gradual transition back to the prior level. Specifically, the community bank leverage ratio is 8% percent for 2020 and 8.5% for 2021 and is reset at 9% beginning January 1, 2022.

**Interstate Banking and Branching.** Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act"), a bank holding company is permitted to acquire the stock or substantially all of the assets of banks located in any state regardless of whether such transaction is prohibited under the laws of any state. The FRB will not approve an interstate acquisition if, as a result of the acquisition, the bank holding company would control more than 10% of the total amount of insured deposits in the United States or would control more than 30% of the insured deposits in the home state of the acquired bank. The 30% of insured deposits state limit does not apply if the acquisition is the initial entry into a state by a bank holding company or if the home state waives such limit. The Riegle-Neal Act also authorizes banks to merge across state lines, thereby creating interstate branches. The Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010, a subset of the Dodd-Frank Act discussed below, permits banks to acquire and establish de novo branches in other states if a state bank in that other state would be permitted to establish the branch.

Under the Riegle-Neal Act, individual states may restrict interstate acquisitions in two ways. A state may prohibit an out-of-state bank holding company from acquiring a bank located in the state unless the target bank has been in existence for a specified minimum period of time (not to exceed five years). A state may also establish limits on the total amount of insured deposits within the state which are controlled by a single bank holding company, provided that such deposit limit does not discriminate against out-of-state bank holding companies.

**Source of Strength.** Bank holding companies, such as the Company, are required by statute to serve as a source of financial strength for their subsidiary depository institutions, by providing financial assistance to their insured depository institution subsidiaries in the event of financial distress. Under the source of strength requirement, the Company could be required to provide financial assistance to the Bank should it experience financial distress. Furthermore, the FRB has the right to order a bank holding company to terminate any activity that the FRB believes is a serious risk to the financial safety, soundness or stability of any subsidiary bank. The regulators may require these and other actions in support of controlled banks even if such action is not in the best interests of the bank holding company or its stockholders.

**Liability of Commonly Controlled Institutions.** Under cross-guaranty provisions of the Federal Deposit Insurance Act (the "FDIA"), bank subsidiaries of a bank holding company are liable for any loss incurred by the Deposit Insurance Fund (the "DIF"), the federal deposit insurance fund for banks, in connection with the failure of any other bank subsidiary of the bank holding company.

**Bank Secrecy Act and USA PATRIOT Act**. The Company and the Bank must comply with the requirements of the Bank Secrecy Act (the "BSA"). The BSA was enacted to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, drug trafficking, money laundering, and other crimes. Since its passage, the BSA has been amended several times. These amendments include the Money Laundering Control Act of 1986, which made money laundering a criminal act, as well as the Money Laundering Suppression Act of 1994, which required regulators to develop enhanced examination procedures and increased examiner training to improve the identification of money laundering schemes in financial institutions. The USA PATRIOT Act, established in 2001, substantially broadened the scope of U.S. anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent, and report money laundering and terrorist financing. The regulations include significant penalties for non-compliance.

**Missouri Bank Holding Company Regulation**. Missouri prohibits any bank holding company from acquiring ownership or control of any bank or Missouri depository trust company that has Missouri deposits if, after such acquisition, the bank holding company would hold or control more than 13% of total Missouri deposits. Because of this restriction, among others, a bank holding company, prior to acquiring control of a bank or depository trust company that has deposits in Missouri, must receive the approval of the Missouri Division of Finance.

**Regulation Applicable to the Bank**

**General.** Hawthorn Bank, a Missouri state non-member depository trust company, is subject to the regulation of the Missouri Division of Finance and the FDIC. The FDIC is empowered to issue cease and desist orders against the Bank if it determines that any activities of the Bank represent unsafe and unsound banking practices or violations of law. In addition, the FDIC has the power to impose civil money penalties for violations of banking statutes and regulations. Regulation by these agencies is designed to protect the depositors of the Bank; not shareholders of Hawthorn.

**Bank Regulatory Capital Requirements.** The FDIC has adopted minimum capital requirements applicable to state non-member banks, which are similar to the capital adequacy guidelines established by the FRB for bank holding companies. Federal banking laws classified an insured financial institution in one of the following five categories, depending upon the amount of its regulatory capital:

- "well-capitalized" if it has a total Tier 1 leverage ratio of 5% or greater, a Common Equity Tier 1 risk-based capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8% or greater and a total risk-based capital ratio of 10% or greater (and is not subject to any order or written directive requiring the bank to adhere to a higher capital ratio);
- "adequately capitalized" if it has a total Tier 1 leverage ratio of 4% or greater, a Common Equity Tier 1 risk-based capital ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6% or greater, and a total risk-based capital ratio of 8% or greater;
- "undercapitalized" if it has a total Tier 1 leverage ratio that is less than 4%, a Common Equity Tier 1 risk-based capital ratio that is less than 4.5%, a Tier 1 risk-based capital ratio that is less than 6% or a total risk-based capital ratio that is less than 8%;
- "significantly undercapitalized" if it has a total Tier 1 leverage ratio that is less than 3%, a Common Equity Tier 1 risk-based capital ratio that is less than 3%, a Tier 1 risk-based capital ratio that is less than 4% or a total risk-based ratio that is less than 6%; and
- "critically undercapitalized" if it has a Tier 1 leverage ratio that is equal to or less than 2%.

Federal regulatory agencies are required to take prompt corrective action against undercapitalized financial institutions. As of December 31, 2020, the Bank was classified as "well-capitalized," which is required for Hawthorn to remain a financial holding company.

The capital ratios and classifications of the Bank as of December 31, 2020 and the minimum requirements to be considered well-capitalized are as follows:

| Tier 1 Leverage Ratio (5.0% minimum requirement) | Common Equity Tier 1 Risk-Based Capital Ratio (6.5%) (min requirement) | Tier 1 Risk-Based Capital Ratio (8.0%) (min requirement) | Total Risk-Based Capital Ratio (10.0%) (min requirement) |
|---|---|---|---|
| 10.41 % | 13.62 % | 13.62 % | 14.87 % |

**Limitations on Interest Rates and Loans to One Borrower.** The rate of interest a bank may charge on certain classes of loans is limited by state and federal law. At certain times in the past, these limitations have resulted in reductions of net interest margins on certain classes of loans. Federal and state laws impose additional restrictions on the lending activities of banks. The maximum amount that a Missouri state-chartered bank may lend to any one person or entity is generally limited to 15% of the unimpaired capital of the bank located in a city having a population of 100,000 or more, 20% of the unimpaired capital of the bank located in a city having a population of less than 100,000 and over 7,000, and 25% of the unimpaired capital of the bank if located elsewhere in the state. In the case of Missouri state-chartered banks with a composite rating of 1 or 2 under the Capital, Assets, Management, Earnings, Liquidity and Sensitivity (CAMELS) rating system, the maximum amount is the greater of (i) the limits listed in the foregoing sentence or (ii) 25% of the unimpaired capital of the bank.

**Payment of Dividends.** The Company's primary source of funds is dividends from the Bank, and the Bank is subject to federal and state laws limiting the payment of dividends. Under the FDIA, an FDIC-insured institution may not pay dividends while it is undercapitalized or if payment would cause it to become undercapitalized. The National Bank Act and Missouri banking law also prohibit the declaration of a dividend out of the capital and surplus of the bank.

**Community Reinvestment Act.** The Bank is subject to the CRA and implementing regulations. The CRA regulations establish the framework and criteria by which the bank regulatory agencies assess an institution's record of helping to meet the credit needs of its community, including low- and moderate-income neighborhoods. CRA ratings are taken into account by regulators in reviewing certain applications made by Hawthorn and its banking subsidiary.

**Limitations on Transactions with Affiliates.** Hawthorn and its non-bank subsidiaries are "affiliates" within the meaning of the Federal Reserve Act. The amount of loans or extensions of credit which the Bank may make to non-bank affiliates, or to third parties secured by securities or obligations of the non-bank affiliates, are substantially limited by the Federal Reserve Act and the FDIA. Such acts further restrict the range of permissible transactions between a bank and an affiliated company. A bank and its subsidiaries may engage in certain transactions, including loans and purchases of assets, with an affiliated company only if the terms and conditions of the transaction, including credit standards, are substantially the same as, or at least as favorable to the bank as, those prevailing at the time for comparable transactions with non-affiliated companies or, in the absence of comparable transactions, on terms and conditions that would be offered to non-affiliated companies.

**Other Banking Activities.** The investments and activities of the Bank are also subject to regulation by federal and state banking agencies regarding, among other things, investments in subsidiaries, investments for their own account (including limitations on investments in junk bonds and equity securities), loans to officers, directors and their affiliates, security requirements, anti-tying limitations, anti-money laundering, financial privacy and customer identity verification requirements, truth-in-lending, the types of interest bearing deposit accounts which it can offer, trust department operations, brokered deposits, audit requirements, issuance of securities, branching and mergers and acquisitions.

**Changes in Laws and Monetary Policies**

**Recent Legislation.** Various pieces of legislation, including proposals to change substantially the financial institution regulatory system, are from time to time introduced and considered by the Missouri state legislature and the United States Congress. In July 2010, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which enacted substantial changes to the legal framework of the entire financial services industry. The Dodd-Frank Act mandates the passage of numerous rules and regulations by various regulatory agencies over the next few years. It also creates the Consumer Financial Protection Bureau, which will overtake supervision of most providers of consumer financial products and services, and will be empowered to declare acts or practices related to the delivery of a consumer financial product or service to be "unfair, deceptive or abusive." This law will continue to change banking regulation and the operating environment of Hawthorn in substantial and unpredictable ways. These changes could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions and other financial institutions. Hawthorn cannot predict the impact that the Dodd-Frank Act, and the various regulations issued thereunder will have on its business.

Key provisions of the EGRRCPA as it relates to community banks and bank holding companies include, but are not limited to: (i) designating mortgages held in portfolio as "qualified mortgages" for banks with less than $10 billion in assets, subject to certain documentation and product limitations; (ii) exempting banks with less than $10 billion in assets (and total trading assets and trading liabilities of 5% or less of total assets) from Volcker Rule requirements relating to proprietary trading; (iii) simplifying capital calculations for banks with less than $10 billion in assets by requiring federal banking agencies to establish a community bank leverage ratio of tangible equity to average consolidated assets of not less than 8% or more than 10%, and provide that banks that maintain tangible equity in excess of such ratio will be deemed to be in compliance with risk-based capital and leverage requirements; (iv) assisting smaller banks with obtaining stable funding by providing an exception for reciprocal deposits from FDIC restrictions on acceptance of brokered deposits; (v) raising the eligibility for use of short-form Call Reports from $1 billion to $5 billion in assets; (vi) clarifying definitions pertaining to high-volatility commercial real estate, which require higher capital allocations, so that only loans with

increased risk are subject to higher risk weightings; and (vii) changing the eligibility for use of the small bank holding company policy statement from institutions with under $1 billion in assets to institutions with under $3 billion in assets.

**Fiscal Monetary Policies.** Hawthorn's business and earnings are affected significantly by the fiscal and monetary policies of the federal government and its agencies. Hawthorn is particularly affected by the policies of the FRB, which regulates the supply of money and credit in the United States. Among the instruments of monetary policy available to the FRB are:

- conducting open market operations in United States government securities;
- changing the discount rates of borrowings of depository institutions;
- imposing or changing reserve requirements against depository institutions' deposits; and
- imposing or changing reserve requirements against certain borrowings by bank and their affiliates.

These methods are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. The policies of the FRB have a material effect on Hawthorn's business, results of operations and financial condition.

The references in the foregoing discussion to various aspects of statutes and regulation are merely summaries, which do not purport to be complete and which are qualified in their entirety by reference to the actual statutes and regulations.

**Available Information**

The address of the Company's principal executive offices is 132 East High Street, Jefferson City, Missouri 65101 and the telephone number at this location is (573)761-6100. The Company's common stock trades on the Nasdaq Global Select Market under the symbol "HWBK".

We electronically file certain documents with the Securities and Exchange Commission (SEC). We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K (as appropriate), along with any related amendments and supplements. From time-to-time, we also may file registration and related statements pertaining to equity or debt offerings. You may read and download the Company's SEC filings over the internet from several commercial document retrieval services as well as at the SEC's internet website (www.sec.gov). You may also read and copy the Company's SEC filings at the SEC's public reference room located at 100 F Street, NE., Washington, DC 20549. Please call the SEC 1-800-SEC-0330 for further information concerning the public reference room and any applicable copy charges.

The Company's internet website address is www.hawthornbancshares.com. Under the "Documents" menu tab of the Company's website (www.hawthornbancshares.com), we make available, without charge, the Company's public filings with the SEC, including the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, or any amendments to those reports filed or furnished to the SEC pursuant to Section 13(a) of the Securities Exchange Act of 1934. Please note that any internet addresses provided in this report are for information purposes only and are not intended to be hyperlinks. Accordingly, no information found and/or provided at such internet addresses is intended or deemed to be incorporated by reference herein.

**Item 1A. Risk Factors.**

**Risk Factors**

We are identifying important risks and uncertainties that could affect the Company's results of operations, financial condition or business and that could cause them to differ materially from the Company's historical results of operations, financial condition or business, or those contemplated by forward-looking statements made herein or elsewhere, by, or on behalf of, the Company. Factors that could cause or contribute to such differences include, but are not

limited to, those factors described below. The risk factors highlighted below are not necessarily the only ones that the Company faces.

**Public health threats or outbreaks of communicable diseases has adversely affected, and is expected to continue to adversely effect on the Company's operations and financial results**. The Company and the Bank may face risks related to public health threats or outbreaks of communicable diseases. A widespread healthcare crisis, such as an outbreak of a communicable disease could adversely affect the global economy and the Company's financial performance. For example, the ongoing global Coronavirus Disease 2019 (COVID-19) pandemic has destabilized the financial markets in which the Bank operates, and likely will continue to cause significant disruption in the global economies and financial markets, including the Bank's local markets. The Company and the Bank are dependent upon the willingness and ability of the Bank's customers to conduct banking and other financial transactions. In reaction to and as preventative measure to attempt to slow the spread of the pandemic, government authorities have in many states and municipalities implemented mandatory closures, shelter-in-place orders, and social distancing protocols, including orders within many of the geographic areas that the Bank operates. Although the Bank is typically considered an essential business, access to its branches and office locations have been restricted at times for the safety of its employees and customers. Limiting customers' access to the Bank's physical business could prevent some customers from transacting with the Bank and lower demand for lending and other services offered by the Bank, adversely affecting the Bank's and the Company's cash flows, financial condition, results of operations, profitability and asset quality and could continue to do so for an indefinite period of time. This could have a material adverse effect on the Bank's and Company's results of operations, financial condition, and liquidity. In particular, the continued spread of COVID-19 and efforts to contain the virus could:

- negatively impact customer demand of the Bank's lending and related services;
- cause the Bank to experience an increase in costs as a result of the Bank implementing operational changes to accommodate its newly-remote workforce;
- cause delayed payments from customers and uncollectible accounts, defaults, foreclosures, and declining collateral values, resulting in losses to the Bank and the Company;
- result in losses on the Bank's investment portfolio, due to volatility in the markets and lower trading volume driven by economic uncertainty;
- cause market interest rates to continue to decline, which could adversely affect the Bank's and the Company's net interest income and profitability;
- cause the Bank's credit losses to grow substantially; and
- impact availability of qualified personnel.

The situation surrounding COVID-19 remains uncertain and the potential for a material adverse impact on the Bank and the Company increases the longer the virus impacts activity levels in the United States and globally. The ultimate extent of the negative impact on the Bank and the Company are highly uncertain and cannot be predicted. The Bank and the Company continue to adapt to the changing dynamics of the COVID-19 impacts to the economy, needs of employees and customers, and authoritative measures mandated by federal, state, and local governments. However, there is no assurance that the Bank and the Company can adequately mitigate the risks of such business disruptions and interruptions. Beyond the current COVID-19 pandemic, the potential impacts of epidemics, pandemics, or other outbreaks of an illness, disease, or virus could therefore materially and adversely affect the Bank's and the Company's business, revenue, operations, financial condition, liquidity and cash flows.

**Because We Primarily Serve Central And West Central Missouri, A Decline In The Local Economic Conditions Could Lower The Company's Profitability**. The profitability of Hawthorn is dependent on the profitability of its banking subsidiary, which operates out of central and west central Missouri. The financial condition of this bank is affected by fluctuations in the economic conditions and business activity prevailing in the portion of Missouri in which its operations are located. Although our customers' business and financial interests may extend well beyond our market areas, the financial conditions of both Hawthorn and its banking subsidiary would be adversely affected by deterioration in the general economic and real estate climate in Missouri.

An increase in unemployment, a decrease in profitability of regional businesses or real estate values or an increase in interest rates are among the factors that could weaken the local economy. With a weaker local economy:

- customers may not want or need the products and services of the Bank,
- borrowers may be unable to repay their loans,
- the value of the collateral security of the Bank's loans to borrowers may decline,
- the number of loan delinquencies and foreclosures may increase, and
- the overall quality of the Bank's loan portfolio may decline.

Originating mortgage loans and consumer loans is a significant source of profits for Hawthorn's banking subsidiary. If individual customers in the local area do not want or need these loans, profits may decrease. Although the Bank could make other investments, the Bank may earn less revenue on these investments than on loans. Also, the Bank's losses on loans may increase if borrowers are unable to make payments on their loans.

**Interest Rate Changes May Reduce The Profitability Of The Company And Of The Bank**. The primary source of earnings for Hawthorn's banking subsidiary is net interest income. To be profitable, the Bank has to earn more money in interest and fees on loans and other interest-earning assets than it pays as interest on deposits and other interest-bearing liabilities and as other expenses. If prevailing interest rates decrease, the amount of interest the Bank earn on loans and investment securities may decrease more rapidly than the amount of interest the Bank has to pay on deposits and other interest-bearing liabilities. This would result in a decrease in the profitability of Hawthorn and its banking subsidiary.

Changes in the level or structure of interest rates also affect:

- the Bank's ability to originate loans,
- the value of the Bank's loan and securities portfolios,
- the Bank's ability to realize gains from the sale of loans and securities,
- the average life of the Bank's deposits, and
- the Bank's ability to obtain deposits.

Fluctuations in interest rates will ultimately affect both the level of income and expense recorded on a large portion of the Bank's assets and liabilities, and the fair value of all interest-earning assets, other than interest-earning assets that mature in the short term. The Bank's interest rate management strategy is designed to stabilize net interest income and preserve capital over a broad range of interest rate movements by matching the interest rate sensitivity of assets and liabilities. Although Hawthorn believes that the Bank's current mix of loans, mortgage-backed securities, investment securities and deposits is reasonable, significant fluctuations in interest rates may have a negative effect on the profitability of the Bank.

**Our Business Depends On Our Ability To Successfully Manage Credit Risk**. The operation of our business requires us to manage credit risk. As a lender, our banking subsidiary is exposed to the risk that borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our loan officers follow those standards. The weakening of these standards for any reason, such as an attempt to attract higher yielding loans, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge-offs and may necessitate that we significantly increase our allowance for loan losses, each of which could adversely affect our net

income. As a result, our inability to successfully manage credit risk could have a material adverse effect on our business, financial condition or results of operations.

**The Company's Profitability Depends On The Bank's Asset Quality And Lending Risks**. Success in the banking industry largely depends on the quality of loans and other assets. A significant source of risk for us arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The loan officers of Hawthorn's banking subsidiary are actively encouraged to identify deteriorating loans. Loans are also monitored and categorized through an analysis of their payment status. The Bank's failure to timely and accurately monitor the quality of its loans and other assets could have a materially adverse effect on the operations and financial condition of Hawthorn and its banking subsidiary. There is a degree of credit risk associated with any lending activity. The Bank attempts to minimize its credit risk through loan diversification. Although the Bank's loan portfolio is varied, with no undue concentration in any one industry, substantially all of the loans in the portfolio have been made to borrowers in central, west central, and southwest Missouri. Therefore, the loan portfolio is susceptible to factors affecting the central, west central, and southwest Missouri area and the level of non-performing assets is heavily dependent upon local conditions. There can be no assurance that the level of the Bank's non-performing assets will not increase above current levels. High levels of non-performing assets could have a materially adverse effect on the operations and financial condition of Hawthorn and its banking subsidiary.

**The Provision For Probable Loan Losses May Need To Be Increased**. Hawthorn's banking subsidiary makes a provision for loan losses based upon management's estimate of probable losses in the loan portfolio and its consideration of prevailing economic and environmental conditions. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond the Company's control, and these losses may exceed current estimates. We cannot fully predict the amount or timing of losses or whether the loss allowance will be adequate in the future. The Bank may need to increase the provision for loan losses through additional provisions in the future if, among other things, the financial condition of any of its borrowers deteriorates, if its borrower fails to perform its obligations to it, or if real estate values decline. Furthermore, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's loan portfolio, provision for loan losses, and real estate acquired by foreclosure. Such agencies may require the Bank to recognize additions to the provision for loan losses based on their judgments of information available to them at the time of the examination. Any additional provision for probable loan losses, whether required as a result of regulatory review or initiated by Hawthorn itself, may materially alter the financial outlook of Hawthorn and its banking subsidiary and may have a material adverse effect on the Company's financial condition and results of operations.

In June of 2016, the Financial Accounting Standards Board, or FASB, decided to review how banks estimate losses in the allowance calculation, and it issued the final current expected credit loss standard, or CECL. Currently, the impairment model is based on incurred losses, and investments are recognized as impaired when there is no longer an assumption that future cash flows will be collected in full under the originally contracted terms. This model will be replaced by the new CECL model that will become effective for the Company in January 2023. Under the new CECL model promulgated under ASU 2016-13 "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments", we will be required to use historical information, current conditions and reasonable forecasts to estimate the expected loss over the life of the loan and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The CECL model is expected to result in more timely recognition of credit losses. The ASU will require new disclosures for financial assets measured at amortized cost, loans and available-for-sale debt securities. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The transition to the CECL model will bring with it significantly greater data requirements and changes to methodologies to accurately account for expected losses under the new parameters.

Management is currently evaluating the impact of these changes to our financial position and results of operations. We anticipate a significant change in the processes and procedures to calculate the allowance, including changes in assumptions and estimates to consider expected credit losses over the life of the loan versus the current accounting practice that utilizes the incurred loss model. We expect to continue developing and implementing processes and procedures to ensure we are fully compliant with the CECL requirements at its adoption date. The allowance is a material estimate of ours, and given the change from an incurred loss model to a methodology that considers the credit loss over the life of the

loan, there is the potential for an increase in the allowance at adoption date. At this time, an estimate of the impact to the Company's financial statements is not known, but the impact could be significantly impacted by the composition, characteristics and quality of the underlying loan portfolio at the time of adoption. The Company has formed a committee and is continuing to evaluate the impact of the ASU's adoption on the Company's consolidated financial statements by assessing different credit risk models. As a result of the FASB issuing a delay in the implementation of this ASU, the Company will extend its evaluation process over the new implementation deadline of January 2023.

**Adverse Market Conditions In The U.S. Economy And The Markets In Which We Operate Could Adversely Impact The Company's Business.** General downward economic trends, reduced availability of commercial credit, and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. This market turmoil and tightening of credit has led to increased commercial and consumer deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. Competition among depository institutions for deposits has increased significantly. Financial institutions have experienced decreased access to deposits or borrowings.

Although there has been a modest recovery in the domestic economy, there can be no assurance that the economy will not enter into another recession, whether in the near or long term future. Furthermore, real estate values and the demand for commercial real estate loans have not fully recovered, and reduced availability of commercial credit and continuing unemployment have negatively impacted the credit performance of commercial and consumer credit. Additional market developments such as a relapse or worsening of economic conditions in other parts of the world would likely exacerbate the lingering effects of the difficult market conditions experienced by us and others in the financial services industry and could further slow, stall or reverse the slow recovery in the U.S. A further deterioration of overall market conditions, a continuation of the economic downturn or prolonged economic stagnation in the Company's markets may have a negative impact on its business, financial condition, results of operations and the trading price of its common stock. If the strength of the U.S. economy in general and the strength of the economy in areas where we lend were to stagnate or decline, this could result in, among other things, a deterioration in credit quality or a reduced demand for credit, including a resultant adverse effect on the Company's loan portfolio and provision for losses on loans. This may exacerbate the Company's exposure to credit risk, impair the Company's ability to assess the creditworthiness of its customers or to estimate the values of its assets and adversely affect the ability of borrowers to perform under the terms of their lending arrangements with us. Negative conditions in the real estate markets where we operate could adversely affect borrowers' ability to repay their loans and the value of the underlying collateral. Real estate values are affected by various factors, including general economic conditions, governmental rules or policies and natural disasters. These factors may adversely impact borrowers' ability to make required payments, which in turn, may negatively impact the Company's financial results. As a result of the difficult market and economic conditions referred to above, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and for bank regulatory agencies to be very aggressive in responding to concerns and trends identified in examinations. This increased government action may increase costs and limit the Company's ability to pursue certain business opportunities.

We cannot predict whether the difficult market and economic conditions will improve in the near future. A worsening of these conditions would likely exacerbate the adverse effects of these difficult conditions on the Company, its customers and the other financial institutions in its market. As a result, we may experience increases in foreclosures, delinquencies and customer bankruptcies, as well as more restricted access to funds, and the Company's business, financial condition, results of operations and stock price may be adversely affected.

**The Soundness Of Other Financial Institutions Could Adversely Affect Us.** The Company's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of a counterparty or client. In addition, the Company's credit risk may be exacerbated when the collateral

held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due us. There is no assurance that any such losses would not materially and adversely affect the Company's results of operations.

**Deterioration In The Housing Market Could Cause Further Increases In Delinquencies And Non-Performing Assets, Including Loan Charge-Offs, And Depress The Company's Income And Growth.** The volume of one-to-four family residential mortgages and home equity lines of credit may decrease during economic downturns as a result of, among other things, a decrease in real estate values, an increase in unemployment, a slowdown in housing price appreciation or increases in interest rates. These factors could reduce earnings and consequently the Company's financial condition because:

- borrowers may not be able to repay their loans;
- the value of the collateral securing loans may decline further;
- the quality of the Company's loan portfolio may decline further; and
- customers may not want or need the Company's products and services.

Any of these scenarios could cause an increase in delinquencies and non-performing assets, require us to charge-off a higher percentage of loans, increase substantially the provision for losses on loans, or make fewer loans, which would reduce income.

**The FDIC's Changes in the Calculation of Deposit Insurance Premiums and Ability to Levy Special Assessments Could Increase The Company's Non-Interest Expense And May Reduce Its Profitability.** The range of base assessment rates historically varies from 12 to 45 basis points depending on an institution's risk category, with newly added financial measures resulting in increased assessment rates for institutions heavily relying on brokered deposits to support rapid asset growth. However, the Dodd-Frank Act requires the FDIC to amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. On February 9, 2011, the FDIC adopted a final rule that defines the assessment base as the average consolidated total assets during the assessment period minus the average tangible equity of the insured depository institution during the assessment period. The FDIC also imposed a new assessment rate scale (which was revised further in 2016). Under the new system, banks will pay assessments at a rate between 3 and 30 basis points per assets minus tangible equity, depending upon an institution's risk category (the final rule also includes progressively lower assessment rate schedules when the FDIC's reserve ratio reaches certain levels). The rulemaking changes the current assessment rate schedule so the schedule will result in the collection of assessment revenue that is approximately the same as generated under the current rate schedule and current assessment base. Nearly all banks with assets less than $10 billion will pay smaller deposit insurance assessments as a result of the new rule. The majority of the changes in the FDIC's final rule became effective on April 1, 2011. The FDIC has the statutory authority to impose special assessments on insured depository institutions in an amount, and for such purposes, as the FDIC may deem necessary. The change in the calculation methodology for deposit insurance premiums and the possible emergency special assessments could increase non-interest expense and may adversely affect the Company's profitability.

**We May Elect Or Be Compelled To Seek Additional Capital In The Future, But That Capital May Not Be Available When It Is Needed.** We are required by regulatory authorities to maintain adequate levels of capital to support operations. In addition, we may elect to raise additional capital to support the growth of the Company's business or to finance acquisitions, if any, or we may elect to raise additional capital for other reasons. In that regard, a number of financial institutions have recently raised considerable amounts of capital as a result of a deterioration in their results of operations and financial condition arising from the turmoil in the mortgage loan market, deteriorating economic conditions, declines in real estate values and other factors. Should we elect or be required by regulatory authorities to raise additional capital, we may seek to do so through the issuance of, among other things, common stock or securities convertible into common stock, which could dilute your ownership interest in the Company. Although we remain "well-capitalized" and have not had a deterioration in liquidity, the future cost and availability of capital may be adversely affected by illiquid credit markets, economic conditions and a number of other factors, many of which are outside of the Company's control. Accordingly, we cannot assure you of the ability to raise additional capital if needed or on terms acceptable to us. If we

cannot raise additional capital when needed or on terms acceptable to us, it may have a material adverse effect on the Company's financial condition and results of operations.

**If We Are Unable To Successfully Compete For Customers In The Company's Market Area, The Company's Financial Condition And Results Of Operations Could Be Adversely Affected**. Hawthorn's banking subsidiary faces substantial competition in making loans, attracting deposits and providing other financial products and services. The Bank has numerous competitors for customers in its market area.

Such competition for loans comes principally from:

- other commercial banks
- savings banks
- savings and loan associations
- mortgage banking companies
- finance companies
- credit unions

Competition for deposits comes principally from:

- other commercial banks
- savings banks
- savings and loan associations
- credit unions
- brokerage firms
- insurance companies
- money market mutual funds
- mutual funds (such as corporate and government securities funds)

Many of these competitors have greater financial resources and name recognition, more locations, more advanced technology and more financial products to offer than the Bank. Competition from larger institutions may increase due to an acceleration of bank mergers and consolidations in Missouri and the rest of the nation. In addition, the Gramm-Leach-Bliley Act removes many of the remaining restrictions in federal banking law against cross-ownership between banks and other financial institutions, such as insurance companies and securities firms. The law will likely increase the number and financial strength of companies that compete directly with the Bank.

The profitability of the Bank depends of its continued ability to attract new customers and compete in it service areas. Increased competition in our markets from new competitors, as well as the expanding operations of existing competitors, may result in:

- interest rate changes to various types of accounts
- a decrease in the amounts of the Bank's loans and deposits
- reduced spreads between loan rates and deposit rates
- Loan terms that are less favorable to the bank.

Any of these results could have a material adverse impact on the Bank's market share of deposits and loans in the Bank's service areas. If the Bank is unable to successfully compete, its financial condition and results of operations will be adversely affected.

**We May Experience Difficulties In Managing Growth And In Effectively Integrating Newly Acquired Companies**. As part of the Company's general strategy, it may continue to acquire banks and businesses that it believes provide a strategic fit with its business. To the extent that the Company does grow, there can be no assurances that we will be able to adequately and profitably manage such growth. Acquiring other banks and businesses will involve risks commonly associated with acquisitions, including:

- potential exposure to liabilities of the banks and businesses acquired;
- difficulty and expense of integrating the operations and personnel of the banks and businesses acquired;
- difficulty and expense of instituting the necessary systems and procedures, including accounting and financial reporting systems, to manage the combined enterprises on a profitable basis;

- potential disruption to existing business and operations;
- potential diversion of the time and attention of management; and
- impairment of relationships with and the possible loss of key employees and customers of the banks and businesses acquired.

The success of the Company's internal growth strategy will depend primarily on the ability of the Bank to generate an increasing level of loans and deposits at acceptable risk levels and on acceptable terms without significant increases in non-interest expenses relative to revenues generated. There is no assurance that we will be successful in implementing the Company's internal growth strategy.

**We May Be Adversely Affected By Changes In Laws And Regulations Affecting The Financial Services Industry**. Banks and bank holding companies such as Hawthorn are subject to regulation by both federal and state bank regulatory agencies. The regulations, which are designed to protect borrowers and promote certain social policies, include limitations on the operations of banks and bank holding companies, such as minimum capital requirements and restrictions on dividend payments. The regulatory authorities have extensive discretion in connection with their supervision and enforcement activities and their examination policies, including the imposition of restrictions on the operation of a bank, the classification of assets by an institution and requiring an increase in a bank's allowance for loan losses. These regulations are not necessarily designed to maximize the profitability of banking institutions.

In July 2010, President Barack Obama signed into law the Dodd-Frank Act, which enacted substantial changes to the legal framework of the entire financial services industry. The Dodd-Frank Act mandates the passage of numerous rules and regulations by various regulatory agencies over the next few years. This legislation will change banking regulation and the operating environment of Hawthorn in substantial and unpredictable ways. It could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions and other financial institutions. Hawthorn cannot predict the impact that the Dodd-Frank Act, and the various regulations issued thereunder will have on its business.

These, and other future changes in the banking laws and regulations and tax and accounting rules applicable to financial institutions, could have a material adverse effect on the operations and financial condition of Hawthorn and its banking subsidiary.

**The Short-Term And Long-Term Impact Of The Changing Regulatory Capital Requirements And New Capital Rules Is Uncertain.** The federal banking agencies have substantially amended the regulatory capital rules applicable to us and the Bank. The amendments implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. The amended rules include new minimum risk-based capital and leverage ratios, which became effective in January 2015, with certain requirements to be phased in beginning in 2016, and refined the definition of what constitutes "capital" for purposes of calculating those ratios.

The application of more stringent capital requirements to us and the Bank could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could further limit the Company's ability to make distributions, including paying out dividends or buying back shares.

The EGRRCPA directs the federal banking agencies to develop a specified Community Bank Leverage Ratio (that is, the ratio of a bank's equity capital to its consolidated assets) of not less than 8% and not more than 10%. On November 4, 2019, federal regulators issued final rules effective January 1, 2020 that provide certain banks and their holding companies with the option to elect out of complying with the Basel III Capital Rules. Under this new rule, a qualifying community banking organization is eligible to elect the community bank leverage ratio framework if it has a community bank leverage ratio, or CBLR, greater than 9% at the time of election. The final rule is described in more detail above under the section entitled "Regulatory Capital Requirements." As of December 31, 2020, the Company and the Bank each qualified to elect the community bank leverage ratio framework because they had a CBLR of greater than 9%

and satisfied the other requirements. Hawthorn has not opted in to CBLO. The Company does not have immediate plans to elect to use the community bank leverage ratio framework but may make such an election in the future. Under the CARES Act and regulations issued by federal banking agencies thereunder, effective October 1, 2020, the community bank leverage ratio has been temporarily reduced to 8% percent for 2020 and 8.5% for 2021 and is reset at 9% beginning January 1, 2022.

**Non-Compliance with the USA PATRIOT Act, Bank Secrecy Act, Real Estate Settlement Procedures Act, Truth-in-Lending Act, Community Reinvestment Act, Fair Lending Laws Or Other Laws And Regulations Could Result In Fines Or Sanctions, And Curtail Expansion Opportunities**. Financial institutions are required under the USA PATRIOT and Bank Secrecy Acts to develop programs to prevent financial institutions from being used for money-laundering and terrorist activities. Financial institutions are also obligated to file suspicious activity reports with the U.S. Treasury Department's Office of Financial Crimes Enforcement Network if such activities are detected. These rules also require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure or the inability to comply with the USA PATRIOT Act and Bank Secrecy Act statutes and regulations could result in fines or penalties, curtailment of expansion opportunities, enforcement actions, intervention or sanctions by regulators and costly litigation or expensive additional controls and systems. During the last few years, several banking institutions have received large fines for non-compliance with these laws and regulations. In addition, the U.S. Government imposed and will continue to expand laws and regulations relating to residential and consumer lending activities that create significant new compliance burdens and financial risks.

**The Bank Is A Community Bank And Our Ability To Maintain The Bank's Reputation Is Critical To The Success Of Our Business And The Failure To Do So Could Materially Adversely Affect Our Performance.** The Bank is a community bank, and its reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results could be materially adversely affected.

**The Company's Success Largely Depends On The Efforts Of Its Executive Officers**. The success of Hawthorn and its banking subsidiary has been largely dependent on the efforts of David Turner, Chairman, CEO, and President and the other executive officers. These individuals are expected to continue to perform their services. However, the loss of the services of Mr. Turner, or any of the other key executive officers could have a materially adverse effect on Hawthorn and its subsidiary bank.

**If We Fail To Maintain An Effective System Of Internal Control Over Financial Reporting, We May Not Be Able To Accurately Report Our Financial Results Or Prevent Fraud, And, As A Result, Investors And Depositors Could Lose Confidence In Our Financial Reporting, Which Could Adversely Affect Our Business, The Trading Price Of Our Stock, And Our Ability To Attract Additional Deposits**. We are required to include in our annual reports filed with the SEC a report from our management regarding internal control over financial reporting. As a result, we documented and evaluated our internal control over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act and SEC rules and regulations, which require an annual management report on our internal control over financial reporting, including, among other matters, management's assessment of the effectiveness of internal control over financial reporting. Failure or circumvention of our system of internal control could have an adverse effect on our business, profitability, and financial condition, and could result in regulatory actions and loss of investor confidence. Additionally, if we fail to identify and correct any significant deficiencies or material weaknesses in the design or operating effectiveness of our internal control over financial reporting or fail to prevent fraud, current and potential stockholders and depositors could lose confidence in our financial reporting, which could adversely affect our business, financial condition and results of operations, the trading price of our stock and our ability to attract additional deposits.

**We Are Subject To Security And Operational Risks Relating To Our Use Of Technology That Could Damage Our Reputation And Our Business**. We rely heavily on communications and information systems to conduct our business. Furthermore, we have access to large amounts of confidential financial information and control substantial financial assets, including those belonging to our customers, to whom we offer remote access, and we regularly transfer substantial financial assets by electronic means. Our operations are dependent upon our ability to protect our computer

equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any failure, interruption or breach in security of our systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations. Although we intend to continue to implement security technology and establish operational procedures to prevent such damage, our security measures may not be successful.

In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations. We also face the risk of operational disruption, failure, termination or capacity constraints caused by third parties that facilitate our business activities by providing technology such as software applications, as well as financial intermediaries. Such parties could also be the source of an attack on, or breach of, our operational systems, data or infrastructure.

We also face the potential risk of loss due to fraud, including commercial checking account fraud, automated teller machine ("ATM") skimming and trapping, write-offs necessitated by debit card fraud, and other forms of online banking fraud, which are becoming more sophisticated and present new challenges as mobile banking increases, as well as employee fraud. Employee errors could also subject us to financial claims for negligence. We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. Should our internal controls fail to prevent or detect an occurrence, and if any resulting loss is not insured or exceeds applicable insurance limits, such failure could have a material adverse effect on our business, financial condition and results of operations.

**The Operation Of Our Business, Including Our Interaction With Customers, Are Increasingly Done Via Electronic Means, And This Has Increased Our Risks Related To Cybersecurity**. We rely on the successful and uninterrupted functioning of our information technology and telecommunications systems to conduct our business. This includes internally developed systems, the systems of third-party service providers, and digital and mobile technologies. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems, and could damage our reputation, result in loss of customer business, subject us to regulatory scrutiny, or expose us to civil litigation and possible financial liability. We are exposed to the risk of cyber-attacks in the normal course of business, which can result from deliberate attacks or unintentional events. We have observed an increased level of attention in the industry focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. Cyber-attacks may also be carried out in a manner that does not require gaining unauthorized access, such as by causing denial-of-service attacks on websites. Cyber-attacks may be carried out by third parties or insiders using techniques that range from highly sophisticated efforts to electronically circumvent network security or overwhelm websites to more traditional intelligence gathering and social engineering aimed at obtaining information necessary to gain access. The objectives of cyber-attacks vary widely and can include theft of financial assets, intellectual property, or other sensitive information, including the information belonging to our banking customers. Cyber-attacks may also be directed at disrupting our operations.

We may incur substantial costs and suffer other negative consequences if we fall victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that may have been caused; increased cybersecurity protection costs that may include organizational changes, deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

**We Continually Encounter Technological Change, And We Cannot Predict How Changes In Technology Will Affect Our Business.** The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology driven by products and services, which include developments in:

- telecommunications
- data processing
- automation
- internet-based banking
- telebanking
- debit cards and so-called "smart cards"

The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

**We Rely On Others To Provide Key Components Of Our Business Infrastructure**. Third party vendors provide key components of our business infrastructure such as internet connections, network access and core application processing. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of their not providing us their services for any reason or their performing their services poorly, could adversely affect our ability to deliver products and services to our customers or otherwise conduct our business efficiently and effectively. Replacing these third party vendors could also entail significant delay and expense.

**The Price Of Our Common Stock Could Fluctuate Significantly, And This Could Make It Difficult For You To Resell Shares Of Our Common Stock At Times Or At Prices You Find Attractive**. The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility during the recent economic downturn. In some cases, the markets have produced downward pressure on stock prices for certain issuers without regard to those issuers' underlying financial strength. As a result, the trading volume in our common stock could fluctuate more than usual and cause significant price variations to occur. This could make it difficult for you to resell shares of our common stock at times or at prices you find attractive.

The trading price of the shares of our common stock will depend on many factors that could change from time to time and could be beyond our control. Among the factors that could affect our stock price are those identified under the heading "Forward-Looking Statements" in Item 7 of this report and as follows:

- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to our common stock or those of other financial institutions;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community generally or relating to our reputation, our market area, our competitors or the financial services industry in general;
- strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;
- actions by our current stockholders, including sales of common stock by existing stockholders and/or directors and executive officers;
- fluctuations in the stock price and operating results of our competitors;
- future sales of our equity, equity-related or debt securities;
- changes in the frequency or amount of dividends or share repurchases;

- proposed or adopted regulatory changes or developments;
- investigations, proceedings or litigation that involve or affect us;
- trading activities in our common stock, including short-selling;
- domestic and local economic factors unrelated to our performance; and
- general market conditions and, in particular, developments related to market conditions for the financial services industry.

A significant decline in our stock price could result in substantial losses for individual stockholders and could lead to costly and disruptive securities litigation.

**The Trading Volume In Our Common Stock Has Been Low, And The Sale Of A Substantial Number Of Shares Of Our Common Stock In The Public Market Could Depress The Price Of Our Common Stock And Make It Difficult For You To Sell Your Shares**. Our common stock is listed to trade on the NASDAQ Global Select Market, but is thinly traded. As a result, you may not be able to sell your shares of common stock on short notice. Additionally, thinly traded stock can be more volatile than stock trading in an active public market. The sale of a substantial number of shares of our common stock at one time could temporarily depress the market price of our common stock, making it difficult for you to sell your shares and impairing our ability to raise capital.

**Our Common Stock Is Not Insured By Any Governmental Entity**. Our common stock is not a deposit account or other obligation of any bank and is not insured by the FDIC or any other governmental entity.

**Additional Factors**. Additional risks and uncertainties that may affect the future results of operations, financial condition or business of the Company and its banking subsidiary include, but are not limited to: (i) adverse publicity, news coverage by the media, or negative reports by brokerage firms, industry and financial analysts regarding the Bank or the Company; and (ii) changes in accounting policies and practices.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

Neither the Company nor Union State Bancshares owns or leases any property. The Company's principal offices are located at 132 East High Street, Jefferson City, Missouri 65101. The table below provides a list of the Bank's facilities.

| Location | Approximate Square Footage | Owned or Leased | | Net Book Value at 12/31/2020 *(in thousands)* |
|---|---|---|---|---|
| 8127 East 171st Street, Belton, MO | 13,000 | Owned | $ | 1,460 |
| 910 West Buchanan Street, California, MO | 2,270 | Owned | $ | 318 |
| 102 North Second Street, Clinton, MO | 11,524 | Owned | $ | 1,201 |
| 1400 East Ohio Street, Clinton, MO | 13,551 | Owned | $ | 2,503 |
| 1712 East Ohio Street, Clinton, MO (inside a Walmart store) | 540 | Leased (1) | $ | 40 |
| 803 E. Walnut St, Columbia, MO | 9,698 | Leased (2) | $ | 1,087 |
| 1110 Club Village Drive, Columbia, MO | 5,000 | Owned | $ | 1,246 |
| 115 South 2nd Street, Drexel, MO | 4,000 | Owned | $ | 91 |
| 100 Plaza Drive, Harrisonville, MO | 4,000 | Owned | $ | 390 |
| 17430 East 39th Street, Independence, MO | 4,070 | Owned | $ | 509 |
| 220 West White Oak, Independence, MO | 1,800 | Owned | $ | 37 |
| 132 East High Street, Jefferson City, MO | 34,800 | Owned | $ | 2,397 |
| 3701 West Truman Blvd, Jefferson City, MO | 21,000 | Owned | $ | 344 |
| 211 West Dunklin Street, Jefferson City, MO | 2,500 | Owned | $ | 1,425 |
| 800 Eastland Drive, Jefferson City, MO | 4,100 | Owned | $ | 590 |
| 3600 Amazonas Drive, Jefferson City, MO | 26,000 | Owned | $ | 2,153 |
| 300 S.W. Longview Blvd, Lee's Summit, MO | 11,700 | Owned | $ | 1,751 |
| 5 Victory lane, Suite 203 & 204, Liberty, MO | 1,667 | Leased (3) | $ | N/A |
| 335 Chestnut, Osceola, MO | 1,580 | Owned | $ | 68 |
| 595 VFW Memorial Drive, St. Robert, MO | 2,236 | Owned | $ | 59 |
| 321 West Battlefield, Springfield, MO | 12,500 | Owned | $ | 1,065 |
| 200 West Main Street, Warsaw, MO | 8,900 | Owned | $ | 77 |
| 1891 Commercial Drive, Warsaw, MO | 11,000 | Owned | $ | 1,357 |
| 12250 Weber Hill Rd Suite 125, St. Louis, MO | 2,253 | Leased (4) | $ | N/A |

(1) The term of this lease began in February 2019 and ends in January 2024.
(2) The term of this lease began in July 2018 and ends in July 2028.
(3) The term of this lease began in May 2019 and ends in April 2021.
(4) The term of this lease began in November 2020 and ends in December 2023.

Management believes that the current condition of each of the Bank's facilities is adequate for its business and that such facilities are adequately covered by insurance.

**Item 3. Legal Proceedings.**

The information required by this Item is set forth in Note 19, *Commitments and Contingencies,* in the Company's consolidated financial statements.

**Item 4. Mine Safety Disclosures.**

Not applicable

**EXECUTIVE OFFICERS OF THE REGISTRANT**

Executive officers of the Company are appointed by the board of directors and serve at the discretion of the board. The following table sets forth certain information with respect to all executive officers of the Company.

| Name | Age | Position |
|---|---|---|
| David T. Turner | 64 | Chairman, Chief Executive Officer, President and Director |
| Stephen E. Guthrie | 64 | Senior Vice President and Chief Financial Officer |
| Kathleen L. Bruegenhemke | 55 | Senior Vice President, Secretary and Director |

The business experience of the executive officers of the Company for the last five years is as follows:

*David T. Turner* has served as a director of the Company and of Hawthorn Bank (or of its constituent predecessors) since January 1997. He has served as president of the Company since March 2002 and as chairman and chief executive officer of the Company since January 2011. He also currently serves as chairman, chief executive officer and president of Hawthorn Bank. Mr. Turner has served as vice chairman of the Company from June 1998 through March 2002 and as senior vice president of the Company from 1993 until June 1998. He served as president of a predecessor to Hawthorn Bank from January 1997 through March 2002 when he assumed the position of chairman, chief executive officer and president. He served as senior vice president of that same predecessor from June 1992 through December 1996 and as its vice president from 1985 until June 1992.

*Stephen E. Guthrie* has served as Senior Vice President and Chief Financial Officer of the Company and of Hawthorn Bank since May 2020. Prior to joining the Company, he most recently served as Executive Vice President and Chief Financial Officer of Landmark Bank in Columbia, Missouri, the wholly-owned subsidiary of The Landrum Company. The Landrum Company was recently acquired by Simmons First National Corporation, holding company for Simmons Bank. Mr. Guthrie served as Senior Vice President, Internal Audit and Risk & Controls for Capmark Finance Inc. from September 2006 to May 2010. From 2003 to 2006, Mr. Guthrie served as Vice President, Internal Audit and Corporate Security for AT&T Corp. From 2000 to 2003, Mr. Guthrie served as Vice President, Auditing Services for Pharmacia Corporation. From 1979 to 2000 Mr. Guthrie served in various capacities with Monsanto Company, serving as Chief Financial Officer of Monsanto Canada, Inc. from 1999 to 2000. Mr. Guthrie is a licensed CPA.

*Kathleen L. Bruegenhemke* has served as a director of our Company and of Hawthorn Bank since March 2017 and as Chief Operating Officer of Hawthorn Bank since January 2017. From October 2014 until December 2016 she served as Columbia Market President of Hawthorn Bank. She has served as Senior Vice President and Secretary of the Company since November 1997 and as Chief Risk Officer of the Company since June 2006. From January 1992 until November 1997, she served as Internal Auditor of Hawthorn Bank (or of one of its constituent predecessors). Prior to joining the Bank, Ms. Bruegenhemke served as a Commissioned Bank Examiner for the Federal Deposit Insurance Corporation. Ms. Bruegenhemke is a certified public accountant and possesses considerable expertise in overseeing various finance, regulatory compliance and risk management aspects of community banking, which she attained through over 30 years of service, first as a bank regulator and then as a dedicated employee of Hawthorn Bank.

There is no arrangement or understanding between any executive officer and any other person pursuant to which such executive officer was selected as an officer.

**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Pursuant to General Instruction G(2) to Form 10-K, the information required by this Item, other than that referred to below, is incorporated herein by reference to the information under the caption "Market Price of and Dividends on Equity Securities and Related Matters" in the Company's 2020 Annual Report to Shareholders.

We refer you to Item 12 of this report under the caption "Securities Authorized For Issuance Under Equity Compensation Plans" for certain equity plan information.

**The Company's Purchases of Equity Securities**

The following table summarizes the purchases made by or on behalf of the Company or certain affiliated purchasers of shares of the Company's common stock during the fourth quarter of the year ended December 31, 2020:

| Period | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs * |
|---|---|---|---|---|
| | | | | $ 2,402,688 |
| October 1-31, 2020 | — | $ — | — | $ 2,402,688 |
| November 1-30, 2020 | — | $ — | — | $ 2,402,688 |
| December 1-31, 2020 | — | $ — | — | $ 2,402,688 |
| Total | — | $ — | — | $ 2,402,688 |

* In the third quarter of 2020, the Company’s Board of Directors authorized the purchase of up to $2.5 million market value of the Company’s common stock. Management was given discretion to determine the number and pricing of the shares to be purchased, as well as, the timing of any such purchases. During the three months ended December 31, 2020, no shares of the Company's common stock were purchased by or on behalf of the Company or affiliated purchasers and $2.4 million remained for share repurchase pursuant to that authorization.

**Recent Issuance of Securities**

None.

**Item 6. Selected Financial Data.**

Pursuant to General Instruction G(2) to Form 10-K, the information required by this Item is incorporated herein by reference to the information under the caption "Selected Consolidated Financial Data" in the Company's 2020 Annual Report to Shareholders.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.**

Pursuant to General Instruction G(2) to Form 10-K, the information required by this Item is incorporated herein by reference to the information under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's 2020 Annual Report to Shareholders.

**Forward-Looking Statements**

This report, including information included or incorporated by reference in this report, contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, strategy, future performance and business of the 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 the Company's loans and other assets,
- increases in non-performing assets in the Company's loan portfolios and adverse economic conditions may necessitate increases to the 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, regulatory, or tax law 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 additional factors that could cause actual results to be materially different from those described in the forward-looking statements, which factors are identified in Item 1A of this report under the heading "Risk Factors." 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 such statement is made. Except as otherwise required by law, we undertake no obligation to publicly update or revise any forward-looking statement to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

The Company's exposure to market risk is reviewed on a regular basis by our Bank's asset/liability committee and board of directors. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent and that the goal is to identify and minimize those risks.

Tools used by the Bank's management include modeling the effects on net interest income under different rate shock scenarios. At December 31, 2020, the Company's rate shock scenario models indicated that annual net interest income could change by as much as 0.73% or (1.81)% should interest rates rise or fall, respectively, 200 basis points from their current level over a one-year period. These levels of interest rate risk are within limits set by the board in the Company's *Funds Management, Investment Asset Liability Policy* and Management believes this is an acceptable level of interest rate risk. However, there are no assurances that the change will not be more or less than this estimate.

Pursuant to General Instruction G(3) to Form 10-K, the information required by this Item, other than that provided above, is incorporated herein by reference to the information under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Quantitative and Qualitative Disclosures About Market Risk" in the Company's 2020 Annual Report to Shareholders.

**Item 8. Financial Statements and Supplementary Data.**

Pursuant to General Instruction G(2) to Form 10-K, the information required by this Item is incorporated herein by reference to the report of the independent registered public accounting firm and the information under the caption "Consolidated Financial Statements" in the Company's 2020 Annual Report to Shareholders.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

**(a) Evaluation of Disclosure Controls and Procedures.**

As of the end of the period covered by this annual report, the Company's management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended). Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that, as of December 31, 2020, the Company's disclosure controls and procedures were effective.

**Internal Controls Over Financial Reporting.**

**(b) Management's Report on Internal Control Over Financial Reporting.**

The Company's management is responsible for establishing and maintaining effective internal control over financial reporting, as such term is defined in Securities Exchange Act Rule 13a-15(f). Under the supervision and with the participation of the Company's management, including the Company's principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the Company's internal control over financial reporting, as of December 31, 2020, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework (2013)*. Based upon its assessment, management has concluded that, as of December 31, 2020, the Company's internal control over financial reporting, is effective based on the criteria established in *Internal Control-Integrated Framework (2013)*.

Management's assessment of the effectiveness of internal control over financial reporting, as of December 31, 2020, has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report, which is included in this Annual Report on Form 10-K.

Remediation of Material Weakness - The Company and its Board of Directors are committed to maintaining a strong internal control environment. Following the identification of the material weakness described in our Annual Report on Form 10-K for the year ended December 31, 2019, related to the design of internal controls over the completeness and accuracy of the information used to determine the qualitative component of the allowance for loan losses estimate, we initiated remediation measures to address the material weakness. Management believes that it has completed its updates to the design and implementation of internal controls to remediate the material weakness and enhance the Company’s internal control environment. As previously reported, the remediation plan was implemented during the first quarter of 2020 to update our design and implementation of controls to remediate the aforementioned deficiency and enhance the Company's internal control environment. Management believes that such enhanced controls have been designed to address the material weakness. We completed our remediation activities by testing the operating effectiveness of the enhanced controls and found them to be effective. Based on the implementation work and results of testing performed, we have concluded that the previously identified material weakness has been remediated as of December 31, 2020.

**(c) Changes in Internal Controls.**

There has been no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended December 31, 2020

that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting other than for the remediation of the material weakness noted in paragraph (b) above.

**Report of Independent Registered Public Accounting Firm**

To the Stockholders and Board of Directors
Hawthorn Bancshares, Inc. and Subsidiaries:

*Opinion on Internal Control Over Financial Reporting*

We have audited Hawthorn Bancshares, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively, the consolidated financial statements), and our report dated March 12, 2021 expressed an unqualified opinion on those consolidated financial statements.

*Basis for Opinion*

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

*Definition and Limitations of Internal Control Over Financial Reporting*

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*/s /* KPMG LLP

St. Louis, Missouri
March 12, 2021

**Item 9B. Other Information.**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

Pursuant to General Instruction G(3) to Form 10-K, the information required by this Item, other than that referred to below, is incorporated herein by reference to:

(i) the information under the caption "Item 1: Election of Directors--What is the structure of our board and how often are directors elected?" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A;

(ii) the information under the caption "Item 1: Election of Directors--Who are this year's nominees?" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A;

(iii) the information under the caption "Item 1: Election of Directors--What is the business experience of the nominees and of our continuing board members?" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A;

(iv) the information under the caption "Executive Officers of the Registrant" in Part I of this report;

(v) the information under the caption "Delinquent Section 16(a) Reports" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A;

(vi) the information under the caption "Corporate Governance and Board Matters--Consideration of Director Nominees" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A; and

(vii) the information under the caption "Corporate Governance and Board Matters--Committees of the Board--Audit Committee" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A.

**Code of Ethics**

The Company has adopted a Code of Business Conduct and Ethics for directors, officers and employees including, the its principal executive officer, principal financial officer, principal accounting officer, controller and persons performing similar functions. This Code of Business Conduct and Ethics is posted on the Company's internet website (www.hawthornbancshares.com) under the "Governance Documents" menu tab and is available for your examination. A copy of this Code will be furnished without charge upon written request to Corporate Secretary, Hawthorn Bancshares, Inc., 132 East High Street, Jefferson City, Missouri 65101. Any substantive amendment to, or waiver from, a

provision of this Code that applies to the Company's principal executive officer, principal financial officer, principal accounting officer, controller, or persons performing similar functions will be disclosed in a report on Form 8-K.

**Item 11. Executive Compensation.**

Pursuant to General Instruction G(3) to Form 10-K, the information required by this Item is incorporated herein by reference to:

(i) the information under the caption "Executive Compensation and Related Matters" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A; and

(ii) the information under the caption "Corporate Governance and Board Matters--Director Compensation" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

Pursuant to General Instruction G(3) to Form 10-K, the information required by this Item, other than that presented below, is incorporated herein by reference to the information under the caption "Ownership of Common Stock" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A.

**Securities Authorized For Issuance Under Equity Compensation Plans**

The Company has no equity compensation plan for its employees pursuant to which options, rights, warrants or other equity awards may be granted. As of December 31, 2020 the Company had no outstanding options, rights or warrants granted under any equity compensation plan.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

Pursuant to General Instruction G(3) to Form 10-K, the information required by this Item is incorporated herein by reference to:

(i) the information under the caption "Related Party Transactions" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A;

(ii) the information under the caption "Item 1: Election of Directors--What is the structure of our board and how often are directors elected?" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A; and

(iii) the information under the caption "Corporate Governance and Board Matters--Committees of the Board" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A.

**Item 14. Principal Accounting Fees and Services.**

Pursuant to General Instruction G(3) to Form 10-K, the information required by this Item is incorporated herein by reference to the information under the caption "Independent Registered Public Accounting Firm Fees and Services" in the Company's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules.

(a) Exhibits, Financial Statements and Financial Statement Schedules:

1. Financial Statements:

The following consolidated financial statements of the Company and reports of the Company's independent registered public accounting firm, included in the Company's Annual Report to Shareholders for the year ended December 31, 2020 under the caption "Consolidated Financial Statements", are incorporated herein by reference:

Report of Independent Registered Public Accounting Firm.

Consolidated Balance Sheets as of December 31, 2020 and 2019.

Consolidated Statements of Income for the years ended December 31, 2020, 2019, and 2018.

Consolidated Statements of Comprehensive Income for the years ended December 31, 2020, 2019, and 2018.

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2020, 2019, and 2018.

Consolidated Statements of Cash Flows for the years ended December 31, 2020, 2019, and 2018.

Notes to the Consolidated Financial Statements.

2. Financial Statement Schedules:

Financial statement schedules have been omitted because they either are not required or are not applicable or because equivalent information has been included in the financial statements, the notes thereto or elsewhere herein.

3. Exhibits:

| Exhibit No. | Description |
|---|---|
| 3.1 | Restated Articles of Incorporation of the Company (filed as Exhibit 3.1 to the Company's current report on Form 8-K on August 9, 2007 and incorporated herein by reference). |
| 3.2 | Amended and Restated Bylaws of the Company (filed as Exhibit 3.1 to the Company's current report on Form 8-K on January 27, 2021 and incorporated herein by reference). |
| 4.1 | Description of the Company's Securities Registered Pursuant to Section 12 of the Securities Exchange Act of 1934 (filed as Exhibit 4.0 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019 and incorporated herein by reference). |
| 4.2 | Specimen certificate representing shares of the Company's $1.00 par value Common Stock (filed as Exhibit 4.1 to the Company's current report on Form 8-K/A on June 23, 2017 and incorporated herein by reference). |

| Exhibit No. | Description |
|---|---|
| 10.1 | Form of Change of Control Agreement and schedule of parties thereto (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period March 31, 2005 and incorporated herein by reference). * |
| 10.2 | Hawthorn Bancshares, Inc. Excess Benefit Plan (filed as Exhibit 10.2 to the Company's current report on Form 8-K on November 13, 2018 and incorporated herein by reference). * |
| 13 | The Company's 2020 Annual Report to Shareholders (only those portions of this Annual Report to Shareholders which are specifically incorporated by reference into this Annual Report on Form 10-K shall be deemed to be filed with the Commission). |
| 14 | Code of Business Conduct and Ethics of the Company (filed as Exhibit 14 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018 and incorporated herein by reference). |
| 21 | List of Subsidiaries (filed as Exhibit 21 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018 and incorporated herein by reference). |
| 23 | Consent of Independent Registered Public Accounting Firm. |
| 24 | Power of Attorney (included on the signature page to this Annual Report on Form 10-K). |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document). |
| 101.SCH | Inline XBRL Taxonomy Extension Schema Document. |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase Document. |
| 104 | Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101). |

* Management contracts or compensatory plans or arrangements required to be identified by Item 15(a).

(b) Exhibits.

See exhibits identified above under Item 15(a)3.

(c) Financial Statement Schedules.

See financial statement identified above under Item 15(a)2, if any.

**EXHIBIT INDEX**

| Exhibit No. | Description | Page No. |
|---|---|---|
| 13 | The Company's 2020 Annual Report to Shareholders (only those portions of this Annual Report to Shareholders which are specifically incorporated by reference into this Annual Report on Form 10-K shall be deemed to be filed with the Commission). | |
| 23 | Consent of Independent Registered Public Accounting Firm. | |
| 24 | Power of Attorney (included on the signature page to this Annual Report on Form 10-K). | |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended. | |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended. | |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | |
| 101.INS | Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document). | |
| 101.SCH | Inline XBRL Taxonomy Extension Schema Document. | |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document. | |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase Document. | |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase Document. | |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase Document. | |
| 104 | Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101). | |

---

* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HAWTHORN BANCSHARES, INC.

Dated: March 12, 2021

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

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David T. Turner and Stephen E. Guthrie, or either of them, his attorneys-in-fact, for such person in any and all capacities, to sign any amendments to this report and to file the same, with exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that either of said attorneys-in-fact, or substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Date | Signature and Title |
|---|---|
| March 12, 2021 | /s/ David T. Turner<br>David T. Turner, Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer) |
| March 12, 2021 | /s/ Stephen E. Guthrie<br>Stephen E. Guthrie, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer) |
| March 12, 2021 | /s/ Kathleen L. Bruegenhemke<br>Kathleen L. Bruegenhemke, Director |
| March 12, 2021 | /s/ Frank E. Burkhead<br>Frank E. Burkhead, Director |
| March 12, 2021 | /s/ Philip D. Freeman<br>Philip D. Freeman, Director |
| March 12, 2021 | /s/ Kevin L. Riley<br>Kevin L. Riley, Director |
| March 12, 2021 | /s/ Gus S. (Jack) Wetzel III<br>Gus S. (Jack) Wetzel III, Director |
| March 12, 2021 | /s/ Jonathan D. Holtaway<br>Jonathan D. Holtaway, Director |

Exhibit 13

# 2020

# ANNUAL REPORT

# TO

# SHAREHOLDERS

# HAWTHORN BANCSHARES, INC.

**Jefferson City, Missouri**

---

March 12, 2021

Dear Shareholders:

By any measure, 2020 was a very challenging year. I hope this letter finds you healthy, safe, and if you have been impacted by the COVID-19 pandemic; on the path to a full recovery. We appreciate the confidence and trust you have demonstrated as an investor in our bank, and once again thank you.

I am happy to report the bank performed very well in 2020.

Hawthorn Bancshares Inc. reported net income of $14.3 million, or $2.20 per diluted share, for the year ended December 31, 2020, compared to $16.1 million, or $2.47 per diluted share, for the prior year. The 2020 net income was negatively impacted by $3.5 million, or $0.54 per diluted share for additional provision expense related to the COVID-19 pandemic.

Our commercial lenders were very much focused in 2020 on addressing the needs in the communities we serve, not the least of which included providing pandemic relief-related lending or loan modifications. We assisted in over $88 million of lending with the origination of over 1,275 SBA-approved loans through the SBA Paycheck Protection Program (“PPP”). Year-over-year, loans grew $118 million, or 10.1%, from $1.2 billion as of December 31, 2019, primarily driven by origination of PPP loans. In addition, as of December 31, 2020 we provided over $296 million in total loan modifications under the CARES Act to our COVID-19 stressed borrowers.

As I mentioned in my 2020 Letter to Shareholders, we continued to expand our mortgage lending team in 2020 and they delivered exceptional production of mortgage loans which were primarily sold to secondary market investors. Gain on sale of mortgage loans was $7.1 million in 2020, compared to $0.8 million in the prior year; incredible first-year results from this newly-formed team. Total 2020 non-interest income was $14.6 million. This represents a 64% increase from 2019 non-interest income and was driven by gain on sale of mortgage loans.

Total non-interest expense in 2020 increased to $44.7 million, a $6.0 million, or 15.4%, increase from non-interest expense in 2019. Most of the increase in non-interest expense was due to the increased costs for our mortgage lending team.

The bank continues to maintain a strong capital position and finished the year with 10.19% in leverage capital and 14.97% in total risk-based capital, far exceeding the minimum regulatory requirements.

Cash dividends paid in 2020 of $0.48 per share increased $0.04 per share, or 9%, compared to $0.44 per share in 2019. The Company’s Board of Directors approved the Company’s quarterly dividend of $0.13 per common share for the first quarter of 2021, payable April 1, 2021 to shareholders as of record March 15, 2021.

I remain committed to further improving earnings performance, sustaining sound and proper capital levels, and paying regular dividends.

As we begin 2021 with a strong capital base and coming off a year of exceptional earnings, we look forward to providing accessible and competitive banking services in the communities we serve. The Hawthorn Bank services delivery teams, management, Board of Directors and Advisory Board members are committed to continuing the growth of our strong community bank presence and delivering long-term value to our shareholders.

We appreciate your support and the referrals you give prospective customers to ***your*** bank.

Sincerely,

David T. Turner,
Chairman, CEO & President

---

## 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 the Company, Hawthorn Bancshares, Inc., and its subsidiaries, including, without limitation:

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

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

- competitive pressures among financial services companies may increase significantly,
- changes in the interest rate environment may reduce interest margins,
- general economic conditions, either nationally or in Missouri, may be less favorable than expected and may adversely affect the quality of our loans and other assets,
- increases in non-performing assets in the Company's loan portfolios and adverse economic conditions may necessitate increases to our provisions for loan losses,
- costs or difficulties related to the integration of the business of the Company and its acquisition targets may be greater than expected,
- legislative, regulatory, or tax law changes may adversely affect the business in which the Company and its subsidiaries are engaged,
- changes may occur in the securities markets and,
- effects of the COVID-19 pandemic, or other adverse external events.

We have described under the caption *Risk Factors* in the Company's Annual Report on Form 10-K for the year ended December 31, 2020, and in other reports filed with the SEC from time to time, additional factors that could cause actual results to be materially different from those described in the forward-looking statements. Other factors that have not been identified in this report could also have this effect. You are cautioned not to put undue reliance on any forward-looking statement, which speak only as of the date they were made.

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

***Overview***

Crucial to the Company's community banking strategy is growth in its commercial banking services, retail mortgage lending and retail banking services. Through the branch network of its subsidiary bank, Hawthorn Bank (the Bank), the Company, with $1.7 billion in assets at December 31, 2020, provides a broad range of commercial and personal banking services. The Bank's specialties include commercial banking for small and mid-sized businesses, including equipment, operating, commercial real estate, Small Business Administration (SBA) loans, and personal banking services including real estate mortgage lending, installment and consumer loans, certificates of deposit, individual retirement and other time deposit accounts, checking accounts, savings accounts, and money market accounts. Other financial services that the Company provides include trust services that include estate planning, investment and asset management services and a comprehensive suite of cash management services. The geographic areas in which the Company provides products and services include the Missouri communities in and surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, St. Louis, and the greater Kansas City metropolitan area.

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

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

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

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

**Significant Developments and Transactions**

Each item listed below materially affects the comparability of our results of operations for each of the years in the five-years ended December 31, 2020, and our financial condition as of and December 31 for each of the five-years ended, and may affect the comparability of financial information we report in future fiscal periods.

***Impact of COVID-19***. The progression of the COVID-19 pandemic in the United States has had an adverse impact on our financial condition and results of operations as of and for the year ended December 31, 2020, and is expected to have a complex and significant adverse impact on the economy, the banking industry and our Company in future fiscal periods, all subject to a high degree of uncertainty.

*Effects on Our Market Areas.* Our commercial and consumer banking products and services are delivered primarily in Missouri, where individual and governmental responses to the COVID-19 pandemic have led to a broad curtailment of economic activity beginning in March 2020. In Missouri, the Director of the Missouri Department of Health and Senior Services issued an order that individuals stay at home and that businesses abide by certain limitations on gathering sizes. This order was effective from April 6, 2020 and extended through May 3, 2020. Effective May 4, 2020, the governor of Missouri announced a partial relaxation of these limitations by lifting the stay at home order for individuals and allowing businesses to reopen subject to social distancing guidelines. The Bank and its branches remained open during

these orders because banking is deemed an essential business, although it did suspend lobby access at its branches from March 18, 2020 until May 4, 2020. Effective June 16, 2020, the governor of Missouri rescinded all COVID-19 related statewide public health orders. He announced it would be the responsibility of local officials to put further measures and regulations in place.

*Policy and Regulatory Developments*. Federal, state and local governments and regulatory authorities have enacted and issued a range of policy responses to the COVID-19 pandemic, including the following:

- The Federal Reserve decreased the range for the federal funds target rate by 0.50% on March 3, 2020, and by another 1.0% on March 16, 2020, reaching a range of 0.0% – 0.25%.
- On March 27, 2020 the Coronavirus Aid, Relief, and Economic Security ("CARES") Act was signed into law. The CARES Act contains provisions to assist individuals and businesses, including the SBA's Paycheck Protection Program ("PPP"). The PPP provided $349 billion in guaranteed loans that are forgivable if certain requirements are met. On April 24, 2020, an additional $310 billion was added to the PPP. In addition, on December 27, 2020, President Trump signed the Consolidated Appropriations Act, 2021, a $900 billion COVID-19 relief package that included an additional $284 billion in PPP funding.

On April 7, 2020, the U.S. banking agencies issued Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised). The statement describes accounting for COVID-19-related loan modifications, including clarifying the interaction between current accounting rules and the temporary relief provided by the CARES Act. The statement also encourages institutions to work constructively with borrowers affected by COVID-19 and states the agencies will not criticize supervised institutions for prudent loan modifications. Both the CARES Act and the interagency statement provide relief from the accounting and reporting implications of troubled debt restructurings.

*Effects on Our Business.* The COVID-19 pandemic and the specific developments referred to above will continue to have a significant impact on our business. In particular, we anticipate that a significant portion of the Bank's borrowers in the hotel, restaurant, gaming, long-term healthcare and retail industries will continue to endure significant economic distress, which has caused, and will continue to cause, them to draw on their existing lines of credit and adversely affect their ability to repay existing indebtedness, and is expected to adversely impact the value of collateral. These developments, together with economic conditions generally, are also expected to impact our commercial real estate portfolio, particularly with respect to real estate with exposure to these industries, our consumer loan business and loan portfolio, and the value of certain collateral securing our loans. As a result, we anticipate that our financial condition, capital levels and results of operations will be adversely affected, as described in further detail below.

*Our Response*. We have taken numerous steps in response to the COVID-19 pandemic, including the following:

- To protect the health and safety of our employees and customers, on March 18, 2020, we closed our banking center lobbies but continued to serve clients by appointment or through our drive-up lanes.
- To meet the financial needs of our customers, we have instituted the following measures:
  - The Bank participated, as a lender, in the Small Business Administration ("SBA") Payroll Protection Program ("PPP") and began taking applications on the first day of the program. Through December 31, 2020, the Bank had processed $88.4 million in PPP loans that had been approved by the SBA. At December 31, 2020, the balance of these loans totaled $65.1 million.
  - To account for the probable increased losses inherent in the loan portfolio due to current economic conditions resulting from the COVID-19 pandemic, Management recorded additional provision for loan losses for the year ended December 31, 2020.

Disaster relief payment modifications granted to-date include approximately 595 loans totaling $296.9 million. At December 31, 2020, 38 loans totaling $86.7 million, or 6.7% of total loans, remained in some form of a modification. These loan modifications include $37.6 million, or 43.4%, on interest only, $44.0 million, or 50.7%, on full deferral, and $5.1 million, or 5.9%, on extended amortization. Of the total remaining $86.7 million loan modifications under the CARES Act, $29.5 million, included in the $44.0 million on full deferral, were determined to be on nonaccrual status as December 31, 2020.

## SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents selected consolidated financial information for the Company as of and for each of the years in the five-years ended December 31, 2020. The selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements of the Company, including the related notes, presented elsewhere herein.

**Selected Financial Data**

| **Income Statement Data**<br>(*In thousands, except per share data)* | **2020** | **2019** | **2018** | **2017** | **2016** |
|---|---|---|---|---|---|
| Interest income | $ 62,985 | $ 63,970 | $ 57,779 | $ 50,935 | $ 46,010 |
| Interest expense | 9,722 | 15,232 | 13,186 | 8,007 | 5,663 |
| Net interest income | 53,263 | 48,738 | 44,593 | 42,928 | 40,347 |
| Provision for loan losses | 5,800 | 1,150 | 1,475 | 1,765 | 1,425 |
| Net interest income after provision for loan losses | 47,463 | 47,588 | 43,118 | 41,163 | 38,922 |
| Non-interest income | 14,649 | 8,937 | 9,341 | 8,950 | 8,315 |
| Investment securities gains (losses), net | 61 | (40) | 255 | 5 | 602 |
| Gain on branch sale, net | — | 2,183 | — | — | — |
| Non-interest expense | 44,697 | 38,731 | 40,332 | 38,802 | 36,807 |
| Income before income taxes | 17,476 | 19,937 | 12,382 | 11,316 | 11,032 |
| Income tax expense | 3,183 | 3,823 | 1,668 | 7,902 | 3,750 |
| Net income | $ 14,293 | $ 16,114 | $ 10,714 | $ 3,414 | $ 7,282 |
| | | | | | |
| **Per Share Data** | | | | | |
| Basic earnings per share | $ 2.20 | $ 2.47 | $ 1.64 | $ 0.52 | $ 1.10 |
| Diluted earnings per share | 2.20 | 2.47 | 1.64 | 0.52 | 1.10 |
| Cash dividends paid on common stock | 3,030 | 2,684 | 1,993 | 1,474 | 1,097 |
| Common stock dividend | 3,829 | 5,795 | 5,014 | 4,166 | 3,149 |
| Book value per share | 20.12 | 17.63 | 15.25 | 13.94 | 13.80 |
| Market price per share | 21.90 | 24.52 | 19.44 | 18.45 | 15.13 |
| Basic weighted average shares of common stock outstanding | 6,489,799 | 6,525,684 | 6,518,772 | 6,552,246 | 6,593,138 |
| Diluted weighted average shares of common stock outstanding | 6,489,799 | 6,525,684 | 6,524,226 | 6,558,192 | 6,593,138 |

| *(In thousands)* | 2020 | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| **Balance Sheet Data (at year end)** | | | | | |
| Total assets | $ 1,733,731 | $ 1,492,962 | $ 1,481,682 | $ 1,429,216 | $ 1,287,048 |
| Loans held for investment | 1,286,967 | 1,168,797 | 1,146,044 | 1,068,049 | 973,867 |
| Loans held for sale | 5,099 | 428 | 583 | 383 | 162 |
| Investment securities | 204,383 | 180,901 | 223,880 | 237,579 | 224,308 |
| Total deposits | 1,383,606 | 1,186,521 | 1,198,468 | 1,125,812 | 1,010,666 |
| Federal Home Loan Bank advances and other borrowings | 106,674 | 96,919 | 95,153 | 121,382 | 93,392 |
| Subordinated notes | 49,486 | 49,486 | 49,486 | 49,486 | 49,486 |
| Total stockholders' equity | 130,589 | 115,038 | 99,414 | 91,371 | 91,017 |
| **Balance Sheet Data (average balances)** | | | | | |
| Total assets | $ 1,628,708 | $ 1,479,035 | $ 1,446,160 | $ 1,352,343 | $ 1,251,741 |
| Loans held for investment | 1,243,971 | 1,153,486 | 1,096,599 | 1,023,273 | 912,239 |
| Loans held for sale | 7,876 | 992 | 785 | 937 | 934 |
| Investment securities | 198,619 | 205,598 | 242,806 | 226,911 | 243,169 |
| Total deposits | 1,287,715 | 1,185,216 | 1,169,243 | 1,068,487 | 997,514 |
| Federal Home Loan Bank advances and other borrowings | 117,214 | 97,443 | 81,945 | 98,383 | 67,212 |
| Subordinated notes | 49,486 | 49,486 | 49,486 | 49,486 | 49,486 |
| Total stockholders' equity | 121,772 | 109,103 | 93,615 | 95,116 | 91,401 |

| **Key Ratios** | | | | | |
|---|---|---|---|---|---|
| **Earnings Ratios** | | | | | |
| Return on average total assets | 0.88 % | 1.09 % | 0.74 % | 0.25 % | 0.58 % |
| Return on average common stockholders' equity | 11.74 | 14.77 | 11.45 | 3.59 | 7.97 |
| Efficiency ratio (3) | 65.82 | 67.15 | 74.78 | 74.79 | 75.64 |
| Net interest spread | 3.25 | 3.20 | 3.06 | 3.24 | 3.36 |
| Net interest margin | 3.48 | 3.51 | 3.31 | 3.41 | 3.48 |
| **Asset Quality Ratios** | | | | | |
| Allowance for loan losses to loans | 1.41 % | 1.07 % | 1.02 % | 1.02 % | 1.02 % |
| Non-performing loans to loans (1) | 2.69 | 0.43 | 0.49 | 0.56 | 0.36 |
| Non-performing assets to loans (2) | 3.64 | 1.53 | 1.68 | 1.80 | 1.81 |
| Non-performing assets to assets (2) | 2.70 | 1.20 | 1.30 | 1.34 | 1.37 |
| Allowance for loan losses to non-performing loans | 52.39 | 246.09 | 208.97 | 180.87 | 282.94 |
| Net loan charge-offs to average loans | 0.01 | 0.03 | 0.06 | 0.08 | 0.02 |
| **Capital Ratios** | | | | | |
| Average stockholders' equity to average total assets | 7.48 % | 7.38 % | 6.47 % | 7.03 % | 7.30 % |
| Period-end stockholders' equity to period-end assets | 7.53 | 7.71 | 6.71 | 6.39 | 7.07 |
| Total risk-based capital ratio | 14.97 | 14.89 | 13.28 | 12.93 | 13.88 |
| Tier 1 risk-based capital ratio | 13.37 | 13.04 | 11.21 | 10.72 | 11.42 |
| Common equity Tier 1 capital | 10.00 | 9.86 | 8.48 | 8.04 | 8.61 |
| Tier 1 leverage ratio | 10.19 | 10.73 | 9.55 | 9.33 | 9.87 |

(1) Non-performing loans consist of nonaccrual loans, non-performing troubled debt restructurings and loans contractually past due 90 days or more and still accruing interest.
(2) Non-performing assets consist of nonperforming loans and other real estate owned and repossessed assets.
(3) Efficiency ratio is calculated as non-interest expense as a percentage of revenue. Total revenue includes net interest income and non-interest income.

**Non-GAAP Financial Measures**

The financial measures in the table below include items that are non-GAAP, meaning they are not presented in accordance with generally accepted accounting principles (GAAP) in the U.S. The non-GAAP items presented are non-GAAP net income, non-GAAP basic earnings per share, non-GAAP diluted earnings per share, non-GAAP return on average assets and non-GAAP return on average common equity. In 2019, these measures include the adjustment to exclude the impact of the gain on the sale of the Company's Branson branch that closed during the quarter ended March 31, 2019, which is non-recurring and not considered indicative of underlying earnings performance. In 2017, these measures include adjustments to exclude the transitional impact of the Tax Cuts and Jobs Act (Tax Act) and the Company's implementation of new tax planning initiatives, which are non-recurring and not considered indicative of underlying earnings performance.

The adjustments do not include the ongoing impacts of the lower U.S. statutory rate under the Tax Act on 2018 earnings. The Company believes that the exclusion of these items provides a useful basis for evaluating the Company's underlying performance, but should not be considered in isolation and is not in accordance with, or a substitute for, evaluating performance utilizing GAAP financial information. The Company uses non-GAAP measures to analyze its financial performance and to make financial comparisons to prior periods presented on a similar basis. The Company believes that providing such adjusted results allows investors to better understand the Company's comparative operating performance for the periods presented. Non-GAAP measures are not formally defined by GAAP or codified in the federal banking regulations, and other entities may use calculation methods that differ from those used by the Company. The Company has reconciled each of these measures to a comparable GAAP measure below:

| **Income Statement Data**<br>*(In thousands, except per share data)* | **2020** | **2019** | **2018** | **2017** | **2016** |
|---|---|---|---|---|---|
| Net income − GAAP | $ 14,293 | $ 16,114 | $ 10,714 | $ 3,414 | $ 7,282 |
| Effect of net deferred tax asset adjustments (a) | — | — | — | 4,105 | — |
| Effect of net gain on branch sale (b) | — | (1,725) | — | — | — |
| Net income − non-GAAP | $ 14,293 | $ 14,389 | $ 10,714 | $ 7,519 | $ 7,282 |
| | | | | | |
| **Per Share Data** | | | | | |
| Basic earnings per share − GAAP | $ 2.20 | $ 2.47 | $ 1.64 | $ 0.52 | $ 1.10 |
| Effect of net deferred tax asset adjustments (a) | — | — | — | 0.63 | — |
| Effect of net gain on branch sale (b) | — | (0.26) | — | — | — |
| Basic earnings per share − non-GAAP | $ 2.20 | $ 2.21 | $ 1.64 | $ 1.15 | $ 1.10 |
| Diluted earnings per share − GAAP | $ 2.20 | $ 2.47 | $ 1.64 | $ 0.52 | $ 1.10 |
| Effect of net deferred tax asset adjustments (a) | — | — | — | 0.63 | — |
| Effect of net gain on branch sale (b) | — | (0.26) | — | — | — |
| Diluted earnings per share − non-GAAP | $ 2.20 | $ 2.21 | $ 1.64 | $ 1.15 | $ 1.10 |
| | | | | | |
| **Key Ratios** | | | | | |
| Return on average total assets − GAAP | 0.88 % | 1.09 % | 0.74 % | 0.25 % | 0.58 % |
| Effect of net deferred tax asset adjustments (a) | — % | — % | — % | 0.31 % | — % |
| Effect of net gain on branch sale (b) | — % | (0.12)% | — % | — % | — % |
| Return on average total assets − non-GAAP | 0.88 % | 0.97 % | 0.74 % | 0.56 % | 0.58 % |
| Return on average stockholders' equity − GAAP | 11.74 % | 14.77 % | 11.45 % | 3.59 % | 7.97 % |
| Effect of net deferred tax asset adjustments (a) | — % | — % | — % | 4.32 % | — % |
| Effect of net gain on branch sale (b) | — % | (1.58)% | — % | — % | — % |
| Return on average stockholders' equity − non-GAAP | 11.74 % | 13.19 % | 11.45 % | 7.91 % | 7.97 % |

(a) Calculated using the difference in combined statutory rates of 38% for 2017 and 21% for subsequent years.

(b) The pre-tax gain on the sale of the Branson Branch was $2.2 million and $1.7 million after tax for the year ended December 31, 2019.

## CRITICAL ACCOUNTING POLICIES

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

### *Allowance for Loan Losses*

Management has identified the accounting policy related to the allowance for loan losses (ALL) as critical to the understanding of the Company's results of operations, since the application of this policy requires significant management assumptions and estimates that could result in materially different amounts to be reported if conditions or underlying circumstances were to change. Further discussion of the methodology used in establishing the allowance and the impact of any associated risks related to these policies on the Company's business

operations is provided in Note 1 to the Company's consolidated financial statements and is also discussed in the *Lending and Credit Management* section below.

## RESULTS OF OPERATIONS ANALYSIS

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

| | | | | $ Change | | % Change | |
|---|---|---|---|---|---|---|---|
| *(In thousands)* | **2020** | **2019** | **2018** | **'20-'19** | **'19-'18** | **'20-'19** | **'19-'18** |
| Net interest income | $ 53,263 | $ 48,738 | $ 44,593 | $ 4,525 | $ 4,145 | 9.3 % | 9.3 % |
| Provision for loan losses | 5,800 | 1,150 | 1,475 | 4,650 | (325) | 404.3 | (22.0) |
| Non-interest income | 14,649 | 8,937 | 9,341 | 5,712 | (404) | 63.9 | (4.3) |
| Investment securities gains (losses), net | 61 | (40) | 255 | 101 | (295) | (252.5) | (115.7) |
| Gain on branch sale, net | — | 2,183 | — | (2,183) | 2,183 | (100.0) | 100.0 |
| Non-interest expense | 44,697 | 38,731 | 40,332 | 5,966 | (1,601) | 15.4 | (4.0) |
| **Income before income taxes** | 17,476 | 19,937 | 12,382 | (2,461) | 7,555 | (12.3) | 61.0 |
| Income tax expense | 3,183 | 3,823 | 1,668 | (640) | 2,155 | (16.7) | 129.2 |
| **Net income** | $ 14,293 | $ 16,114 | $ 10,714 | $ (1,821) | $ 5,400 | (11.3)% | 50.4 % |

*Consolidated net income* decreased $1.8 million to $14.3 million, or $2.20 per diluted share, for the year ended December 31, 2020 compared to $16.1 million, or $2.47 per diluted share, for the year ended December 31, 2019. For the year ended December 31, 2020, the return on average assets (ROA) was 0.88%, the return on average stockholders' equity (ROE) was 11.74%, and the efficiency ratio was 65.82%.

*Consolidated net income* increased $5.4 million to $16.1 million, or $2.47 per diluted share, for the year ended December 31, 2019 compared to $10.7 million, or $1.64 per diluted share, for the year ended December 31, 2018. For the year ended December 31, 2019, the return on average assets (ROA) was 1.09%, the return on average stockholders' equity (ROE) was 14.77%, and the efficiency ratio was 67.15%.

***Net interest income*** was $53.3 million for the year ended December 31, 2020 compared to $48.7 million and $44.6 million for the years ended December 31, 2019 and 2018, respectively. The net interest margin was 3.48% for the year ended December 31, 2020 compared to 3.51% and 3.31% for the years ended December 31, 2019 and 2018, respectively.

A $5.8 million ***provision for loan losses*** was recorded for the year ended December 31, 2020 compared to a $1.2 million and $1.5 million provision for the years ended December 31, 2019 and 2018, respectively. The increase in the provision was primarily due to current economic conditions resulting from the COVID-19 pandemic.

The Company's net charge-offs for the year ended December 31, 2020, were $164,000, or 0.01% of average loans compared to $325,000, or 0.03% of average loans for the year ended December 31, 2019, and $675,000, or 0.06% of average loans for the year ended December 31, 2018.

Non-performing loans totaled $34.6 million, or 2.69% of total loans, at December 31, 2020 compared to $5.1 million, or 0.43% of total loans at December 31, 2019, and $5.6 million, or 0.49% of total loans, at December 31, 2018.

***Non-interest income*** increased $5.7 million, or 63.9%, for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $404,000, or 4.3%, for the year ended December 31, 2019 compared to the year ended December 31, 2018. These changes are discussed in greater detail below under Non-interest Income.

***Investment securities gains (losses), net*** of $61,000 were recorded for the year ended December 31, 2020 compared to $(40,000) and $255,000 for the years ended December 31, 2019 and 2018, respectively. Securities gains for the year ended December 31, 2018 included gains realized from a series of short term sales of U.S. Treasury securities with repurchase agreements in order to generate capital gains to offset capital losses expiring in 2018 and 2019.

***Gain on branch sale, net*** On February 8, 2019, Hawthorn Bank, a wholly-owned subsidiary of Hawthorn Bancshares, Inc., completed the sale of its branch located in Branson, Missouri to Branson Bank, Branson, Missouri. The Company sold the land and building for $3.5 million with a net book value of $1.7 million and transferred approximately $10.6 million in deposits. The sale resulted in a pre-tax gain of approximately $2.2 million, or $1.7 million after tax, for the year ended December 31, 2019.

***Non-interest expense*** increased $6.0 million, or 15.4%, for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $1.6 million, or 4.0%, for the year ended December 31, 2019 compared to the year ended December 31, 2018. These changes are discussed in greater detail below under Non-interest Expense.

***Average Balance Sheets***

***Net interest income*** is the largest source of revenue resulting from the Company's lending, investing, borrowing, and deposit gathering activities. It is affected by both changes in the level of interest rates and changes in the amounts and mix of interest earning assets and interest bearing liabilities. The following table presents average balance sheets, net interest income, average yields of earning assets, average costs of interest bearing liabilities, net interest spread and net interest margin on a fully taxable equivalent basis for each of the years in the three year periods ended December 31, 2020, 2019, and 2018, respectively.

| (In thousands) | 2020 Average Balance | 2020 Interest Income/ Expense(1) | 2020 Rate Earned/ Paid(1) | 2019 Average Balance | 2019 Interest Income/ Expense(1) | 2019 Rate Earned/ Paid(1) | 2018 Average Balance | 2018 Interest Income/ Expense(1) | 2018 Rate Earned/ Paid(1) |
|---|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | | |
| **Loans: (2) (3)** | | | | | | | | | |
| Commercial | $ 264,160 | $ 13,012 | 4.93 % | $ 201,062 | $ 11,051 | 5.50 % | $ 199,448 | $ 10,039 | 5.03 % |
| Real estate construction - residential | 26,184 | 1,360 | 5.19 | 25,953 | 1,553 | 5.98 | 29,481 | 1,562 | 5.30 |
| Real estate construction - commercial | 85,132 | 4,004 | 4.70 | 116,944 | 6,086 | 5.20 | 103,880 | 5,072 | 4.88 |
| Real estate mortgage - residential | 252,898 | 11,933 | 4.72 | 247,695 | 12,697 | 5.13 | 244,952 | 11,850 | 4.84 |
| Real estate mortgage - commercial | 586,188 | 27,103 | 4.62 | 530,091 | 25,939 | 4.89 | 485,911 | 22,704 | 4.67 |
| Installment and other consumer | 29,409 | 1,232 | 4.19 | 31,741 | 1,393 | 4.39 | 32,927 | 1,285 | 3.90 |
| **Total loans** | $ 1,243,971 | $ 58,644 | 4.71 % | $ 1,153,486 | $ 58,719 | 5.09 % | $ 1,096,599 | $ 52,512 | 4.79 % |
| **Loans held for sale** | $ 7,876 | $ 120 | 1.52 % | $ 992 | $ — | — % | 785 | — | — % |
| **Investment securities:** | | | | | | | | | |
| U.S. Treasury | $ 1,792 | $ 24 | 1.34 % | $ 1,866 | $ 40 | 2.14 % | $ 13,092 | $ 215 | 1.64 % |
| U.S. government and federal agency obligations | 39,572 | 779 | 1.97 | 40,425 | 780 | 1.93 | 53,856 | 951 | 1.77 |
| Obligations of states and political subdivisions | 44,410 | 1,285 | 2.89 | 34,916 | 978 | 2.80 | 41,807 | 1,122 | 2.68 |
| Mortgage-backed securities | 97,905 | 1,688 | 1.72 | 118,197 | 2,487 | 2.10 | 124,492 | 2,631 | 2.11 |
| Other debt securities | 8,294 | 426 | 5.14 | 4,380 | 251 | 5.73 | 4,455 | 247 | 5.54 |
| **Total investment securities** | $ 191,973 | $ 4,202 | 2.19 % | $ 199,784 | $ 4,536 | 2.27 % | $ 237,702 | $ 5,166 | 2.17 % |
| Other investment securities | 6,646 | 343 | 5.16 | 5,814 | 272 | 4.68 | 5,104 | 218 | 4.27 |
| Federal funds sold and interest bearing deposits in other financial institutions | 110,117 | 667 | 0.61 | 47,967 | 1,125 | 2.35 | 32,142 | 699 | 2.17 |
| **Total interest earning assets** | $ 1,560,583 | $ 63,976 | 4.10 % | $ 1,408,043 | $ 64,652 | 4.59 % | $ 1,372,332 | $ 58,595 | 4.27 % |
| All other assets | 83,896 | | | 82,975 | | | 85,049 | | |
| Allowance for loan losses | (15,771) | | | (11,983) | | | (11,221) | | |
| **Total assets** | $ 1,628,708 | | | $ 1,479,035 | | | $ 1,446,160 | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | | | | | | | |
| NOW accounts | $ 196,895 | $ 659 | 0.33 % | $ 199,323 | $ 1,978 | 0.99 % | $ 218,328 | $ 2,131 | 0.98 % |
| Savings | 117,598 | 55 | 0.05 | 96,621 | 89 | 0.09 | 94,964 | 48 | 0.05 |
| Interest checking | 53,090 | 401 | 0.76 | 18,561 | 330 | 1.78 | 3,249 | 34 | 1.05 |
| Money market | 279,071 | 743 | 0.27 | 278,429 | 2,845 | 1.02 | 295,982 | 3,220 | 1.09 |
| Time deposits | 301,676 | 3,994 | 1.32 | 331,882 | 5,155 | 1.55 | 310,381 | 3,419 | 1.10 |
| **Total interest bearing deposits** | $ 948,330 | $ 5,852 | 0.62 % | $ 924,816 | $ 10,397 | 1.12 % | $ 922,904 | $ 8,852 | 0.96 % |
| Federal funds purchased and securities sold under agreements to repurchase | 34,026 | 146 | 0.43 | 22,528 | 140 | 0.62 | 39,564 | 603 | 1.52 |
| Federal Home Loan Bank advances and other borrowings | 117,214 | 2,199 | 1.88 | 97,443 | 2,338 | 2.40 | 81,945 | 1,517 | 1.85 |
| Subordinated notes | 49,486 | 1,527 | 3.09 | 49,486 | 2,376 | 4.80 | 49,486 | 2,229 | 4.50 |
| **Total borrowings** | $ 200,726 | $ 3,872 | 1.93 % | $ 169,457 | $ 4,854 | 2.86 % | $ 170,995 | $ 4,349 | 2.54 % |
| **Total interest bearing liabilities** | $ 1,149,056 | $ 9,724 | 0.85 % | $ 1,094,273 | $ 15,251 | 1.39 % | $ 1,093,899 | $ 13,201 | 1.21 % |
| Demand deposits | 339,385 | | | 260,400 | | | 246,339 | | |
| Other liabilities | 18,495 | | | 15,259 | | | 12,307 | | |
| **Total liabilities** | 1,506,936 | | | 1,369,932 | | | 1,352,545 | | |
| Stockholders' equity | 121,772 | | | 109,103 | | | 93,615 | | |
| **Total liabilities and stockholders' equity** | $ 1,628,708 | | | $ 1,479,035 | | | $ 1,446,160 | | |
| **Net interest income (FTE)** | | $ 54,252 | | | $ 49,401 | | | $ 45,394 | |
| **Net interest spread** | | | 3.25 % | | | 3.20 % | | | 3.06 % |
| **Net interest margin** | | | 3.48 % | | | 3.51 % | | | 3.31 % |

(1) Interest income and yields are presented on a fully taxable equivalent basis using the Federal statutory income tax rate of 21%, net of nondeductible interest expense for the years ended December 31, 2020, 2019 and 2018, respectively. Such adjustments totaled $991,000, $682,000 and $816,000 for the years ended December 31, 2020, 2019, and 2018, respectively.
(2) Non-accruing loans are included in the average amounts outstanding.
(3) Fees and costs on loans are included in interest income.

***Rate and volume analysis***

The following table summarizes the changes in net interest income on a fully taxable equivalent basis, by major category of interest earning assets and interest bearing liabilities, identifying changes related to volumes and rates for the years ended December 31, 2020, compared to

December 31, 2019, and for the years ended December 31, 2019 compared to December 31, 2018. The change in interest due to the combined rate/volume variance has been allocated to rate and volume changes in proportion to the absolute dollar amounts of change in each.

| | 2020 | | | 2019 | | |
|---|---|---|---|---|---|---|
| | | Change due to | | | Change due to | |
| *(In thousands)* | Total Change | Average Volume | Average Rate | Total Change | Average Volume | Average Rate |
| **Interest income on a fully taxable equivalent basis: (1)** | | | | | | |
| **Loans: (2) (3)** | | | | | | |
| Commercial | $ 1,961 | $ 3,197 | $ (1,236) | $ 1,012 | $ 82 | $ 930 |
| Real estate construction - residential | (193) | 14 | (207) | (9) | (199) | 190 |
| Real estate construction - commercial | (2,082) | (1,538) | (544) | 1,014 | 666 | 348 |
| Real estate mortgage - residential | (764) | 263 | (1,027) | 847 | 134 | 713 |
| Real estate mortgage - commercial | 1,164 | 2,646 | (1,482) | 3,235 | 2,128 | 1,107 |
| Installment and other consumer | (161) | (99) | (62) | 108 | (47) | 155 |
| **Loans held for sale** | 120 | — | 120 | — | — | — |
| **Investment securities:** | | | | | | |
| U.S. Treasury | (16) | (2) | (14) | (175) | (226) | 51 |
| U.S. government and federal agency obligations | (1) | (16) | 15 | (171) | (253) | 82 |
| Obligations of states and political subdivisions | 307 | 274 | 33 | (144) | (191) | 47 |
| Mortgage-backed securities | (799) | (389) | (410) | (144) | (132) | (12) |
| Other debt securities | 175 | 203 | (28) | 4 | (4) | 8 |
| Other investment securities | 71 | 41 | 30 | 54 | 32 | 22 |
| Federal funds sold and interest bearing deposits in other financial institutions | (458) | 770 | (1,228) | 426 | 367 | 59 |
| **Total interest income** | (676) | 5,364 | (6,040) | 6,057 | 2,357 | 3,700 |
| **Interest expense:** | | | | | | |
| NOW accounts | (1,319) | (24) | (1,295) | (153) | (189) | 36 |
| Savings | (34) | 16 | (50) | 41 | 1 | 40 |
| Interest checking | 71 | 344 | (273) | 296 | 258 | 38 |
| Money market | (2,102) | 7 | (2,109) | (375) | (185) | (190) |
| Time deposits | (1,161) | (443) | (718) | 1,736 | 251 | 1,485 |
| Federal funds purchased and securities sold under agreements to repurchase | 6 | 57 | (51) | (463) | (195) | (268) |
| Federal Home Loan Bank advances and other borrowings | (139) | 424 | (563) | 821 | 320 | 501 |
| Subordinated notes | (849) | — | (849) | 147 | — | 147 |
| **Total interest expense** | (5,527) | 381 | (5,908) | 2,050 | 261 | 1,789 |
| **Net interest income on a fully taxable equivalent basis** | $ 4,851 | $ 4,983 | $ (132) | $ 4,007 | $ 2,096 | $ 1,911 |

(1) Interest income and yields are presented on a fully taxable equivalent basis using the Federal statutory income tax rate of 21%, net of nondeductible interest expense for the years ended December 31, 2020, 2019 and 2018, respectively. Such adjustments totaled $991,000, $682,000 and $816,000 for the years ended December 31, 2020, 2019, and 2018, respectively.
(2) Non-accruing loans are included in the average amounts outstanding.
(3) Fees and costs on loans are included in interest income.

Financial results for the year ended December 31, 2020 compared to the year ended December 31, 2019 reflected an increase in net interest income, on a tax equivalent basis, of $4.9 million, or 9.8%, and financial results for the year ended December 31, 2019 compared to the year ended December 31, 2018 reflected an increase of $4.0 million, or 8.8%.

Measured as a percentage of average earning assets, the net interest margin (expressed on a fully taxable equivalent basis) was 3.48% for the year ended December 31, 2020, compared to 3.51% and 3.31% for the years ended December 31, 2019 and 2018, respectively.

The increase in net interest income for 2020 over 2019 was primarily due to a decrease in rates paid on average interest bearing liabilities, while the decrease in the net interest margin was primarily due to a decrease in the rates earned on the significant increase in average earning assets resulting from PPP loans, real estate mortgage loan activity and excess liquidity in Federal funds sold. Contributing to this decrease in net interest margin was the reversal of $1.1 million of interest income previously recorded on approximately $30 million of loans modified under the CARES Act which were moved to non-accrual in the fourth quarter.

The increase in net interest income and net interest margin for 2019 over 2018 was primarily due to an increase in average balances and rates earned on loans. The prime rate was 3.25% at December 31, 2020 compared to 4.75% and 5.50% at December 31, 2019 and 2018, respectively.

Average interest-earning assets increased $152.5 million, or 10.8%, to $1.56 billion for the year ended December 31, 2020 compared to $1.41 billion for the year ended December 31, 2019, and average interest bearing liabilities increased $54.8 million, or 5.0%, to $1.15 billion for the year ended December 31, 2020 compared to $1.09 billion for the year ended December 31, 2019.

Average interest-earning assets increased $35.7 million, or 2.6%, to $1.41 billion for the year ended December 31, 2019 compared to $1.37 billion for the year ended December 31, 2018, and average interest bearing liabilities increased $374,000, or 0.03%, to $1.09 billion for the year ended December 31, 2019 compared to $1.09 billion for the year ended December 31, 2018.

***Total interest income*** (expressed on a fully taxable equivalent basis) decreased to $64.0 million for the year ended December 31, 2020 compared to $64.7 million and $58.6 million for the years ended December 31, 2019 and 2018, respectively. The Company's rates earned on interest earning assets were 4.10% for the year ended December 31, 2020 compared to 4.59% and 4.27% for the years ended December 31, 2019 and 2018, respectively.

***Interest income on loans held for investment*** decreased to $58.6 million for the year ended December 31, 2020 compared to $58.7 million and $52.5 million for the years ended December 31, 2019 and 2018, respectively. As mentioned above, $1.1 million of interest income previously recorded was reversed on approximately $30 million of loans modified under the CARES Act which were moved to non-accrual in the fourth quarter of 2020. Also included in income was $0.5 million in fees earned on loans associated with the government-sponsored Main Street Lending Program ("MSLP") and $1.8 million in SBA PPP loan fees.

Average loans outstanding increased $90.5 million, or 7.8%, to $1.24 billion for the year ended December 31, 2020 compared to $1.15 billion for the year ended December 31, 2019. The average yield on loans receivable decreased to 4.71% during the year ended December 31, 2020 compared to 5.09% for the year ended December 31, 2019.

Average loans outstanding increased $56.9 million, or 5.2%, to $1.15 billion for the year ended December 31, 2019 compared to $1.10 billion for the year ended December 31, 2018. The average yield on loans receivable increased to 5.09% during the year ended December 31, 2019 compared to 4.79% for the year ended December 31, 2018. See the *Lending and Credit Management* section for further discussion of changes in the composition of the lending portfolio.

***Interest income on available-for-sale securities*** decreased to $4.2 million for the year ended December 31, 2020 compared to $4.5 million and $5.2 million for the years ended December 31, 2019 and 2018, respectively.

Average securities decreased $7.8 million, or 3.9%, to $192.0 million for the year ended December 31, 2020 compared to $199.8 million for the year ended December 31, 2019. The average yield on securities decreased to 2.19% for the year ended December 31, 2020 compared to 2.27% for the year ended December 31, 2019.

Average securities decreased $37.9 million, or 16.0%, to $199.8 million for the year ended December 31, 2019 compared to $237.7 million for the year ended December 31, 2018. The average yield on securities increased to 2.27% for the year ended December 31, 2019 compared to 2.17% for the year ended December 31, 2018. See the *Liquidity Management* section for further discussion

***Total interest expense*** was $9.7 million for the year ended December 31, 2020 compared to $15.3 million and $13.2 million for the years ended December 31, 2019 and 2018, respectively. The Company's rates paid on interest bearing liabilities was 0.85% for the year ended December 31, 2020 compared to 1.39% and 1.21% for the years ended December 31, 2019 and 2018, respectively. See the *Liquidity Management* section for further discussion.

***Interest expense on deposits*** was $5.9 million for the year ended December 31, 2020 compared to $10.4 million and $8.85 million for the years ended December 31, 2019 and 2018, respectively.

Average interest bearing deposits increased $23.5 million, or 2.5%, to $948.3 million for the year ended December 31, 2020 compared to $924.8 million for the year ended December 31, 2019. The average cost of deposits decreased to 0.62% during the year ended December 31, 2020 compared to 1.12% for the year ended December 31, 2019. Although offering rates remain low in response to lower market interest rates, growth in deposits was positively impacted in part by customers who deposited PPP loan proceeds.

Average interest bearing deposits increased $1.9 million, or 0.2%, to $924.8 million for the year ended December 31, 2019 compared to $922.9 million for the year ended December 31, 2018. The average cost of deposits increased to 1.12% during the year ended December 31, 2019 compared to 0.96% for the year ended December 31, 2018.

***Interest expense on borrowings*** was $3.9 million for year ended December 31, 2020 compared to $4.9 million and $4.3 million for the years ended December 31, 2019 and 2018, respectively. Average borrowings were $200.7 million for the year ended December 31, 2020 compared to $169.5 million and $171.0 million for the years ended December 31, 2019 and 2018, respectively.

Average borrowings increased $31.3 million, or 18.5%, to $200.7 million for the year ended December 31, 2020 compared to $169.5 million for the year ended December 31, 2019. The average cost of borrowings decreased to 1.93% for the year ended December 31, 2020 compared to 2.86% for the year ended December 31, 2019. The decrease in cost of funds primarily resulted from lower market interest rates.

Average borrowings decreased $1.5 million, or 0.9%, to $169.5 million for the year ended December 31, 2019 compared to $171.0 million for the year ended December 31, 2018. The average cost of borrowings increased to 2.86% for the year ended December 31, 2019 compared to 2.54% for the year ended December 31, 2018.

The increase in average borrowings for the year ended 2020 was primarily due to an increase in FHLB advances to fund liquidity needs as refinancing activity increased when rates dropped during the first quarter of 2020. This in turn was offset beginning in April of 2020 when the Company had an increase in liquidity due to participation in the CARES Act economic stimulus programs. The Company experienced significant deposit growth primarily due to stimulus checks, proceeds from PPP loan funding, deferral of income tax payments, and customers holding on to savings due to uncertain times. See the *Liquidity Management* section for further discussion.

***Non-interest Income and Expense***

**Non-interest income for the years ended December 31, 2020, 2019, and 2018 was as follows:**

| | | | | $ Change | | % Change | |
|---|---|---|---|---|---|---|---|
| *(In thousands)* | **2020** | **2019** | **2018** | **'20-'19** | **'19-'18** | **'20-'19** | **'19-'18** |
| **Non-interest income** | | | | | | | |
| Service charges and other fees | $ 2,954 | $ 3,611 | $ 3,736 | $ (657) | $ (125) | (18.2)% | (3.3)% |
| Bank card income and fees | 3,201 | 3,061 | 2,754 | 140 | 307 | 4.6 | 11.1 |
| Trust department income | 1,185 | 1,237 | 1,166 | (52) | 71 | (4.2) | 6.1 |
| Real estate servicing fees, net | (49) | 39 | 794 | (88) | (755) | (225.6) | (95.1) |
| Gain on sales of mortgage loans, net | 7,109 | 771 | 721 | 6,338 | 50 | 822.0 | 6.9 |
| Other | 249 | 218 | 170 | 31 | 48 | 14.2 | 28.2 |
| **Total non-interest income** | $ 14,649 | $ 8,937 | $ 9,341 | $ 5,712 | $ (404) | 63.9 % | (4.3)% |
| Non-interest income as a % of total revenue * | 21.6 % | 15.5 % | 17.3 % | | | | |

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

***Total non-interest income*** increased $5.7 million, or 63.9%, to $14.6 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $404,000, or 4.3%, to $8.9 million for the year ended December 31, 2019 compared to the year ended December 31, 2018.

***Service charges and fees*** decreased $657,000, or 18.2%, to $3.0 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $125,000, or 3.3%, to $3.6 million for the year ended December 31, 2019 over the year ended December 31, 2018. The decrease in fees in 2020 was primarily due to a decrease in nonsufficient fund service charges (NSF) resulting from both a decrease in volume, in addition to temporary fee waivers for customers related to the COVID-19 pandemic.

***Bank card income and fees*** increased $140,000, or 4.6%, to $3.2 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and increased $307,000, or 11.1%, to $3.1 million for the year ended December 31, 2019 compared to the year ended December 31, 2018. The increase in all years presented was mainly the result of higher transaction volume in debit and credit card fees.

***Real estate servicing fees, net*** of the change in valuation of mortgage serving rights (MSRs) decreased $88,000 to $(49,000) for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $755,000 to $39,000 for the year ended December 31, 2019 compared to the year ended December 31, 2018.

Mortgage loan servicing fees earned on loans sold were $854,000 for the year ended December 31, 2020 compared to $778,000 and $821,000 for the years ended 2019 and 2018, respectively. The Company was servicing $292.7 million of mortgage loans at December 31, 2020 compared to $271.4 million and $279.9 million at December 31, 2019 and 2018, respectively. The decreases year over year were primarily due to decreases in fair value of the MSRs from increased loan prepayments assumptions resulting from lower market interest rates. The

dramatic drop in market interest rates from December 31, 2018 to December 31, 2020, created an economic incentive for borrowers to refinance their existing home mortgage loans.

***Gain on sales of mortgage loans*** increased $6.3 million to $7.1 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and increased $50,000, to $771,000 for the year ended December 31, 2019 compared to the year ended December 31, 2018. The Company sold loans totaling $195.9 million for the year ended December 31, 2020 compared to $44.3 million and $37.0 million for the years ended December 31, 2019 and 2018, respectively. During the fourth quarter of 2019, the Company focused on the creation and development of a new mortgage loan department and began offering new mortgage loan products in addition to Freddie and Fannie loans that are sold to the secondary market.

***Other income*** increased $31,000, or 14.2%, to $249,000 for the year ended December 31, 2020 compared to the year ended December 31, 2019, and increased $48,000, or 28.2%, to $218,000 for the year ended December 31, 2019 compared to the year ended December 31, 2018. The increase in the year ended 2020 over the year ended 2019 was primarily due to increased brokerage income, partially offset by a decrease in insurance commissions, rental income from other real estate owned, and income earned on bank owned life insurance policies due to one of the Company's polices being redeemed in the third quarter of 2019. The increase in the year ended 2019 over 2018 was primarily due to an increase in rental income received from other real estate owned.

**Investment securities (losses) gains, net for the years ended December 31, 2020, 2019, and 2018 was as follows:**

| *(in thousands)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| ***Investment securities gains (losses), net*** | | | |
| **Available for sale securities:** | | | |
| Gains realized on sales | $ 49 | $ 6 | $ 253 |
| Losses realized on sales | (8) | (46) | — |
| Other-than-temporary impairment recognized | — | — | — |
| **Other investment securities:** | | | |
| Fair value adjustments, net | 20 | — | 2 |
| **Investment securities gains (losses), net** | **$ 61** | **$ (40)** | **$ 255** |

During the year ended December 31, 2020, the Company received $5.8 million proceeds from the sale of available for sale debt securities and recognized net securities gains, which include the unrealized net gains related to equity securities, of $61,000. This is compared to $21.5 million and $77.2 million proceeds from the sale of available debt securities and recognized net gains (losses) of $(40,000) and $255,000 for the years ended December 31, 2019 and 2018, respectively.

The sale transaction in 2020 was the result of bond sales and purchases to replace several smaller holdings with fewer, larger investments without materially changing the duration or yield of the investment portfolio. The sale transaction in 2019 provided liquidity necessary to fund the replacement of a major deposit account relationship. During 2018, the Company entered into a sale of a series of short term U.S. Treasury securities purchased with repurchase agreements in order to generate capital gains to offset capital losses that were to expire during 2018 and 2019.

**Non-interest expense for the years ended December 31, 2020, 2019, and 2018 was as follows:**

| | | | | $ Change | | % Change | |
|---|---|---|---|---|---|---|---|
| *(In thousands)* | **2020** | **2019** | **2018** | **'20-'19** | **19-'18** | **'20-'19** | **19-'18** |
| **Non-interest expense** | | | | | | | |
| Salaries | $ 19,765 | $ 15,876 | $ 17,109 | $ 3,889 | $ (1,233) | 24.5 % | (7.2)% |
| Employee benefits | 6,386 | 5,721 | 5,995 | 665 | (274) | 11.6 | (4.6) |
| Occupancy expense, net | 3,069 | 3,122 | 2,957 | (53) | 165 | (1.7) | 5.6 |
| Furniture and equipment expense | 2,939 | 2,847 | 3,001 | 92 | (154) | 3.2 | (5.1) |
| Processing, network and bank card expense | 3,864 | 3,882 | 3,484 | (18) | 398 | (0.5) | 11.4 |
| Legal, examination, and professional fees | 1,458 | 1,211 | 1,223 | 247 | (12) | 20.4 | (1.0) |
| Advertising and promotion | 1,095 | 1,256 | 1,233 | (161) | 23 | (12.8) | 1.9 |
| Postage, printing, and supplies | 897 | 871 | 996 | 26 | (125) | 3.0 | (12.6) |
| Loan expense | 917 | 625 | 612 | 292 | 13 | 46.7 | 2.1 |
| Other | 4,307 | 3,320 | 3,722 | 987 | (402) | 29.7 | (10.8) |
| **Total non-interest expense** | $ 44,697 | $ 38,731 | $ 40,332 | $ 5,966 | $ (1,601) | 15.4 % | (4.0)% |
| Efficiency ratio* | 65.8 % | 67.2 % | 74.8 % | | | | |
| Number of full-time equivalent employees | 299 | 278 | 288 | | | | |

* Efficiency ratio is calculated as non-interest expense as a percentage of total revenue. Total revenue includes net interest income and non-interest income.

***Total non-interest expense*** increased $6.0 million, or 15.4%, to $44.7 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $1.6 million, or 4.0%, to $38.7 million for the year ended December 31, 2019 compared to the year ended December 31, 2018.

***Salaries*** increased $3.9 million, or 24.5%, to $19.8 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $1.2 million, or 7.2%, to $15.9 million for the year ended December 31, 2019 compared to the year ended December 31, 2018. The increase for the year ended 2020 over the year ended 2019 was primarily due to adding 25 full-time equivalent (FTE) employees to expand the Company's new mortgage loan department that formed in late 2019. The decrease for the year ended 2019 over the year ended 2018 was primarily due to a reduction of FTE employees during the year. FTE staff decreased 55, or 16.5%, since December 31, 2017.

***Employee benefits*** increased $665,000, or 11.6%, to $6.4 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $274,000, or 4.6%, to $5.7 million for the year ended December 31, 2019 compared to the year ended December 31, 2018. The increase for the year ended 2020 over the year ended 2019 was primarily due to higher pension cost due to lower annual discount rate assumptions compared to the prior year's assumptions, an increase in payroll taxes due to an increase in FTE mentioned above, and an increase in 401(k) plan contributions. The decrease for the year ended 2019 over the year ended 2018 was primarily due to a reduction in medical plan premiums due to a reduction of staff mentioned above, and a reduction in the periodic pension cost due to a higher assumed discount rate, partially offset by an increase in the 401(k) and profit-sharing contribution.

***Processing, network, and bank card expense*** decreased $18,000, or 0.5%, to $3.9 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and increased $398,000, or 11.4%, to $3.9 million for the year ended December 31, 2019 compared to the year ended December 31, 2018. The decrease for the year ended 2020 over the year ended 2019 was primarily due to decreases in ATM and debit card processing expense. The increase for the year ended 2019 over the year ended 2018 was primarily due to a credit card software conversion and an increase in debit and credit card processing expenses.

***Legal, examination, and professional fees*** increased $247,000, or 20.4%, to $1.5 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $12,000, or 1.0%, to $1.2 million for the year ended December 31, 2019 compared to the year ended December 31, 2018. The increase for the year ended 2020 over the year ended 2019 was primarily related to an increase in legal fees related to one pending lawsuit that is in its early stages, in addition to an increase in consulting expenses. The decrease for the year ended 2019 over the year ended 2018 was primarily related to a decrease in consulting fees partially offset by an increase in legal fees.

***Loan expense*** increased $292,000, or 46.7%, to $917,000 for the year ended December 31, 2020 compared to the year ended December 31, 2019, and increased $13,000, or 2.1%, to $625,000 for the year ended December 31, 2019 compared to the year ended December 31, 2018. The increase for the year ended 2020 over the year ended 2019 was primarily related to increases in real estate loan expenses related to the growth in loan volume, partially offset by real estate foreclosure (gain) expense. In the second quarter of 2020, the Company sold an out-of-service branch building being held as other real estate owned (OREO) to a non-profit organization. This transaction consisted of a $266,000

donation expense and the company realized a net gain of $210,000. The increase for the year ended 2019 over the year ended 2018 was primarily related to an increase in home equity loan expenses driven by a 2019 promotion, partially offset by decreases in real estate foreclosure, real estate, and commercial loan expenses.

***Other non-interest expense*** increased $987,000, or 29.7%, to $4.3 million for the year ended December 31, 2020 compared to the year ended December 31, 2019, and decreased $402,000, or 10.8%, to $3.3 million for the year ended December 31, 2019 compared to the year ended December 31, 2018. The increase in the year ended 2020 over the year ended 2019 was primarily due to increases in donations, FDIC assessment expense, and credit card fraud charge-offs. In the second quarter of 2020, the Company sold an out-of-service branch building being held as other real estate owned (OREO) to a non-profit organization. This transaction consisted of a $266,000 donation expense and the company realized a net gain of $210,000. During the third quarter of 2020 the Company recognized approximately $150,000 of disputed credit card fraud losses from prior years. The decrease for the year ended 2019 over the year ended 2018 was primarily related to a FDIC assessment credit that began reducing the quarterly assessment in the third quarter of 2019 and continued through the first quarter of 2020.

***Income taxes***

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 18.2% for the year ended December 31, 2020 compared to 19.2% and 13.5% for the years ended December 31, 2019 and 2018, respectively.

The decrease in the effective tax rate for the year ended December 31, 2020 compared to the year ended December 31, 2019 was primarily attributable to tax-free revenues having a greater impact on pre-tax income due to the reduced level of earnings in 2020. The increase in the effective tax rate for the year ended December 31, 2019 compared to the year ended December 31, 2018 was primarily attributable to a one-time benefit recorded in 2018 associated with the finalization of the Company’s analysis of the Tax Cuts and Jobs Act (Tax Act), a one-time benefit recorded in 2018 associated with the Company’s state tax planning initiatives, and the increased earnings and branch sale gain in 2019.

**Lending and Credit Management**

Interest earned on the loan portfolio is a primary source of interest income for the Company. Net loans represented 73.2% of total assets as of December 31, 2020 compared to 77.5% as of December 31, 2019.

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

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

| *(In thousands)* | **2020** | **2019** | **2018** | **2017** | **2016** |
|---|---|---|---|---|---|
| Commercial, financial, and agricultural (a) | $ 272,918 | $ 199,022 | $ 207,720 | $ 192,238 | $ 182,881 |
| Real estate construction − residential | 29,692 | 23,035 | 28,610 | 26,492 | 18,907 |
| Real estate construction − commercial | 78,144 | 84,998 | 106,784 | 98,340 | 55,653 |
| Real estate mortgage − residential | 262,339 | 252,643 | 240,934 | 246,371 | 259,738 |
| Real estate mortgage − commercial | 617,133 | 576,635 | 529,536 | 472,455 | 426,470 |
| Installment and other consumer | 26,741 | 32,464 | 32,460 | 32,153 | 30,218 |
| **Total loans** | $ 1,286,967 | $ 1,168,797 | $ 1,146,044 | $ 1,068,049 | $ 973,867 |
| **Percent of categories to total loans:** | | | | | |
| Commercial, financial, and agricultural | 21.2 % | 17.0 % | 18.1 % | 18.0 % | 18.8 % |
| Real estate construction − residential | 2.3 | 2.0 | 2.5 | 2.5 | 1.9 |
| Real estate construction − commercial | 6.1 | 7.3 | 9.3 | 9.2 | 5.7 |
| Real estate mortgage − residential | 20.4 | 21.6 | 21.0 | 23.1 | 26.7 |
| Real estate mortgage − commercial | 48.0 | 49.3 | 46.2 | 44.2 | 43.8 |
| Installment and other consumer | 2.1 | 2.8 | 2.8 | 3.0 | 3.1 |
| **Total** | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % |

(a) Includes $63.3 million SBA PPP loans, net

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

The contractual maturities of loan categories at December 31, 2020 and the composition of those loans between fixed rate and floating rate loans are as follows:

| | Principal Payments Due | | | |
|---|---|---|---|---|
| *(In thousands)* | One Year Or Less | Over One Year Through Five Years | Over Five Years | Total |
| Commercial, financial, and agricultural | $ 57,567 | $ 135,151 | $ 80,200 | $ 272,918 |
| Real estate construction – residential | 25,318 | 2,962 | 1,412 | 29,692 |
| Real estate construction – commercial | 28,409 | 20,296 | 29,439 | 78,144 |
| Real estate mortgage – residential | 16,920 | 35,109 | 210,310 | 262,339 |
| Real estate mortgage – commercial | 72,524 | 280,488 | 264,121 | 617,133 |
| Installment and other consumer | 3,006 | 19,486 | 4,249 | 26,741 |
| **Total loans** | $ 203,744 | $ 493,492 | $ 589,731 | $ 1,286,967 |
| | | | | |
| Loans with fixed rates | 107,446 | 438,339 | 147,649 | 693,434 |
| Loans with floating rates | 96,298 | 55,153 | 442,082 | 593,533 |
| **Total loans** | $ 203,744 | $ 493,492 | $ 589,731 | $ 1,286,967 |

The Company generally does not retain long-term fixed rate residential mortgage loans in its portfolio. Fixed rate loans conforming to standards required by the secondary market are offered to qualified borrowers, but are not funded until the Company has a non-recourse purchase commitment from the secondary market at a predetermined price. For the year ended December 31, 2020, the Company sold approximately $195.9 million of loans to investors compared to $44.3 million and $37.0 million for the years ended December 31, 2019 and 2018, respectively. At December 31, 2020, the Company was servicing approximately $292.7 million of loans sold to the secondary market compared to $271.4 million at December 31, 2019, and $279.9 million at December 31, 2018.

*Risk Elements of the Loan Portfolio*

Management, the senior loan committee, and internal loan review, formally review all loans in excess of certain dollar amounts (periodically established) at least annually. Loans in excess of $2.0 million in aggregate and all adversely classified credits identified by management are reviewed by the senior loan committee. In addition, all other loans are reviewed on a risk weighted selection process. The senior loan committee reviews and reports to the board of directors, on a monthly basis, past due, classified, and watch list loans in order to classify or reclassify loans as loans requiring attention, substandard, doubtful, or loss. During this review, management also determines which loans should be considered impaired. Management follows the guidance provided in the FASB's ASC Topic 310-10-35 in identifying and measuring loan impairment. If management determines that it is probable that all amounts due on a loan will not be collected under the original terms of the loan agreement, the loan is considered to be impaired. These loans are evaluated individually for impairment, and in conjunction with current economic conditions and loss experience, specific reserves are estimated as further discussed below.

Loans not individually evaluated are aggregated and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type; loss emergence factors; lending policies and procedures; economic conditions; the nature, volume and terms of the portfolio; lending staff and management; nonaccrual loans; the loan review system; collateral values; concentrations of credit; and external factors. Management believes, but there can be no assurance, that these procedures keep management informed of potential problem loans. Based upon these procedures, both the allowance and provision for loan losses are adjusted to maintain the allowance at a level considered necessary by management to provide for probable losses inherent in the loan portfolio.

*Nonperforming Assets*

The following table summarizes nonperforming assets at the dates indicated:

| *(In thousands)* | 2020 | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| **Nonaccrual loans:** | | | | | |
| Commercial, financial, and agricultural | $ 6,717 | $ 982 | $ 1,857 | $ 2,507 | $ 982 |
| Real estate construction − residential | 192 | — | — | — | — |
| Real estate construction − commercial | 200 | 137 | 153 | 97 | 50 |
| Real estate mortgage − residential | 2,105 | 2,135 | 2,720 | 1,956 | 1,888 |
| Real estate mortgage − commercial | 25,314 | 1,359 | 474 | 936 | 420 |
| Installment and other consumer | 31 | 141 | 210 | 176 | 89 |
| **Total** | $ 34,559 | $ 4,754 | $ 5,414 | $ 5,672 | $ 3,429 |
| **Loans contractually past - due 90 days or more and still accruing:** | | | | | |
| Real estate mortgage - residential | $ — | $ 304 | $ 156 | $ 28 | $ 54 |
| Installment and other consumer | 17 | 12 | 6 | 23 | 11 |
| **Total** | $ 17 | $ 316 | $ 162 | $ 328 | $ 65 |
| **Total non-performing loans (a)** | 34,576 | 5,070 | 5,576 | 6,000 | 3,494 |
| **Other real estate owned and repossessed assets** | 12,291 | 12,781 | 13,691 | 13,182 | 14,162 |
| **Total non-performing assets** | $ 46,867 | $ 17,851 | $ 19,267 | $ 19,182 | $ 17,656 |
| | | | | | |
| Loans held for investment | $ 1,286,967 | $ 1,168,797 | $ 1,146,044 | $ 1,068,049 | $ 973,867 |
| Allowance for loan losses to loans | 1.41 % | 1.07 % | 1.02 % | 1.02 % | 1.02 % |
| Non-performing loans to loans (a) | 2.69 % | 0.43 % | 0.49 % | 0.56 % | 0.36 % |
| Non-performing assets to loans (b) | 3.64 % | 1.53 % | 1.68 % | 1.80 % | 1.81 % |
| Non-performing assets to assets (b) | 2.70 % | 1.20 % | 1.30 % | 1.34 % | 1.37 % |
| Allowance for loan losses to non-performing loans | 52.39 % | 246.09 % | 208.97 % | 180.87 % | 282.94 % |

(a) Non-performing loans include loans 90 days past due and accruing, nonaccrual loans, and non-performing TDRs included in nonaccrual loans and 90 days past due.
(b) Non-performing assets include non-performing loans and other real estate owned and repossessed assets.

Total non-performing assets were $46.9 million, or 3.64% of total loans, at December 31, 2020 compared to $17.9 million, or 1.53% of total loans, at December 31, 2019.

Total non-accrual loans at December 31, 2020 increased $29.8 million to $34.6 million compared to $4.8 million at December 31, 2019. The increase in non-accrual loans primarily consisted of six commercial and commercial real estate loan relationships totaling $30.8 million that moved to nonaccrual status during the fourth quarter of 2020. Of this increase, $29.5 million was related to loan modifications under the CARES Act.

Loans past due 90 days and still accruing interest at December 31, 2020, were $17,000 compared to $316,000 at December 31, 2019. Other real estate owned and repossessed assets at December 31, 2020 were $12.3 million compared to $12.8 million at December 31, 2019. During the year ended December 31, 2020, $73,000 of non-accrual loans, net of charge-offs taken, moved to other real estate owned and repossessed assets compared to $452,000 for the year ended December 31, 2019.

As of December 31, 2020, approximately $6.0 million compared to $9.0 million at December 31, 2019, of loans classified as substandard, which include performing TDRs, and are not included in the non-performing asset table, were identified as potential problem loans having more than normal risk which raised doubts as to the ability of the borrower to comply with present loan repayment terms. Management believes the general allowance was sufficient to cover the risks and probable losses related to such loans at December 31, 2020 and December 31, 2019, respectively.

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

| | December 31, 2020 | | | December 31, 2019 | | |
|---|---|---|---|---|---|---|
| *(In thousands)* | Number of contracts | Recorded Investment | Specific Reserves | Number of contracts | Recorded Investment | Specific Reserves |
| **Performing TDRs** | | | | | | |
| Commercial, financial and agricultural | 7 | $ 835 | $ 90 | 5 | $ 532 | $ 177 |
| Real estate mortgage − residential | 5 | 1,521 | 28 | 6 | 1,615 | 33 |
| Real estate mortgage − commercial | 2 | 343 | 7 | 2 | 352 | 7 |
| Installment and other consumer | 5 | 77 | 10 | 2 | 36 | 2 |
| **Total performing TDRs** | 19 | $ 2,776 | $ 135 | 15 | $ 2,535 | $ 219 |
| **Non-performing TDRs** | | | | | | |
| Commercial, financial and agricultural | 1 | $ 4 | $ 1 | 6 | $ 496 | $ 99 |
| Real estate mortgage − residential | 8 | 895 | 78 | 6 | 782 | 117 |
| Real estate mortgage − commercial | — | — | — | 2 | 266 | — |
| Installment and other consumer | — | — | — | 2 | 72 | 7 |
| **Total non-performing TDRs** | 9 | $ 899 | $ 79 | 16 | $ 1,616 | $ 223 |
| **Total TDRs** | 28 | $ 3,675 | $ 214 | 31 | $ 4,151 | $ 442 |

At December 31, 2020, loans classified as TDRs totaled $3.7 million, with $214,000 of specific reserves compared to $4.1 million of loans classified as TDRs, with $442,000 of specific reserves at December 31, 2019. Both performing and non-performing TDRs are considered impaired loans. When an individual loan is determined to be a TDR, the amount of impairment is based upon the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the underlying collateral less applicable selling costs if the loan is collateral dependent. The net decrease in total TDRs from December 31, 2019 to December 31, 2020 was primarily due to approximately $753,000 of payments received on TDRs, partially offset by $224,000 of new loans designated as TDRs during the year ended December 31, 2020.

**Allowance for Loan Losses and Provision**

*Allowance for Loan Losses*

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

| *(In thousands)* | 2020 | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| **Allocation of allowance for loan losses at end of period:** | | | | | |
| Commercial, financial, and agricultural | $ 5,121 | $ 2,918 | $ 3,237 | $ 3,325 | $ 2,753 |
| Real estate construction − residential | 213 | 64 | 140 | 170 | 108 |
| Real estate construction − commercial | 475 | 369 | 757 | 807 | 413 |
| Real estate mortgage − residential | 2,679 | 2,118 | 2,071 | 1,689 | 2,385 |
| Real estate mortgage − commercial | 9,354 | 6,547 | 4,914 | 4,437 | 3,793 |
| Installment and other consumer | 264 | 381 | 334 | 345 | 274 |
| Unallocated | 7 | 80 | 199 | 79 | 160 |
| **Total** | $ 18,113 | $ 12,477 | $ 11,652 | $ 10,852 | $ 9,886 |

The allowance for loan losses was $18.1 million, or 1.41%, of loans outstanding at December 31, 2020 compared to $12.5 million, or 1.07%, of loans outstanding at December 31, 2019. The ratio of the allowance for loan losses to non-performing loans was 52.39% at December 31, 2020, compared to 246.09% at December 31, 2019.

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

| *(In thousands)* | 2020 | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| **Allocation of allowance for loan losses:** | | | | | |
| Individually evaluated for impairment − specific reserves | $ 5,113 | $ 615 | $ 1,194 | $ 1,333 | $ 1,080 |
| Collectively evaluated for impairment − general reserves | 13,000 | 11,862 | 10,458 | 9,519 | 8,806 |
| **Total** | $ 18,113 | $ 12,477 | $ 11,652 | $ 10,852 | $ 9,886 |

The *specific reserve component* applies to loans evaluated individually for impairment. The net carrying value of impaired loans is generally based on the fair values of collateral obtained through independent appraisals and/or internal evaluations, or by discounting the total expected future cash flows. Once the impairment amount is calculated, a specific reserve allocation is recorded. At December 31, 2020, $5.1 million of the Company's allowance for loan losses was allocated to impaired loans totaling approximately $37.3 million compared to $615,000 of the Company's allowance for loan losses allocated to impaired loans totaling approximately $7.4 million at December 31, 2019. Management determined that $11.9 million, or 32%, of total impaired loans required no reserve allocation at December 31, 2020 compared to $2.6 million, or 35%, at December 31, 2019 primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

The *incurred loss component* of the general reserve, or loans collectively evaluated for impairment, is determined by applying loss rates to pools of loans by asset type. Loans not individually evaluated are aggregated by risk characteristics and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type; loss emergence factors; lending policies and procedures; economic conditions; the nature, volume and terms of the portfolio; lending staff and management; nonaccrual loans; the loan review system; collateral values; concentrations of credit; and external factors. In the first quarter 2019, management adjusted the look-back period to begin with loss history in the first quarter 2012 as the starting point through the current quarter and it will continue to include this starting point going forward. At that time, management determined that with the extended current economic recovery, the look-back period should be expanded to include the current economic cycle. The look-back period will continue to be evaluated and will be adjusted once a sustained loss producing downturn is recognized and found to be representative of historical losses expected for the current portfolio.

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

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

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

Due to the COVID-19 pandemic that surfaced in the first quarter of 2020, management reassessed the calculation of the allowance for loan loss by increasing the economic qualitative factor in order to capture the impact on the credit risk present in the loan portfolio given the economic environment that existed at that time. The unemployment rate was considered the best indicator of risk compared to the other factors previously used measured on a quarter lag and would not exhibit the effects of COVID-19 for possibly several quarters. While these lagging indicators have been very reliable for some time, they did not accurately capture the risk that has been brought about by rapid changes in the economy due to the pandemic. As of the fourth quarter of 2020, management again reassessed the qualitative factor and economic indicators. Enough time had passed so that data after the outbreak would be available and a better interpretation of the impact of the virus on the economy. As of December 31, 2020, management determined that the local market and economy has been able to transition to a functional level while adapting to the new requirements aimed at stopping the spread of the virus and decreased the qualitative adjustment according to the Company's methodology.

The more significant changes from December 31, 2019 to December 31, 2020 in the allocations of the allowance for loan losses to the loan portfolios listed above was primarily attributed to the additional economic qualitative factor adjustment resulting from the COVID-19 pandemic during the first quarter through the third quarter of 2020.

Additionally, the funding of $88.4 million in PPP loans during the second and third quarter required management to assess the methodology that would be adopted in regard to the allowance for loan loss applicable to these loans. As the SBA PPP loans are expected to be mostly paid off in the next six to twelve months and carry a 100% credit guarantee from the SBA, management determined that no allowance for loan loss was deemed necessary for these loans. At December 31, 2020 the balance of these loans totaled $65.1 million.

*Provision*

A $5.8 million provision for loan losses was required for the year ended December 31, 2020 compared to $1.2 million for the year ended December 31, 2019, and $1.5 million for the year ended December 31, 2018. The increase in the provision was primarily due to current economic conditions resulting from the COVID-19 pandemic.

The following table summarizes loan loss experience for the years ended as indicated:

| *(In thousands)* | 2020 | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| **Analysis of allowance for loan losses:** | | | | | |
| Balance beginning of period | $ 12,477 | $ 11,652 | $ 10,852 | $ 9,886 | $ 8,604 |
| **Charge-offs:** | | | | | |
| Commercial, financial, and agricultural | 207 | 295 | 484 | 649 | 389 |
| Real estate construction − residential | — | — | 48 | — | — |
| Real estate construction − commercial | — | — | 30 | — | 1 |
| Real estate mortgage − residential | 52 | 277 | 186 | 219 | 495 |
| Real estate mortgage − commercial | 39 | 25 | 38 | 45 | 147 |
| Installment and other consumer | 211 | 196 | 255 | 268 | 258 |
| **Total charge-offs** | 509 | 793 | 1,041 | 1,181 | 1,290 |
| **Recoveries:** | | | | | |
| Commercial, financial, and agricultural | 169 | 144 | 100 | 74 | 299 |
| Real estate construction − residential | 64 | 50 | 62 | 88 | — |
| Real estate construction − commercial | — | — | — | — | 502 |
| Real estate mortgage − residential | 45 | 129 | 52 | 83 | 60 |
| Real estate mortgage − commercial | 8 | 40 | 58 | 32 | 140 |
| Installment and other consumer | 59 | 105 | 94 | 105 | 146 |
| **Total recoveries** | 345 | 468 | 366 | 382 | 1,147 |
| **Net charge-offs** | **164** | **325** | **675** | **799** | **143** |
| Provision for loan losses | 5,800 | 1,150 | 1,475 | 1,765 | 1,425 |
| **Balance end of period** | $ 18,113 | $ 12,477 | $ 11,652 | $ 10,852 | $ 9,886 |

*Net Loan Charge-offs*

The Company's net loan charge-offs were $164,000, or 0.01% of average loans, for the year ended December 31, 2020 compared to net charge-offs of $325,000, or 0.03% of average loans, for the year ended December 31, 2019, and $675,000, or 0.06% of average loans for the year ended December 31, 2018.

The net decrease in the Company's net charge-offs for the year ended December 31, 2020 compared to the years ended December 31, 2019 and 2018 was primarily due to a decrease in commercial, financial, and agricultural, and real estate mortgage – residential loan charge-offs. The Company recovered commercial deposit fraud charge-offs through the Company's insurance captive during the second quarter of 2020, two real estate construction – residential recoveries, and one real estate mortgage – residential recovery obtained in a settlement. This is compared to one large commercial loan relationship recovery and one real estate mortgage – residential recovery received during the first quarter of 2019.

*Loans Held For Sale*

The Company designates certain long-term fixed rate personal real estate loans as held for sale, and the Company carries them at the lower of cost or fair value. The loans are primarily sold to Freddie Mac, Fannie Mae, and PennyMac and other various secondary market investors. At December 31, 2020, the carrying amount of these loans was $5.1 million compared to $428,000 at December 31, 2019. A contributing factor for the increase in balance of loans held for sale at December 31, 2020 was due to the significant increase in real estate mortgage

originations, as compared to the capability of the relatively recently formed mortgage lending department to sell the mortgages to investors (as more fully described in the following paragraph.)

In the fourth quarter of 2019 the Company expanded its current home loan program to better serve our customers. This expansion began with hiring new mortgage lending personnel and expanding the bank's available loan products and upgrading the Company's operating systems. New home loan programs for its customers include VA loans, designed for military families and veterans; USDA loans for those buying homes in rural communities; and FHA loans, which offer low down payments and flexible underwriting guidelines. In addition, we have added several secondary market investors, allowing us to sell loans on the secondary market versus servicing them at the Company. This provides us with the ability to offer clients more aggressive pricing and at the same time improve the Company's financial return.

**Investment Portfolio**

The Company's investment portfolio consists of securities which are classified as available-for-sale, equity or other. The largest component, available-for-sale debt securities are carried at estimated fair 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.

The Company does not engage in trading activities and accordingly does not have any debt or equity securities classified as trading securities. Historically the 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 the Company's interest rate sensitivity position, all debt securities are classified as available-for-sale.

At December 31, 2020, the investment portfolio classified as available-for-sale represented 11.4% of total consolidated assets. Future levels of investment securities can be expected to vary depending upon liquidity and interest sensitivity needs as well as other factors.

*Available for sale securities*

The following table presents the composition of the investment portfolio and related fair value by major category:

| *(In thousands)* | **2020** | **2019** |
|---|---|---|
| U.S. Treasury | $ 2,798 | $ 995 |
| U.S. government and federal agency obligations | 11,929 | 8,047 |
| U.S. government-sponsored enterprises | 22,874 | 22,283 |
| Obligations of states and political subdivisions | 58,744 | 33,789 |
| Mortgaged-backed securities | 90,112 | 105,616 |
| Other debt securities (a) | 10,344 | 3,053 |
| Bank issued trust preferred securities (a) | 1,229 | 1,310 |
| **Total available for sale debt securities, at fair value** | $ 198,030 | $ 175,093 |

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

As of December 31, 2020, the maturity of debt securities in the investment portfolio was as follows:

| *(In thousands)* | **One Year Or Less** | **Over One Through Five Years** | **Over Five Through Ten Years** | **Over Ten Years** | **Total** | **Weighted Average Yield** |
|---|---|---|---|---|---|---|
| U.S. Treasury | $ — | $ 2,798 | $ — | $ — | $ 2,798 | 0.68 % |
| U.S. government and federal agency obligations | — | 2,624 | 3,431 | 5,874 | 11,929 | 1.63 |
| U.S. government-sponsored enterprises | 1,513 | — | 21,361 | — | 22,874 | 2.12 |
| States and political subdivisions (2) | 1,827 | 13,663 | 7,420 | 35,834 | 58,744 | 2.69 |
| Mortgage-backed securities (1) | 5,381 | 84,328 | 403 | — | 90,112 | 1.65 |
| Other debt securities | — | 2,986 | 7,358 | — | 10,344 | 5.37 |
| Bank issued trust preferred securities | — | — | — | 1,229 | 1,229 | 2.54 |
| **Total available-for-sale debt securities** | $ 8,721 | $ 106,399 | $ 39,973 | $ 42,937 | $ 198,030 | 2.20 % |
| Weighted average yield | 2.06 % | 1.80 % | 2.85 % | 2.60 % | 2.20 % | |

(1) Mortgage-backed securities have been included using historic repayment speeds. Repayment speeds were determined from actual portfolio experience during the twelve months ended December 31, 2020 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.

(2) Rates on obligations of states and political subdivisions have been adjusted to fully taxable equivalent rates using the statutory federal income tax rate of 21%.

At December 31, 2020, $17.8 million 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.

*Other investment securities*

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

| *(In thousands)* | **2020** | **2019** |
|---|---|---|
| Federal Home Loan Bank of Des Moines stock | $ 6,170 | $ 5,644 |
| Midwest Independent Bank stock | 151 | 151 |
| Equity securities with readily determinable fair values | 32 | 13 |
| **Total other investment securities** | $ 6,353 | $ 5,808 |

***Liquidity and Capital Resources***

**Liquidity Management**

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

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

The Company has a number of sources of funds to meet liquidity needs on a daily basis. The Company's most liquid assets are comprised of available for sale investment securities, federal funds sold, and excess reserves held at the Federal Reserve Bank.

| *(In thousands)* | **2020** | **2019** |
|---|---|---|
| Federal funds sold and other interest-bearing deposits | $ 161,128 | $ 55,545 |
| Certificates of deposit in other banks | 9,376 | 10,862 |
| Available-for-sale investment securities | 198,030 | 175,093 |
| **Total** | $ 368,534 | $ 241,500 |

Federal funds sold and resale agreements normally have overnight maturities and are used for general daily liquidity purposes. The fair value of the available for sale investment portfolio was $198.0 million at December 31, 2020 and included an unrealized net gain of $4.2 million. The portfolio includes projected maturities and mortgage-backed securities pay-downs of approximately $8.6 million over the next twelve months, which offer resources to meet either new loan demand or reductions in the Company's deposit base.

The Company pledges portions of its investment securities portfolio as collateral to secure public fund deposits, federal funds purchase lines, securities sold under agreements to repurchase, borrowing capacity at the Federal Reserve Bank, and for other purposes required by law. The Company's unpledged securities in the available for sale portfolio totaled approximately $44.1 million and $35.3 million at December 31, 2020 and 2019, respectively.

Total investment securities pledged for these purposes were as follows:

| *(In thousands)* | 2020 | 2019 |
|---|---|---|
| **Investment securities pledged for the purpose of securing:** | | |
| Federal Reserve Bank borrowings | $ 9,115 | $ 9,385 |
| Federal funds purchased and securities sold under agreements to repurchase | 59,695 | 38,238 |
| Other deposits | 85,130 | 92,189 |
| **Total pledged, at fair value** | $ 153,940 | $ 139,812 |

Liquidity is available from the Company's base of core customer deposits, defined as demand, interest checking, savings, money market deposit accounts, and time deposits less than $250,000, less all brokered deposits under $250,000. Such deposits totaled $1.25 billion and represented 90.3% of the Company's total deposits at December 31, 2020, compared to $1.03 billion and represented 87.0% of the Company's total deposits at December 31, 2019. These core deposits are normally less volatile and are often tied to other products of the Company through long lasting relationships.

Core deposits at December 31, 2020 and 2019 were as follows:

| *(In thousands)* | 2020 | 2019 |
|---|---|---|
| **Core deposit base:** | | |
| Non-interest bearing demand | $ 382,492 | $ 261,166 |
| Interest checking | 292,375 | 227,662 |
| Savings and money market | 391,248 | 346,593 |
| Other time deposits | 183,072 | 197,089 |
| **Total** | $ 1,249,187 | $ 1,032,510 |

Time deposits and certificates of deposit of $250,000 and greater at December 31, 2020 and 2019 were $91.3 million and $104.3 million, respectively. The Company had brokered deposits totaling $40.2 million and $45.2 million at December 31, 2020 and 2019, respectively.

Other components of liquidity are the level of borrowings from third party sources and the availability of future credit. The Company's outside borrowings are comprised of securities sold under agreements to repurchase, Federal Home Loan Bank advances, and subordinated notes. Federal funds purchased are overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved credit lines. As of December 31, 2020, under agreements with these unaffiliated banks, the Bank may borrow up to $50.0 million in federal funds on an unsecured basis and $15.7 million on a secured basis. There were no federal funds purchased outstanding at December 31, 2020. Securities sold under agreements to repurchase are generally borrowed overnight and are secured by a portion of the Company's investment portfolio. At December 31, 2020, there were $45.2 million in repurchase agreements. The Company may periodically borrow additional short-term funds from the Federal Reserve Bank through the discount window; although no such borrowings were outstanding at December 31, 2020.

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, 2020, the Bank had $106.7 million in outstanding borrowings with the FHLB. In addition, the Company has $49.5 million at December 31, 2020 in outstanding subordinated notes issued to wholly-owned grantor trusts, funded by preferred securities issued by the trusts.

Borrowings outstanding at December 31, 2020 and 2019 were as follows:

| *(In thousands)* | 2020 | 2019 |
|---|---|---|
| **Borrowings:** | | |
| Federal funds purchased and securities sold under agreements to repurchase | $ 45,154 | $ 27,272 |
| Federal Home Loan Bank advances | 106,660 | 96,895 |
| Subordinated notes | 49,486 | 49,486 |
| Other borrowings | 14 | 24 |
| **Total** | $ 201,314 | $ 173,677 |

The Company pledges certain assets, including loans and investment securities to the Federal Reserve Bank, FHLB, and other correspondent banks as security to establish lines of credit and borrow from these entities. Based on the type and value of collateral pledged, the Company may draw advances against this collateral.

The following table reflects the advance equivalent of the assets pledged, borrowings, and letters of credit outstanding, in addition to the estimated future funding capacity available to the Company.

| | 2020 | | | | 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| *(In thousands)* | FHLB | Federal Reserve Bank | Federal Funds Purchased Lines | Total | FHLB | Federal Reserve Bank | Federal Funds Purchased Lines | Total |
| Advance equivalent | $ 300,633 | $ 8,898 | $ 56,835 | $ 366,366 | $ 284,813 | $ 9,190 | $ 56,839 | $ 350,842 |
| Letters of credit | (123,000) | — | — | (123,000) | (115,000) | — | — | (115,000) |
| Advances outstanding | (106,660) | — | — | (106,660) | (96,895) | — | — | (96,895) |
| **Total available** | $ 70,973 | $ 8,898 | $ 56,835 | $ 136,706 | $ 72,918 | $ 9,190 | $ 56,839 | $ 138,947 |

At December 31, 2020, loans of $589.4 million were pledged to the Federal Home Loan Bank as collateral for borrowings and letters of credit. At December 31, 2020, investments with a market value of $18.1 million were pledged to secure federal funds purchase lines and borrowing capacity at the Federal Reserve Bank.

**Sources and Uses of Funds**

Cash and cash equivalents were $180.4 million at December 31, 2020 compared to $78.1 million at December 31, 2019. The $102.2 million increase resulted from changes in the various cash flows produced by operating, investing, and financing activities of the Company, as shown in the accompanying consolidated statement of cash flows for the year ended December 31, 2020. Cash flow provided from operating activities consists mainly of net income adjusted for certain non-cash items. Operating activities provided cash flow of $20.2 million for the year ended December 31, 2020.

Investing activities consisting mainly of purchases, sales and maturities of available for sale securities, and changes in the level of the loan portfolio, used total cash of $138.7 million. The cash outflow primarily consisted of $118.4 million increase in loans and $100.2 million purchase of investment securities, partially offset by $80.1 million from maturities, calls, and sales of investment securities. The increase in loans was primarily a result of $63.3 million (net of PPP deferred fees at December 31, 2020) increase in commercial loans due to customers who participated in the PPP.

Financing activities provided cash of $220.8 million, resulting primarily from a $121.3 million increase in demand deposits, and a $109.5 million increase in interest-bearing transaction accounts. The growth in deposits was positively impacted by customers who deposited PPP loan proceeds into demand accounts. Future short-term liquidity needs arising from daily operations are not expected to vary significantly during 2021.

In the normal course of business, the Company enters into certain forms of off-balance-sheet transactions, including unfunded loan commitments and letters of credit. These transactions are managed through the Company's various risk management processes. Management considers both on-balance sheet and off-balance-sheet transactions in its evaluation of the Company's liquidity. The Company had $441.6 million in unused loan commitments and standby letters of credit as of December 31, 2020. Although the Company's current liquidity resources are adequate to fund this commitment level, the nature of these commitments is such that the likelihood of such a funding demand is very low.

The Company is a legal entity, separate and distinct from the Bank, which must provide its own liquidity to meet its operating needs. The Company's ongoing liquidity needs primarily include funding its operating expenses and paying cash dividends to its shareholders. The Company paid cash dividends to its common shareholders totaling approximately $3.0 million and $2.7 million for the years ended December 31, 2020 and 2019, respectively. A large portion of the Company's liquidity is obtained from the Bank in the form of dividends. The Bank declared and paid $4.0 million and $8.0 million in dividends to the Company during the years ended December 31, 2020 and 2019, respectively. At December 31, 2020 and 2019, the Company had cash and cash equivalents totaling $2.0 million and $2.6 million, respectively.

**Capital Management**

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

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

In addition to the higher requirements, the Basel III Rules established bank holding companies are required to maintain a common equity Tier 1 capital conservation buffer of at least 2.5% of risk-weighted assets over and above the minimum risk-based capital requirements. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement began being phased in over four years beginning in 2016. On January 1, 2016, the first phase of the requirement went into effect at 0.625% of risk-weighted assets, and increased each subsequent year by an additional 0.625 percentage points, to reach its final level of 2.5% of risk weighted assets on January 1, 2019. At December 31, 2019, the capital conservation buffer requirement of 2.5%, effectively raised the minimum required risk-based capital ratios to 7% Common Equity Tier 1 Capital, 8.5% Tier 1 Capital and 10.5% Total Capital on a fully phased-in basis.

Under the Basel III requirements, at December 31, 2020, the Company met all capital adequacy requirements and had regulatory capital ratios in excess of the levels established for well-capitalized institutions, as shown in the following table as of December 31, for the years indicated:

| | 2020 | 2019 | 2018 | 2017 | 2016 | Minimum Capital Required - Basel III Fully Phased-In * | Minimum Required to be Considered Well-Capitalized Under Prompt Corrective Action Banks |
|---|---|---|---|---|---|---|---|
| **Risk-based capital ratios:** | | | | | | | |
| Total capital ratio | 14.97 % | 14.89 % | 13.28 % | 12.93 % | 13.88 % | 10.5 % | 10.0 % |
| Tier 1 capital ratio | 13.37 | 13.04 | 11.21 | 10.72 | 11.42 | 8.5 | 8.0 |
| Common Equity Tier 1 capital ratio | 10.00 | 9.86 | 8.48 | 8.04 | 8.61 | 7.0 | 6.5 |
| Tier 1 leverage ratio | 10.19 | 10.73 | 9.55 | 9.33 | 9.87 | 4.0 | 5.0 |

*At December 31, 2019 the Basel III capital conservation buffer requirement of 2.5% had been fully phased-in.

***Stock Dividend*** For the twelfth consecutive year, on July 1, 2020, the Company distributed a four percent stock dividend to common shareholders of record at the close of business on June 15, 2020. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect the stock dividend.

***Repurchase Program*** In the third quarter of 2020, the Company's Board of Directors authorized the purchase of up to $2.5 million market value of the Company's common stock. Management was given discretion to determine the number and pricing of the shares to be purchased, as well as, the timing of any such purchases. As of December 31, 2020, $2.4 million remained for share repurchase pursuant to that authorization.

**Commitments, Contractual Obligations, and Off-Balance-Sheet Arrangements**

The required payments of time deposits and other borrowed money, not including interest, at December 31, 2020 are as follows:

| | | Payments due by Period | | | |
|---|---|---|---|---|---|
| *(In thousands)* | Total | Less than 1 Year | 1-3 Years | 3-5 Years | Over 5 Years |
| Time deposits | $ 277,306 | $ 191,565 | $ 83,127 | $ 2,614 | $ — |
| Federal Home Loan Bank advances and other borrowed money | 106,674 | 29,241 | 20,433 | 26,000 | 31,000 |
| Subordinated notes | 49,486 | — | — | — | 49,486 |
| Operating lease liabilities | 2,137 | 374 | 733 | 515 | 515 |
| Total | 433,466 | 220,806 | 104,293 | 29,129 | 81,001 |

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

The 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, 2020 are as follows:

| | | Amount of Commitment Expiration per Period | | | |
|---|---|---|---|---|---|
| *(In thousands)* | Total | Less than 1 Year | 1-3 Years | 3-5 Years | Over 5 Years |
| Unused loan commitments | $ 264,528 | $ 193,696 | $ 28,958 | $ 7,813 | $ 34,061 |
| Commitments to originate residential first and second mortgage loans | 51,270 | 51,270 | — | — | — |
| Standby letters of credit | 125,800 | 125,800 | — | — | — |
| **Total** | $ 441,598 | $ 370,766 | $ 28,958 | $ 7,813 | $ 34,061 |

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**

**Asset/Liability and Interest Rate Risk**

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

The principal objective of the Company's asset and liability management function is to evaluate the interest rate risk within the balance sheet and pursue a controlled assumption of interest rate risk while maximizing earnings and preserving adequate levels of liquidity and capital. The asset and liability management function is under the guidance of the Asset Liability Committee from direction of the Board of Directors. The Asset Liability Committee meets monthly to review, among other things, the sensitivity of the Company's assets and liabilities to interest rate changes, local and national market conditions and rates. The Asset Liability Committee also reviews the liquidity, capital, deposit mix, loan mix and investment positions of the Company.

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

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

The table below illustrates the impact of an immediate and sustained 200 and 100 basis point increase and a 200 and 100 basis point decrease in interest rates on net interest income based on the interest rate risk model at December 31, 2020 and 2019.

| Hypothetical shift in interest rates (bps) | % Change in projected net interest income December 31, 2020 | 2019 |
|---|---|---|
| 200 | 0.73 % | 1.07 % |
| 100 | 0.10 % | 1.61 % |
| (100) | (1.28)% | 0.78 % |
| (200) | (1.81)% | (0.51)% |

The change in our interest rate risk exposure from December 31, 2019 to December 31, 2020 was primarily due to the significant decrease in market rates over this period that has caused the yields for both interest-bearing liabilities and earning assets to be lower. In addition, the increase in Federal funds sold and the PPP loan program have caused an overall shortening of the balance sheet, creating a larger asset sensitive position in a rising rate environment. These factors have caused the Company’s balance sheet to become more asset sensitive in the next 12 months, where interest rate increases translate into higher net interest income. Management believes the change in projected net interest income from interest rate shifts of up 200 bps and down 200 bps is an acceptable level of interest rate risk.

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

**Effects of Inflation**

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

Inflation does have an impact on the growth of total assets in the banking industry, often resulting in a need to increase capital at higher than normal rates to maintain an appropriate capital to asset ratio. In the opinion of management, inflation did not have a significant effect on the Company's operations for the three months ended December 31, 2020.

**Impact of New Accounting Standards**

***Financial Instruments*** In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (CECL). The revised accounting guidance will remove all recognition thresholds and will require a company to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. It also amends the credit loss measurement guidance for available-for-sale debt securities and beneficial interests in securitized financial assets. This new accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2022. While the Company generally expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, the Company has not determined the magnitude of any such one-time adjustment or the overall impact of the new guidance on the Company's consolidated financial statements. The Company has formed a committee and is continuing to evaluate the impact of the ASU's adoption on the Company's consolidated financial statements by assessing different credit risk models. In 2019 and 2020, the Company modeled the various methods prescribed in the ASU against the identified loan segments. The Company will continue to run parallel computations as it continues to evaluate the impact of adoption of this ASU on January 1, 2023.

***Rate Reform*** In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848) - Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The amendments in this update provide optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. It provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. The amendments in this update are effective for all entities as of March 12, 2020 through December 31, 2022. The Company is currently evaluating the impact of the reference rate reform on the Company’s consolidated financial statements.

**CONSOLIDATED FINANCIAL STATEMENTS**

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


| | Page |
|---|---|
| Report of Independent Registered Public Accounting Firm | 30 |
| Consolidated Balance Sheets as of December 31, 2020 and 2019 | 322 |
| Consolidated Statements of Income for each of the years ended December 31, 2020, 2019, and 2018 | 33 |
| Consolidated Statements of Comprehensive Income for each of the years ended December 31, 2020, 2019, and 2018 | 34 |
| Consolidated Statements of Stockholders' Equity for each of the years ended December 31, 2020, 2019, and 2018 | 35 |
| Consolidated Statements of Cash Flows for each of the years ended December 31, 2020, 2019, and 2018 | 366 |
| Notes to the Consolidated Financial Statements | 377 |

**Report of Independent Registered Public Accounting Firm**

To the Stockholders and Board of Directors
Hawthorn Bancshares, Inc. and Subsidiaries:

*Opinion on the Consolidated Financial Statements*

We have audited the accompanying consolidated balance sheets of Hawthorn Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2020, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 12, 2021 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

*Basis for Opinion*

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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

*Critical Audit Matter*

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

*Allowance for loan losses related to loans collectively evaluated for impairment*

As discussed in Notes 1 and 2 to the consolidated financial statements, the Company's allowance for loan losses related to loans collectively evaluated for impairment (collective ALL) was $13.0 million of a total allowance for loan losses (ALL) of $18.1 million as of December 31, 2020. The methodology used to estimate the collective ALL consists of both quantitative and qualitative loss components. The quantitative portion of the collective ALL estimates loss rates developed using internal historical loan loss experience by loan type over a defined look-back period. The loss rates are multiplied by loss emergence periods (LEP) which represent the estimated time period between a borrower first experiencing financial difficulty and the recognition of a loss. The qualitative portion of the collective ALL uses qualitative risk factors to adjust estimates of losses based on the most recent information available and to address other limitations in the quantitative component.

We identified the assessment of the collective ALL as a critical audit matter. A high degree of audit effort, including specialized skills and knowledge, and subjective and complex auditor judgment was involved in the assessment of the collective ALL because of significant measurement uncertainty. Specifically, the assessment encompassed an evaluation of the ALL methodology, including for the collective

ALL (1) the methods used to estimate the loss rates and the key assumptions of pooling of loans by loan type, the look-back period, and the loss emergence periods, and (2) the qualitative risk factors.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of certain internal controls related to the collective ALL process, including controls related to the:

- development of the ALL methodology
- identification and determination of the key assumptions used in developing the loss rates
- development of the qualitative risk factors, including the judgments used in the determination of those factors
- analysis of the ALL results, trends, and ratios.

We evaluated the process to develop the collective ALL by testing certain sources of data, factors, and assumptions, and considered the relevance and reliability of such data, factors, and assumptions. We analyzed trends in the ALL, including the qualitative risk factors, for consistency with trends in loan portfolio growth (attrition) and credit performance. In addition, we involved credit risk professionals with specialized skills and knowledge, who assisted in:

- evaluating the ALL methodology for compliance with U.S. generally accepted accounting principles.
- evaluating the pooling of loans by loan type by assessing similar characteristics of the loan portfolio, including levels of delinquencies, nonperforming loans, and net charge-offs.
- assessing the method, including the relevance of sources of internal and external data used to develop the look back period by evaluating (1) if loss data in the look back period was representative of the credit characteristics of the current portfolio and (2) the sufficiency of loss data within the look back period.
- assessing the loss emergence periods by considering the Company’s credit risk policies and evaluating the method used to develop the loss emergence periods, including identifying and evaluating the loss triggers for certain loan charge-offs.
- reviewing the qualitative factor framework and related judgments by (1) assessing the maximum qualitative factor adjustment based on the highest losses over a rolling six quarter period during the historical loss period, (2) evaluating the metrics, including the relevance of sources of data and assumptions, used to determine the qualitative risk factor adjustments, and (3) analyzing the determination of each qualitative risk factor adjustment.

/s/ KPMG LLP

We have served as the Company's auditor since 1993.

St. Louis, Missouri
March 12, 2021

**HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**
**Consolidated Balance Sheets**

| (In thousands, except per share data) | December 31, 2020 | December 31, 2019 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 19,235 | $ 22,576 |
| Federal funds sold and other interest-bearing deposits | 161,128 | 55,545 |
| Cash and cash equivalents | 180,363 | 78,121 |
| Certificates of deposit in other banks | 9,376 | 10,862 |
| Available-for-sale debt securities, at fair value | 198,030 | 175,093 |
| Other investments | 6,353 | 5,808 |
| **Total investment securities** | 204,383 | 180,901 |
| Loans held for investment | 1,286,967 | 1,168,797 |
| Allowance for loan losses | (18,113) | (12,477) |
| **Net loans** | 1,268,854 | 1,156,320 |
| Loans held for sale, at lower of cost or fair value | 5,099 | 428 |
| Premises and equipment - net | 34,561 | 35,388 |
| Mortgage servicing rights, at fair value | 2,445 | 2,482 |
| Other real estate owned - net | 12,291 | 12,781 |
| Accrued interest receivable | 6,640 | 6,481 |
| Cash surrender value - life insurance | 2,451 | 2,398 |
| Other assets | 7,268 | 6,800 |
| **Total assets** | $ 1,733,731 | $ 1,492,962 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Deposits | | |
| Non-interest bearing demand | $ 382,492 | $ 261,166 |
| Savings, interest checking and money market | 723,808 | 614,331 |
| Time deposits $250,000 and over | 91,263 | 104,262 |
| Other time deposits | 186,043 | 206,762 |
| **Total deposits** | 1,383,606 | 1,186,521 |
| Federal funds purchased and securities sold under agreements to repurchase | 45,154 | 27,272 |
| Federal Home Loan Bank advances and other borrowings | 106,674 | 96,919 |
| Subordinated notes | 49,486 | 49,486 |
| Operating lease liabilities | 2,137 | 2,224 |
| Accrued interest payable | 837 | 1,136 |
| Other liabilities | 15,248 | 14,366 |
| **Total liabilities** | 1,603,142 | 1,377,924 |
| Stockholders' equity: | | |
| Common stock, $1 par value, authorized 15,000,000 shares; issued 6,769,322 and 6,519,874 shares, respectively | 6,769 | 6,520 |
| Surplus | 59,307 | 55,727 |
| Retained earnings | 68,935 | 61,590 |
| Accumulated other comprehensive income (loss), net of tax | 1,528 | (3,755) |
| Treasury stock; 289,214, and 243,638 shares, at cost, respectively | (5,950) | (5,044) |
| **Total stockholders' equity** | 130,589 | 115,038 |
| **Total liabilities and stockholders' equity** | $ 1,733,731 | $ 1,492,962 |

See accompanying notes to the consolidated financial statements.

## HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
## Consolidated Statements of Income

| *(In thousands, except per share amounts)* | Years Ended December 31, 2020 | 2019 | 2018 |
|---|---|---|---|
| **INTEREST INCOME** | | | |
| Interest and fees on loans | $ 58,129 | $ 58,414 | $ 52,151 |
| Interest and fees on loans held for sale | 120 | — | — |
| Interest on investment securities: | | | |
| Taxable | 3,038 | 3,623 | 4,114 |
| Nontaxable | 688 | 536 | 597 |
| Federal funds sold, other interest-bearing deposits, and certificates of deposit in other banks | 667 | 1,125 | 699 |
| Dividends on other investments | 343 | 272 | 218 |
| **Total interest income** | 62,985 | 63,970 | 57,779 |
| **INTEREST EXPENSE** | | | |
| Interest on deposits: | | | |
| Savings, interest checking and money market | 1,858 | 5,242 | 5,433 |
| Time deposit accounts $250,000 and over | 1,351 | 2,110 | 1,272 |
| Time deposits | 2,641 | 3,026 | 2,132 |
| **Total interest expense on deposits** | 5,850 | 10,378 | 8,837 |
| Interest on federal funds purchased and securities sold under agreements to repurchase | 146 | 140 | 603 |
| Interest on Federal Home Loan Bank advances | 2,199 | 2,338 | 1,517 |
| Interest on subordinated notes | 1,527 | 2,376 | 2,229 |
| **Total interest expense on borrowings** | 3,872 | 4,854 | 4,349 |
| **Total interest expense** | 9,722 | 15,232 | 13,186 |
| **Net interest income** | 53,263 | 48,738 | 44,593 |
| Provision for loan losses | 5,800 | 1,150 | 1,475 |
| **Net interest income after provision for loan losses** | 47,463 | 47,588 | 43,118 |
| **NON-INTEREST INCOME** | | | |
| Service charges and other fees | 2,954 | 3,611 | 3,736 |
| Bank card income and fees | 3,201 | 3,061 | 2,754 |
| Trust department income | 1,185 | 1,237 | 1,166 |
| Real estate servicing fees, net | (49) | 39 | 794 |
| Gain on sale of mortgage loans, net | 7,109 | 771 | 721 |
| Other | 249 | 218 | 170 |
| **Total non-interest income** | 14,649 | 8,937 | 9,341 |
| **Investment securities gains (losses), net** | 61 | (40) | 255 |
| **Gain on branch sale, net** | — | 2,183 | — |
| **NON-INTEREST EXPENSE** | | | |
| Salaries and employee benefits | 26,151 | 21,597 | 23,104 |
| Occupancy expense, net | 3,069 | 3,122 | 2,957 |
| Furniture and equipment expense | 2,939 | 2,847 | 3,001 |
| Processing, network, and bank card expense | 3,864 | 3,882 | 3,484 |
| Legal, examination, and professional fees | 1,458 | 1,211 | 1,223 |
| Advertising and promotion | 1,095 | 1,256 | 1,233 |
| Postage, printing, and supplies | 897 | 871 | 996 |
| Loan expense | 917 | 625 | 612 |
| Other | 4,307 | 3,320 | 3,722 |
| **Total non-interest expense** | 44,697 | 38,731 | 40,332 |
| Income before income taxes | 17,476 | 19,937 | 12,382 |
| Income tax expense | 3,183 | 3,823 | 1,668 |
| **Net income** | $ 14,293 | $ 16,114 | $ 10,714 |
| Basic earnings per share | $ 2.20 | $ 2.47 | $ 1.64 |
| Diluted earnings per share | $ 2.20 | $ 2.47 | $ 1.64 |

See accompanying notes to the consolidated financial statements.

**HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**
**Consolidated Statements of Comprehensive Income**

| | Years Ended December 31, | | |
|---|---|---|---|
| *(In thousands)* | 2020 | 2019 | 2018 |
| Net income | $ 14,293 | $ 16,114 | $ 10,714 |
| Other comprehensive income, net of tax | | | |
| Investment securities available-for-sale: | | | |
| Unrealized gains (losses) on investment securities available-for-sale, net of tax | 3,408 | 3,400 | (955) |
| Adjustment for (gains) losses on sale of investment securities, net of tax | (32) | 32 | — |
| Defined benefit pension plans: | | | |
| Net gains (losses) arising during the year, net of tax | 1,738 | (1,150) | 345 |
| Amortization of prior service cost included in net periodic pension cost, net of tax | 169 | 62 | 173 |
| Total other comprehensive income (loss) | 5,283 | 2,344 | (437) |
| Total comprehensive income | $ 19,576 | $ 18,458 | $ 10,277 |

See accompanying notes to the consolidated financial statements.

**HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**
**Consolidated Statements of Stockholders' Equity**

| *(In thousands)* | Common Stock | Surplus | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total Stock - holders' Equity |
|---|---|---|---|---|---|---|
| **Balance, December 31, 2017** | $ 6,047 | $ 45,442 | $ 50,595 | $ (5,662) | $ (5,051) | $ 91,371 |
| Net income | — | — | 10,714 | — | — | 10,714 |
| Other comprehensive loss | — | — | — | (437) | — | (437) |
| Issuance of stock under equity compensation plan | — | (51) | — | — | 186 | 135 |
| Purchase of treasury stock | — | — | — | — | (179) | (179) |
| Stock dividend ($0.04 per share) | 232 | 4,782 | (5,014) | — | — | — |
| Cash dividends declared, common stock ($0.37 per share) | — | — | (2,190) | — | — | (2,190) |
| **Balance, December 31, 2018** | $ 6,279 | $ 50,173 | $ 54,105 | $ (6,099) | $ (5,044) | $ 99,414 |
| Net income | — | — | 16,114 | — | — | 16,114 |
| Other comprehensive income | — | — | — | 2,344 | — | 2,344 |
| Stock dividend ($0.04 per share) | 241 | 5,554 | (5,795) | — | — | — |
| Cash dividends declared, common stock ($0.46 per share) | — | — | (2,834) | — | — | (2,834) |
| **Balance, December 31, 2019** | $ 6,520 | $ 55,727 | $ 61,590 | $ (3,755) | $ (5,044) | $ 115,038 |
| Net income | — | — | 14,293 | — | — | 14,293 |
| Other comprehensive income | — | — | — | 5,283 | — | 5,283 |
| Purchase of treasury stock | — | — | — | — | (906) | (906) |
| Stock dividend ($0.04 per share) | 249 | 3,580 | (3,829) | — | — | — |
| Cash dividends declared, common stock ($0.49 per share) | — | — | (3,119) | — | — | (3,119) |
| **Balance, December 31, 2020** | $ 6,769 | $ 59,307 | $ 68,935 | $ 1,528 | $ (5,950) | $ 130,589 |

See accompanying notes to the consolidated financial statements.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| *(In thousands)* | 2020 | 2019 | 2018 |
| **Cash flows from operating activities:** | | | |
| Net income | $ 14,293 | $ 16,114 | $ 10,714 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | 5,800 | 1,150 | 1,475 |
| Depreciation expense | 2,265 | 2,062 | 1,797 |
| Net amortization of investment securities, premiums, and discounts | 1,493 | 1,386 | 1,506 |
| Change in fair value of mortgage servicing rights | 903 | 739 | 27 |
| Investment securities (gains) losses, net | (61) | 40 | (255) |
| (Gains) losses on sales and dispositions of premises and equipment | (104) | 48 | 3 |
| Gain on sales and dispositions of other real estate | (224) | (122) | (14) |
| Gain on branch sale, net | — | (2,183) | — |
| Provision for other real estate owned | 5 | 49 | 26 |
| Increase in accrued interest receivable | (159) | (319) | (535) |
| Increase in cash surrender value - life insurance | (53) | (78) | (58) |
| Decrease in other assets | 9 | 1,158 | 854 |
| Operating lease liabilities | (87) | (201) | — |
| (Decrease) increase in accrued interest payable | (299) | 101 | 481 |
| Increase (decrease) in other liabilities | 1,907 | (718) | 667 |
| Origination of mortgage loans held for sale | (193,488) | (43,355) | (36,469) |
| Proceeds from the sale of mortgage loans held for sale | 195,926 | 44,281 | 36,990 |
| Gain on sale of mortgage loans, net | (7,109) | (771) | (721) |
| Other, net | (866) | (290) | (186) |
| **Net cash provided by operating activities** | 20,151 | 19,091 | 16,302 |
| **Cash flows from investing activities:** | | | |
| Purchase of certificates of deposit in other banks | (980) | (988) | (8,787) |
| Proceeds from maturities of certificates of deposit in other banks | 2,466 | 2,373 | — |
| Net increase in loans | (118,407) | (23,530) | (79,298) |
| Purchase of available-for-sale debt securities | (100,206) | (31,106) | (103,078) |
| Proceeds from maturities of available-for-sale debt securities | 52,962 | 39,467 | 34,586 |
| Proceeds from calls of available-for-sale debt securities | 21,285 | 16,165 | 1,685 |
| Proceeds from sales of available-for-sale debt securities | 5,845 | 21,503 | 77,168 |
| Purchases of FHLB stock | (2,018) | (6,522) | (4,713) |
| Proceeds from sales of FHLB stock | 1,492 | 6,390 | 5,591 |
| Purchases of premises and equipment | (1,828) | (2,168) | (2,326) |
| Proceeds from sales of premises and equipment | 178 | 17 | 13 |
| Proceeds from Bank owned life insurance policy | — | 222 | — |
| Payment for branch sale, net | — | (6,700) | — |
| Proceeds from sales of other real estate and repossessed assets | 516 | 1,435 | 585 |
| **Net cash (used in) provided by investing activities** | (138,695) | 16,558 | (78,574) |
| **Cash flows from financing activities:** | | | |
| Net increase in demand deposits | 121,325 | 3,999 | 17,477 |
| Net increase in interest-bearing transaction accounts | 109,477 | 3,548 | 29,572 |
| Net decrease in time deposits | (33,717) | (8,865) | 25,607 |
| Net increase in federal funds purchased and securities sold under agreements to repurchase | 17,882 | 2,625 | (2,913) |
| Repayment of FHLB advances and other borrowings | (59,245) | (176,708) | (220,542) |
| FHLB advances | 69,000 | 178,474 | 194,313 |
| Issuance of stock under equity compensation plan | — | — | 135 |
| Purchase of treasury stock | (906) | — | (179) |
| Cash dividends paid - common stock | (3,030) | (2,684) | (1,993) |
| **Net cash provided by financing activities** | 220,786 | 389 | 41,477 |
| Net increase (decrease) in cash and cash equivalents | 102,242 | 36,038 | (20,795) |
| Cash and cash equivalents, beginning of year | 78,121 | 42,083 | 62,878 |
| **Cash and cash equivalents, end of year** | $ 180,363 | $ 78,121 | $ 42,083 |
| **Supplemental disclosures of cash flow information:** | | | |
| Cash paid during the year for: | | | |
| Interest | $ 10,023 | $ 15,150 | $ 12,719 |
| Income taxes | $ 2,305 | $ 3,620 | $ 241 |
| **Noncash investing and financing activities:** | | | |
| Other real estate and repossessed assets acquired in settlement of loans | $ 73 | $ 452 | $ 1,106 |
| Net deposits and fixed assets transferred to other assets related to the Branson branch sale | $ — | $ (8,885) | — |
| Right of use assets obtained in exchange for new operating lease liabilities | $ 169 | $ 2,424 | — |
| Stock dividends | $ 3,829 | $ 5,795 | $ 5,014 |

See accompanying notes to the consolidated financial statements.

**(1) Summary of Significant Accounting Policies**

Hawthorn Bancshares, Inc. (the Company) through its subsidiary, Hawthorn Bank (the Bank), provides a broad range of banking services to individual and corporate customers located within the communities in and surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, St. Louis, and the greater Kansas City metropolitan area. The Company is subject to competition from other financial and nonfinancial institutions providing financial products. Additionally, the Company and its subsidiaries are subject to the regulations of certain regulatory agencies and undergo periodic examinations by those regulatory agencies.

The accompanying consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP). The preparation of the consolidated financial statements includes all adjustments that, in the opinion of management, are necessary in order to make those statements not misleading. Management is required to make estimates and assumptions, including the determination of the allowance for loan losses, real estate acquired in connection with foreclosure or in satisfaction of loans, and fair values of investment securities available-for-sale that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's management has evaluated and did not identify any subsequent events or transactions requiring recognition or disclosure in the consolidated financial statements.

The significant accounting policies used by the Company in the preparation of the consolidated financial statements are summarized below:

***Principles of Consolidation***

In December of 2008, the Company formed Hawthorn Real Estate, LLC, (the Real Estate Company); a wholly owned subsidiary of the Company. In December of 2017, the Company formed Hawthorn Risk Management, Inc., (the Insurance Captive); a wholly owned subsidiary of the Company. The consolidated financial statements include the accounts of the Company, Hawthorn Bank (the Bank), the Real Estate Company, and the Insurance Captive. All significant intercompany accounts and transactions have been eliminated in consolidation.

***Loans***

Loans that the Company has the intent and ability to hold for the foreseeable future or to maturity are held for investment at their stated unpaid principal balance amount less unearned income and the allowance for loan losses. Income on loans is accrued on a simple-interest basis. Loan origination fees and certain direct costs are deferred and recognized over the life of the loan as an adjustment to yield.

*Loans Held for Sale*

Loans originated, primarily one-to-four family residential mortgage loans, with the intent to be sold in the secondary market are classified as held for sale and are accounted for at the lower of cost or fair value. Adjusted cost reflects the funded loan amount and any loan origination costs and fees. In order to manage the risk associated with such activities, the Company upon locking in an interest rate with the borrower enters into an agreement to sell such loans in the secondary market. Loans held for sale are typically sold with servicing rights retained and without recourse except for normal and customary representation and warranty provisions. Mortgage loans held for sale were $5.1 million at December 31, 2020 compared to $428,000 at December 31, 2019.

*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.

*Non-Accrual Loans*

Loans are placed on nonaccrual status when management believes that the borrower's financial condition, after consideration of business conditions and collection efforts, is such that collection of interest is doubtful. Loans that are contractually 90 days past due as to principal and/or interest payments are generally placed on non-accrual, unless they are both well-secured and in the process of collection. Consumer loans and real estate loans secured by one-to-four family residential properties are exempt from these non-accrual guidelines. These loans are placed on non-accrual after 120 days past due. Subsequent interest payments received on such loans are applied to principal if doubt exists as to the collectability of such principal; otherwise, such receipts are recorded as interest income on a cash basis. A loan remains on nonaccrual status until the loan is current as to payment of both principal and interest and/or the borrower demonstrates the ability to pay and remain current.

*Restructured Loans*

A loan is accounted for as a troubled debt restructuring (TDR) if the Company, for economic or legal reasons related to the borrowers' financial difficulties, grants a concession to the borrower that it would not otherwise consider. A TDR typically involves (1) modification of terms such as a reduction of the stated interest rate, loan principal, accrued interest, or an extended maturity date (2) a loan renewal at a stated interest rate lower than the current market rate for a new loan with similar risk, or (3) debt that was not reaffirmed in bankruptcy. Nonperforming TDRs are returned to performing status once the borrower demonstrates the ability to pay under the terms of the restructured note through a sustained period of repayment performance, which is generally six months. The Company includes all performing and non-performing TDRs in the impaired and non-performing asset totals. The Company measures the impairment loss of a TDR in the same manner as described below. TDRs which are performing under their contractual terms continue to accrue interest which is recognized in current earnings.

***Allowance for Loan Losses***

Management has identified the accounting policy related to the allowance for loan losses as critical to the understanding of the Company's results of operations, since the application of this policy requires significant management assumptions and estimates that could result in materially different amounts to be reported if conditions or underlying circumstances were to change. The fair value of impaired loans deemed collateral dependent, for purposes of the measurement of the impairment loss, can be subject to changing market conditions, supply and demand, condition of the collateral and other factors over time. Such volatility can have an impact on the financial performance of the Company.

Loans, or portions of loans, are charged off to the extent deemed uncollectible or a loss is confirmed. When loans become 90 days past due, they are generally placed on nonaccrual status or charged off unless extenuating circumstances justify leaving the loan on accrual basis. When loans reach 120 days past due and there is little likelihood of repayment, the uncollectible portion of the loans are charged off. Loan charge-offs reduce the allowance for loan losses, and recoveries of loans previously charged off are added back to the allowance. If management determines that it is probable that all amounts due on a loan will not be collected under the original terms of the loan agreement, the loan is considered to be impaired.

The *specific reserve component* applies to loans evaluated individually for impairment. The net carrying value of impaired loans is generally based on the fair values of collateral obtained through independent appraisals and/or internal evaluations, or by discounting the total expected future cash flows. Once the impairment amount is calculated, a specific reserve allocation is recorded.

The *incurred loss component* of the general reserve, or loans collectively evaluated for impairment, is determined by applying loss rates to pools of loans by loan type. Loans not individually evaluated are aggregated by risk characteristics and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type. The Company believes that the look-back period beginning January 1, 2012 provides a representative historical loss period in the current economic environment. These historical loss rates for each risk group are used as the starting point to determine loss rates for measurement purposes. The historical loan loss rates are multiplied by loss emergence periods (LEP) which represent the estimated time period between a borrower first experiencing financial difficulty and the recognition of a loss.

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

***Certificates of Deposit in other banks***

Certificates of deposit are investments made by the Company with other financial institutions, in amounts less than $250,000 each in order to qualify for FDIC insurance coverage, that are carried at cost which approximates fair values.

***Investment Securities***

*Available for sale securities*

The largest component of the Company's investment portfolio consists of debt securities which 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 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 prepayment rates for mortgage-backed securities, as an adjustment to yield. Dividend and interest income are recognized when earned. Realized gains and losses for securities classified as available-for-sale are included in earnings based on the specific identification method for determining the cost of securities sold.

*Other investment securities*

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

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

***Capital Stock of the Federal Home Loan Bank***

The Bank, as a member of the Federal Home Loan Bank System administered by the Federal Housing Finance Agency, is required to maintain an investment in the capital stock of the Federal Home Loan Bank of Des Moines (FHLB) in an amount equal to 12 basis points of the Bank's year-end total assets plus 4.00% of advances from the FHLB to the Bank. These investments are recorded at cost, which represents redemption value.

***Premises and Equipment***

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation applicable to buildings and improvements and furniture and equipment is charged to expense using straight-line and accelerated methods over the estimated useful lives of the assets. Such lives are estimated to be 5 to 40 years for buildings and improvements and 3 to 15 years for furniture and equipment. Maintenance and repairs are charged to expense as incurred.

***Mortgage Servicing Rights***

The Company originates and sells residential mortgage loans in the secondary market and typically retains the right to service the loans sold. Servicing involves the collection of payments from individual borrowers and the distribution of those payments to the investors or master servicer. Upon a sale of mortgage loans for which servicing rights are retained, the retained mortgage servicing rights asset is capitalized at the fair value of future net cash flows expected to be realized for performing servicing activities.

Mortgage servicing rights are carried at fair value in the consolidated balance sheet with changes in the fair value recognized in earnings. As most servicing rights do not trade in an active market with readily observable prices, the Company determines the fair value of mortgage servicing rights by estimating the fair value of the future cash flows associated with the mortgage loans being serviced. Key assumptions used in measuring the fair value of mortgage servicing rights include, but are not limited to, prepayment speeds, discount rates, delinquencies, ancillary income, and cost to service. These assumptions are validated on a periodic basis. The fair value is validated on a quarterly basis with an independent third party valuation specialist firm.

In addition to the changes in fair value of the mortgage servicing rights, the Company also recorded loan servicing fee income as part of real estate servicing fees, net in the consolidated statements of income. Loan servicing fee income represents revenue earned for servicing mortgage loans. The servicing fees are based on contractual percentage of the outstanding principal balance and recognized as revenue as the related mortgage payments are collected. Corresponding loan servicing costs are charged to expense as incurred.

***Other Real Estate Owned and Repossessed Assets***

Other real estate owned and repossessed assets consist of loan collateral that has been repossessed through foreclosure. This collateral is comprised of commercial and residential real estate and other non-real estate property, including autos, manufactured homes, and construction equipment. Other real estate owned assets are initially recorded as held for sale at the 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 valuation write-downs are recorded as other non-interest expense. The Company establishes a valuation allowance related to other real estate owned and repossessed assets 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 the asset.

***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*.

***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 the Company's financial statements or tax returns. Deferred income tax assets and liabilities are provided as temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements at the enacted tax rate expected to be applied in the period the deferred tax item is expected to be realized. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years.

A tax position is initially recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. Penalties and interest incurred under the applicable tax law are classified as income tax expense. The Company has not recognized any tax liabilities or any interest or penalties in income tax expense related to uncertain tax positions as of December 31, 2020, 2019, and 2018.

***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, overnight interest earning deposits with banks, cash, and due from banks.

***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. Gains on the sale of treasury stock are credited to additional paid-in-capital. Losses on the sale of treasury stock are charged to additional paid-in-capital to the extent of pervious gains, otherwise charged to retained earnings.

***Stock Dividend*** On July 1, 2020, the Company paid a special stock dividend of four percent to shareholders of record at the close of business on June 15, 2020. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect this change.

***CARES Act*** On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") was signed into law, which, in part, established a loan program administered through the U.S. Small Business Administration ("SBA"), referred to as the Paycheck Protection Program ("PPP"). Under the PPP, small businesses, sole proprietorships, independent contractors, non-profit organizations and self-employed individuals could apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. The Company is participating as a lender in the PPP program. All loans have a 1% interest rate and the Company earns a fee that is based upon a tiered schedule corresponding with the amount of the loan to the borrower, which is deferred and recognized over the life of the loan. Based upon the borrower meeting certain criteria as defined by the CARES Act, the loan may be forgiven by the SBA. The Company reports these loans at their principal amount outstanding, net of unearned income, unamortized deferred loan fee income and loan origination costs. Interest is accrued as earned and loan origination fees and direct costs are deferred and accreted or amortized into interest income, as an adjustment to the yield, over the life of the loan using the level yield method. When a PPP loan is paid off or forgiven by the SBA, the remaining unaccreted or unamortized net origination fees or costs are immediately recognized into income.

***Reclassifications*** Certain prior year information has been reclassified to conform to the 2020 presentation.

**The following represents significant new accounting principles adopted in 2020:**

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

***Fair Value Measurement*** In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820) - Changes to the Disclosure Requirements for Fair Value Measurement.* ASU 2018-13 removes the requirement to disclose the amount of and reasons for transfers between Level 1 and Level 2 fair value measurement methodologies, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements. It also adds a requirement to disclose changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 measurements. For certain unobservable inputs, entities may disclose other quantitative information in lieu of the weighted average if the other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The ASU did not have a material impact on the Company's Consolidated Financial Statements.

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

**(2) Loans and Allowance for Loan Losses**

*Loans*

A summary of loans, by major class within the Company's loan portfolio, at December 31, 2020 and 2019 is as follows:

| *(in thousands)* | | **2020** | | **2019** |
|---|---|---|---|---|
| Commercial, financial, and agricultural (a) | $ | 272,918 | $ | 199,022 |
| Real estate construction − residential | | 29,692 | | 23,035 |
| Real estate construction − commercial | | 78,144 | | 84,998 |
| Real estate mortgage − residential | | 262,339 | | 252,643 |
| Real estate mortgage − commercial | | 617,133 | | 576,635 |
| Installment and other consumer | | 26,741 | | 32,464 |
| **Total loans held for investment** | $ | 1,286,967 | $ | 1,168,797 |

(a) Includes $63.3 million SBA PPP loans, net

The Bank grants real estate, commercial, installment, and other consumer loans to customers located within the communities surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, St. Louis, and the greater Kansas City metropolitan area. As such, the Bank is susceptible to changes in the economic environment in these communities. The Bank does not have a concentration of credit in any one economic sector. Installment and other consumer loans consist primarily of the financing of vehicles. At December 31, 2020, $589.4 million of loans were pledged to the Federal Home Loan Bank as collateral for borrowings and letters of credit.

The following is a summary of loans to directors and executive officers or to entities in which such individuals had a beneficial interest of the Company:

| *(in thousands)* | | |
|---|---|---|
| Balance at December 31, 2019 | $ | 5,601 |
| New loans | | 1,081 |
| Amounts collected | | (1,603) |
| Balance at December 31, 2020 | $ | 5,079 |

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.

*Allowance for loan losses*

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

| *(in thousands)* | Commercial, Financial, & Agricultural | Real Estate Construction - Residential | Real Estate Construction - Commercial | Real Estate Mortgage - Residential | Real Estate Mortgage - Commercial | Installment and other Consumer | Un-allocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2017** | **$ 3,325** | **$ 170** | **$ 807** | **$ 1,689** | **$ 4,437** | **$ 345** | **$ 79** | **$ 10,852** |
| Additions: | | | | | | | | |
| Provision for loan losses | 296 | (44) | (20) | 516 | 457 | 150 | 120 | 1,475 |
| Deductions: | | | | | | | | |
| Loans charged off | 484 | 48 | 30 | 186 | 38 | 255 | — | 1,041 |
| Less recoveries on loans | (100) | (62) | — | (52) | (58) | (94) | — | (366) |
| **Net loans charged off** | 384 | (14) | 30 | 134 | (20) | 161 | — | 675 |
| **Balance at December 31, 2018** | **$ 3,237** | **$ 140** | **$ 757** | **$ 2,071** | **$ 4,914** | **$ 334** | **$ 199** | **$ 11,652** |
| Additions: | | | | | | | | |
| Provision for loan losses | (168) | (126) | (388) | 195 | 1,618 | 138 | (119) | 1,150 |
| Deductions: | | | | | | | | |
| Loans charged off | 295 | — | — | 277 | 25 | 196 | — | 793 |
| Less recoveries on loans | (144) | (50) | — | (129) | (40) | (105) | — | (468) |
| **Net loans charged off** | 151 | (50) | — | 148 | (15) | 91 | — | 325 |
| **Balance at December 31, 2019** | **$ 2,918** | **$ 64** | **$ 369** | **$ 2,118** | **$ 6,547** | **381** | **$ 80** | **$ 12,477** |
| Additions: | | | | | | | | |
| Provision for loan losses | 2,241 | 85 | 106 | 568 | 2,838 | 35 | (73) | 5,800 |
| Deductions: | | | | | | | | |
| Loans charged off | 207 | — | — | 52 | 39 | 211 | — | 509 |
| Less recoveries on loans | (169) | (64) | — | (45) | (8) | (59) | — | (345) |
| **Net loans charged off** | 38 | (64) | — | 7 | 31 | 152 | — | 164 |
| **Balance at December 31, 2020** | **$ 5,121** | **$ 213** | **$ 475** | **$ 2,679** | **$ 9,354** | **$ 264** | **$ 7** | **$ 18,113** |

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

In the first quarter of 2019, management adjusted the look-back period to begin with loss history in the first quarter 2012 as the starting point through the current quarter and it will continue to include this starting point going forward. At that time, Management determined that with the extended economic recovery then existing, the look-back period should be expanded to include the current economic cycle. The look-back period will continue to be evaluated and will be adjusted once a sustained loss producing downturn is recognized and found to be representative of historical losses expected for the current portfolio.

Due to the COVID-19 pandemic that surfaced in the first quarter of 2020, management reassessed the calculation of the allowance for loan loss by increasing the economic qualitative factor in order to capture the impact on the credit risk present in the loan portfolio given the economic environment that existed at that time. The unemployment rate was considered the best indicator of risk compared to the other factors previously used measured on a quarter lag and would not exhibit the effects of COVID-19 for possibly several quarters. While these lagging indicators have been very reliable for some time, they did not accurately capture the risk that has been brought about by rapid changes in the economy due to the pandemic. As of the fourth quarter of 2020, management again reassessed the qualitative factor and economic indicators. Enough time had passed so that data after the outbreak would be available and a better interpretation of the impact of

the virus on the economy. As of December 31, 2020, management determined that the local market and economy has been able to transition to a functional level while adapting to the new requirements aimed at stopping the spread of the virus and decreased the qualitative adjustment according to the Company's methodology.

Additionally, the funding of $88.4 million in PPP loans during the second and third quarter required management to assess the methodology that would be adopted in regard to the allowance for loan loss applicable to these loans. As the SBA PPP loans are expected to be mostly paid off in the next six to twelve months and carry a 100% credit guarantee from the SBA, management determined that no allowance for loan loss was deemed necessary for these loans. At December 31, 2020 the balance of these loans totaled $65.1 million.

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

| *(in thousands)* | Commercial, Financial, and Agricultural | Real Estate Construction - Residential | Real Estate Construction - Commercial | Real Estate Mortgage - Residential | Real Estate Mortgage - Commercial | Installment and Other Consumer | Un-allocated | Total |
|---|---|---|---|---|---|---|---|---|
| **December 31, 2020** | | | | | | | | |
| **Allowance for loan losses:** | | | | | | | | |
| Individually evaluated for impairment | $ 2,187 | $ 27 | $ 28 | $ 263 | $ 2,594 | $ 14 | $ — | $ 5,113 |
| Collectively evaluated for impairment | 2,934 | 186 | 447 | 2,416 | 6,760 | 250 | 7 | 13,000 |
| **Total** | $ 5,121 | $ 213 | $ 475 | $ 2,679 | $ 9,354 | $ 264 | $ 7 | $ 18,113 |
| **Loans outstanding:** | | | | | | | | |
| Individually evaluated for impairment | $ 7,552 | $ 192 | $ 200 | $ 3,626 | $ 25,657 | $ 108 | $ — | $ 37,335 |
| Collectively evaluated for impairment | 265,366 | 29,500 | 77,944 | 258,713 | 591,476 | 26,633 | — | 1,249,632 |
| **Total** | $ 272,918 | $ 29,692 | $ 78,144 | $ 262,339 | $ 617,133 | $ 26,741 | $ — | $ 1,286,967 |
| **December 31, 2019** | | | | | | | | |
| **Allowance for loan losses:** | | | | | | | | |
| Individually evaluated for impairment | $ 311 | $ — | $ — | $ 264 | $ 23 | $ 17 | $ — | $ 615 |
| Collectively evaluated for impairment | 2,607 | 64 | 369 | 1,854 | 6,524 | 364 | 80 | 11,862 |
| **Total** | $ 2,918 | $ 64 | $ 369 | $ 2,118 | $ 6,547 | $ 381 | $ 80 | $ 12,477 |
| **Loans outstanding:** | | | | | | | | |
| Individually evaluated for impairment | $ 1,514 | $ — | $ 137 | $ 3,856 | $ 1,711 | $ 177 | $ — | $ 7,395 |
| Collectively evaluated for impairment | 197,508 | 23,035 | 84,861 | 248,787 | 574,924 | 32,287 | — | 1,161,402 |
| **Total** | $ 199,022 | $ 23,035 | $ 84,998 | $ 252,643 | $ 576,635 | $ 32,464 | $ — | $ 1,168,797 |

*Impaired loans*

Loans evaluated under ASC 310-10-35 include loans which are individually evaluated for impairment. All other loans are collectively evaluated for impairment under ASC 450-20. Impaired loans individually evaluated for impairment totaled $37.3 million and $7.4 million at December 31, 2020 and 2019, respectively, and are comprised of loans on non-accrual status and loans which have been classified as troubled debt restructurings (TDRs).

The net carrying value of impaired loans is based on the fair values of collateral obtained through independent appraisals or internal evaluations, or by discounting the total expected future cash flows. At December 31, 2020, $32.2 million of impaired loans were evaluated based on the fair value less estimated selling costs of the loans' collateral compared to $3.0 million at December 31, 2019. Once the impairment amount is calculated, a specific reserve allocation is recorded. At December 31, 2020, $5.1 million of the Company's allowance for loan losses was allocated to impaired loans totaling $37.3 million compared to $615,000 of the Company's allowance for loan losses allocated to impaired loans totaling approximately $7.4 million at December 31, 2019. Management determined that $11.9 million, or 32%, of total impaired loans required no reserve allocation at December 31, 2020 compared to $2.6 million, or 35%, at December 31, 2019 primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

The categories of impaired loans at December 31, 2020 and 2019 are as follows:

| *(in thousands)* | **2020** | **2019** |
|---|---|---|
| Non-accrual loans | $ 34,559 | $ 4,754 |
| Non-performing TDRs - 90 days past due | — | 106 |
| Performing TDRs | 2,776 | 2,535 |
| **Total impaired loans** | $ 37,335 | $ 7,395 |

The following tables provide additional information about impaired loans at December 31, 2020 and 2019, respectively, segregated between loans for which an allowance has been provided and loans for which no allowance has been provided.

| *(in thousands)* | **Recorded Investment** | **Unpaid Principal Balance** | **Specific Reserves** |
|---|---|---|---|
| **December 31, 2020** | | | |
| **With no related allowance recorded:** | | | |
| Commercial, financial and agricultural | $ 1,703 | $ 1,731 | $ — |
| Real estate mortgage − residential | 1,300 | 1,395 | — |
| Real estate mortgage − commercial | 8,943 | 8,943 | — |
| **Total** | $ 11,946 | $ 12,069 | $ — |
| **With an allowance recorded:** | | | |
| Commercial, financial and agricultural | $ 5,849 | $ 6,180 | $ 2,187 |
| Real estate construction − residential | 192 | 192 | 27 |
| Real estate construction − commercial | 200 | 251 | 28 |
| Real estate mortgage − residential | 2,326 | 2,786 | 263 |
| Real estate mortgage − commercial | 16,714 | 16,787 | 2,594 |
| Installment and other consumer | 108 | 112 | 14 |
| **Total** | $ 25,389 | $ 26,308 | $ 5,113 |
| **Total impaired loans** | $ 37,335 | $ 38,377 | $ 5,113 |

| *(in thousands)* | **Recorded Investment** | **Unpaid Principal Balance** | **Specific Reserves** |
|---|---|---|---|
| **December 31, 2019** | | | |
| **With no related allowance recorded:** | | | |
| Commercial, financial and agricultural | $ 342 | $ 487 | $ — |
| Real estate construction − commercial | 137 | 173 | — |
| Real estate mortgage − residential | 697 | 784 | — |
| Real estate mortgage − commercial | 1,388 | 1,433 | — |
| Installment and other consumer | 12 | 12 | — |
| **Total** | $ 2,576 | $ 2,889 | $ — |
| **With an allowance recorded:** | | | |
| Commercial, financial and agricultural | $ 1,172 | $ 1,470 | $ 311 |
| Real estate mortgage − residential | 3,159 | 3,482 | 264 |
| Real estate mortgage − commercial | 323 | 425 | 23 |
| Installment and other consumer | 165 | 189 | 17 |
| **Total** | $ 4,819 | $ 5,566 | $ 615 |
| **Total impaired loans** | $ 7,395 | $ 8,455 | $ 615 |

The following table presents by class, information related to the average recorded investment and interest income recognized on impaired loans for the years ended December 31, 2020 and 2019:

| (in thousands) | 2020 | | 2019 | |
|---|---|---|---|---|
| | Average Recorded Investment | Interest Recognized For the Period Ended | Average Recorded Investment | Interest Recognized For the Period Ended |
| **With no related allowance recorded:** | | | | |
| Commercial, financial and agricultural | $ 1,629 | $ 144 | $ 805 | $ — |
| Real estate construction − commercial | 162 | — | 145 | — |
| Real estate mortgage − residential | 1,692 | 28 | 685 | — |
| Real estate mortgage − commercial | 2,975 | 13 | 1,062 | 6 |
| Installment and other consumer | 6 | — | 6 | — |
| **Total** | $ 6,464 | $ 185 | $ 2,703 | $ 6 |
| **With an allowance recorded:** | | | | |
| Commercial, financial and agricultural | $ 2,395 | $ 48 | $ 1,097 | $ 40 |
| Real estate construction − residential | 48 | — | — | — |
| Real estate construction − commercial | 367 | — | — | — |
| Real estate mortgage − residential | 2,564 | 45 | 3,583 | 88 |
| Real estate mortgage − commercial | 4,830 | 22 | 334 | 28 |
| Installment and other consumer | 113 | 8 | 199 | 3 |
| **Total** | $ 10,317 | $ 123 | $ 5,213 | $ 159 |
| **Total impaired loans** | $ 16,781 | $ 308 | $ 7,916 | $ 165 |

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 $308,000 and $165,000, for the years ended December 31, 2020 and 2019, 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 once payments become 30 days or more past due. The Company's policy is to discontinue the accrual of interest income on any loan when, in the opinion of management, the ultimate collectability of interest or principal is no longer probable. In general, loans are placed on non-accrual when they become 90 days or more past due. However, management considers many factors before placing a loan on non-accrual, including the delinquency status of the loan, the overall financial condition of the borrower, the progress of management's collection efforts and the value of the underlying collateral. Subsequent interest payments received on non-accrual loans are applied to principal if any doubt exists as to the collectability of such principal; otherwise, such receipts are recorded as interest income on a cash basis. Non-accrual loans are returned to accrual status when, in the opinion of management, the financial condition of the borrower indicates that the timely collectability of interest and principal is probable and the borrower demonstrates the ability to pay under the terms of the note through a sustained period of repayment performance, which is generally six months.

The following table provides aging information for the Company's past due and non-accrual loans at December 31, 2020 and 2019.

| *(in thousands)* | Current or Less Than 30 Days Past Due | 30 - 89 Days Past Due | 90 Days Past Due And Still Accruing | Non-Accrual | Total |
|---|---|---|---|---|---|
| **December 31, 2020** | | | | | |
| Commercial, Financial, and Agricultural | $ 265,821 | $ 380 | $ — | $ 6,717 | $ 272,918 |
| Real estate construction − residential | 29,500 | — | — | 192 | 29,692 |
| Real estate construction − commercial | 77,944 | — | — | 200 | 78,144 |
| Real estate mortgage − residential | 259,688 | 546 | — | 2,105 | 262,339 |
| Real estate mortgage − commercial | 591,815 | 4 | — | 25,314 | 617,133 |
| Installment and Other Consumer | 26,576 | 117 | 17 | 31 | 26,741 |
| **Total** | $ 1,251,344 | $ 1,047 | $ 17 | $ 34,559 | $ 1,286,967 |
| **December 31, 2019** | | | | | |
| Commercial, Financial, and Agricultural | $ 197,828 | $ 212 | $ — | $ 982 | $ 199,022 |
| Real estate construction − residential | 22,468 | 567 | — | — | 23,035 |
| Real estate construction − commercial | 84,861 | — | — | 137 | 84,998 |
| Real estate mortgage − residential | 249,516 | 688 | 304 | 2,135 | 252,643 |
| Real estate mortgage − commercial | 575,140 | 136 | — | 1,359 | 576,635 |
| Installment and Other Consumer | 32,179 | 132 | 12 | 141 | 32,464 |
| **Total** | $ 1,161,992 | $ 1,735 | $ 316 | $ 4,754 | $ 1,168,797 |

The Company's past due and non-accrual loans at December 31, 2020 do not include $57.1 million of loans accepting forbearance under the CARES Act. Their delinquency status will not change through the forbearance period as they are fulfilling the agreement they have made with the Company. Of the total remaining $86.7 million loan modifications under the CARES Act, $29.5 million, were determined to be on nonaccrual status during the fourth quarter of 2020.

*Credit Quality*

The Company categorizes loans into risk categories based upon an internal rating system reflecting management’s risk assessment. Loans are placed on *watch* status when one or more weaknesses are identified that may result in the borrower being unable to meet repayment terms or the Company’s credit position could deteriorate at some future date. Loans classified as *substandard* are inadequately protected by the current sound worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified may have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Such loans are characterized by the distinct possibility that the Company may sustain some loss if the deficiencies are not corrected. A loan is classified as a *troubled debt restructuring* (*TDR)* when a borrower is experiencing financial difficulties that lead to the restructuring of a loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. Loans classified as TDRs that are accruing interest are classified as performing TDRs. Loans classified as TDRs that are not accruing interest or is 90 days past due are classified as nonperforming TDRs. It is the Company’s policy to discontinue the accrual of interest income on loans when management believes that the collection of interest or principal is doubtful.

The following table presents the risk categories by class at December 31, 2020 and 2019.

| (in thousands) | Commercial, Financial, & Agricultural | Real Estate Construction - Residential | Real Estate Construction - Commercial | Real Estate Mortgage - Residential | Real Estate Mortgage - Commercial | Installment and other Consumer | Total |
|---|---|---|---|---|---|---|---|
| **At December 31, 2020** | | | | | | | |
| Watch | $ 9,649 | $ 545 | $ 10,806 | $ 15,835 | $ 66,936 | $ — | $ 103,771 |
| Substandard | 598 | — | — | 1,002 | 1,662 | — | 3,262 |
| Performing TDRs | 835 | — | — | 1,521 | 343 | 77 | 2,776 |
| Non-accrual loans (a) | 6,717 | 192 | 200 | 2,105 | 25,314 | 31 | 34,559 |
| **Total** | $ 17,799 | $ 737 | $ 11,006 | $ 20,463 | $ 94,255 | $ 108 | $ 144,368 |
| **At December 31, 2019** | | | | | | | |
| Watch | $ 16,288 | $ 763 | $ 8,484 | $ 15,280 | $ 37,271 | $ — | $ 78,086 |
| Substandard | 3,249 | — | 273 | 2,291 | 677 | — | 6,490 |
| Performing TDRs | 532 | — | — | 1,615 | 352 | 36 | 2,535 |
| Non-performing TDRs - 90 days past due (a) | — | — | — | 106 | — | — | 106 |
| Non-accrual loans (a) | 982 | — | 137 | 2,135 | 1,359 | 141 | 4,754 |
| **Total** | $ 21,051 | $ 763 | $ 8,894 | $ 21,427 | $ 39,659 | $ 177 | $ 91,971 |

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

*Troubled Debt Restructurings*

At December 31, 2020, loans classified as TDRs totaled $3.7 million, of which $900,000 were classified as non-performing TDRs and $2.8 million were classified as performing TDRs. At December 31, 2019, loans classified as TDRs totaled $4.1 million, of which $1.6 million were classified as non-performing TDRs and $2.5 million were classified as performing TDRs. Both performing and nonperforming TDRs are considered impaired loans. When an individual loan is determined to be a TDR, the amount of impairment is based upon the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral less applicable selling costs. Accordingly, specific reserves of $214,000 and $442,000 related to TDRs were allocated to the allowance for loan losses at December 31, 2020 and 2019, respectively.

The CARES Act provides all banks with the option to elect either or both of the following from March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the termination of the national emergency:

(i) to suspend the requirements under GAAP for loan modifications related to the COVID–19 pandemic that would otherwise be categorized as a TDR; and/or

(ii) to suspend any determination of a loan modified as a result of the effects of the COVID–19 pandemic as being a TDR, including impairment for accounting purposes.

If a bank elects a suspension noted above, the suspension (i) will be effective for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019; and (ii) will not apply to any adverse impact on the credit of a borrower that is not related to the COVID–19 pandemic.

As provided for by the CARES Act, the Company offered payment modifications to borrowers. Disaster relief payment modifications granted to-date include approximately 578 loans totaling $296.9 million, or 23.1% of the total loan portfolio. At December 31, 2020, 38 loans totaling $86.7 million, or 6.7% of total loans, remained in some form of a modification. (See table below titled – *Loan Modifications under the CARES Act by NAICS Code.)*

| | Total Remaining Loan Modifications under the CARES Act by NAICS Code as of December 31, 2020 | | | | | | |
|---|---|---|---|---|---|---|---|
| **Industry Category** | **Interest Only** | **% of Total Remaining Loan Modifications** | **Full Deferral (1)** | **% of Total Remaining Loan Modifications** | **Extended Amortizations** | **% of Total Remaining Loan Modifications** | **Totals** |
| Real Estate and Rental and Leasing | $ 5,166 | 6.0 % | $ 6,338 | 7.3 % | $ 501 | 0.6 % | $ 12,005 |
| Accommodations and Food Services | 19,859 | 22.9 | 32,486 | 37.5 | 4,621 | 5.3 | 56,966 |
| Construction | 144 | 0.2 | - | — | — | — | 144 |
| Churches | 263 | 0.3 | - | — | — | — | 263 |
| Lands and lots | 2,005 | 2.3 | - | — | — | — | 2,005 |
| Cinemas | — | — | 4,691 | 5.4 | — | — | 4,691 |
| Health Care and Social Assistance | — | — | 208 | 0.2 | — | — | 208 |
| Arts, Entertainment, Recreation | 10,165 | 11.7 | - | — | — | — | 10,165 |
| Non-NAICS (Consumer) | — | 0.0 | 232 | 0.3 | — | — | 232 |
| **Total modifications** | $ 37,602 | 43.4 % | $ 43,955 | 50.7 % | $ 5,122 | 5.9 % | $ 86,679 |

| | |
|---|---|
| Remaining loan modifications under the CARES Act as a percent of the total loan portfolio | 6.7% |
| Total loan modifications under the CARES Act to date | $296,890 |
| Total loan modifications under the CARES Act to date as a percent of the total loan portfolio | 23.1% |

(1) Of the $44.0 million loan modifications on full deferral, $29.5 million, or 34.1% of the total remaining loan modifications, were determined to be on nonaccrual status during the fourth quarter of 2020.

The following table summarizes loans that were modified as TDRs during the years ended December 31, 2020 and 2019.

| | 2020 | | | 2019 | | |
|---|---|---|---|---|---|---|
| | Recorded Investment (1) | | | Recorded Investment (1) | | |
| *(in thousands)* | **Number of Contracts** | **Pre-Modification** | **Post-Modification** | **Number of Contracts** | **Pre-Modification** | **Post-Modification** |
| **Troubled Debt Restructurings** | | | | | | |
| Commercial, financial and agricultural | — | $ — | $ — | 2 | $ 80 | $ 58 |
| Real estate mortgage – residential | 2 | 209 | 211 | — | — | — |
| Real estate mortgage – commercial | — | — | — | 2 | 267 | 266 |
| Installment and other consumer | 1 | 6 | 4 | — | — | — |
| **Total** | 3 | $ 215 | $ 215 | 4 | $ 347 | $ 324 |

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

The Company's portfolio of loans classified as TDRs include concessions for the borrower due to deteriorated financial condition such as interest rates below the current market rate, deferring principal payments, and extending maturity dates. During the year ended December 31, 2020, three loans meeting the TDR criteria were modified compared to four loans during the year ended December 31, 2019.

The Company considers a TDR to be in default when it is 90 days or more past due under the modified terms, a charge-off occurs, or it is in the process of foreclosure. There were no loans modified as a TDR, where a concession was made and subsequently defaulted during the year ended December 31, 2020, within twelve months of its modification date. This is compared to one commercial TDR with a $7,000 balance, where a concession was made and subsequently defaulted and was moved to non-accrual status and some collateral was liquidated to pay down the balance during the year ended December 31, 2019, within twelve months of its modification date. See *Lending and Credit Management* section for further information.

*Loans Held For Sale*

The Company designates certain long-term fixed rate personal real estate loans as held for sale, and the Company carries them at the lower of cost or fair value. The loans are primarily sold to Freddie Mac, Fannie Mae, PennyMac, and other various secondary market investors. At December 31, 2020, the carrying amount of these loans was $5.1 million compared to $428,000 at December 31, 2019.

## (3) Other Real Estate Acquired in Settlement of Loans

| *(in thousands)* | 2020 | 2019 |
|---|---|---|
| Commercial | $ 920 | $ 1,155 |
| Real estate construction - commercial | 10,986 | 11,553 |
| Real estate mortgage - residential | 201 | 230 |
| Real estate mortgage - commercial | 2,798 | 2,799 |
| Total | $ 14,905 | $ 15,737 |
| Less valuation allowance for other real estate owned | (2,614) | (2,956) |
| **Total other real estate owned** | $ 12,291 | $ 12,781 |

Changes in the net carrying amount of other real estate owned for the years indicated:

| | |
|---|---|
| **Balance at December 31, 2018** | $ 16,693 |
| Additions | 452 |
| Proceeds from sales | (1,435) |
| Charge-offs against the valuation allowance for other real estate owned, net | (95) |
| Net gain on sales | 122 |
| **Balance at December 31, 2019** | $ 15,737 |
| Additions | 73 |
| Proceeds from sales | (516) |
| Charge-offs against the valuation allowance for other real estate owned, net | (347) |
| Donation | (266) |
| Net gain on sales | 224 |
| Total other real estate owned | $ 14,905 |
| Less valuation allowance for other real estate owned | (2,614) |
| **Balance at December 31, 2020** | $ 12,291 |

At December 31, 2020, $287,000 of consumer mortgage loans secured by residential real estate properties were in the process of foreclosure compared to $252,000 of consumer mortgage loans in the process of foreclosure at December 31, 2019.

Activity in the valuation allowance for other real estate owned in settlement of loans for the years indicated:

| *(in thousands)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| **Balance, beginning of period** | $ 2,956 | $ 3,002 | $ 3,221 |
| Provision for other real estate owned | 5 | 49 | 26 |
| Charge-offs | (347) | (95) | (245) |
| **Balance, end of period** | $ 2,614 | $ 2,956 | $ 3,002 |

## (4) Investment Securities

The amortized cost, gross unrealized gains and losses, and fair value of debt securities classified as available-for-sale at December 31, 2020 and 2019 were as follows:

| (*in thousands*) | Total Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2020** | | | | |
| U.S. Treasury | $ 2,772 | $ 26 | $ — | $ 2,798 |
| U.S. government and federal agency obligations | 11,732 | 197 | — | 11,929 |
| U.S. government-sponsored enterprises | 22,495 | 379 | — | 22,874 |
| Obligations of states and political subdivisions | 56,943 | 1,801 | — | 58,744 |
| Mortgage-backed securities | 88,357 | 1,809 | (54) | 90,112 |
| Other debt securities (a) | 10,000 | 358 | (14) | 10,344 |
| Bank issued trust preferred securities (a) | 1,486 | — | (257) | 1,229 |
| **Total available-for-sale securities** | $ 193,785 | $ 4,570 | $ (325) | $ 198,030 |
| | | | | |
| **December 31, 2019** | | | | |
| U.S. Treasury | $ 987 | $ 8 | $ — | $ 995 |
| U.S. government and federal agency obligations | 8,124 | — | (77) | 8,047 |
| U.S. government-sponsored enterprises | 22,300 | 41 | (58) | 22,283 |
| Obligations of states and political subdivisions | 33,704 | 144 | (59) | 33,789 |
| Mortgage-backed securities | 105,522 | 522 | (428) | 105,616 |
| Other debt securities (a) | 3,000 | 53 | — | 3,053 |
| Bank issued trust preferred securities (a) | 1,486 | — | (176) | 1,310 |
| **Total available-for-sale securities** | $ 175,123 | $ 768 | $ (798) | $ 175,093 |

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

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

Debt securities with carrying values aggregating approximately $153.9 million and $139.8 million at December 31, 2020 and December 31, 2019, respectively, were pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities classified as available-for-sale at December 31, 2020, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without prepayment penalties.

| (in thousands) | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $ 3,323 | $ 3,340 |
| Due after one year through five years | 21,829 | 22,071 |
| Due after five years through ten years | 38,404 | 39,570 |
| Due after ten years | 41,872 | 42,937 |
| Total | 105,428 | 107,918 |
| Mortgage-backed securities | 88,357 | 90,112 |
| **Total available-for-sale securities** | $ 193,785 | $ 198,030 |

*Other investment securities*

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

| (in thousands) | 2020 | 2019 |
|---|---|---|
| **Other securities:** | | |
| FHLB stock | $ 6,170 | $ 5,644 |
| MIB stock | 151 | 151 |
| Equity securities with readily determinable fair values | 32 | 13 |
| **Total other investment securities** | $ 6,353 | $ 5,808 |

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, 2020 and December 31, 2019 were as follows:

| | Less than 12 months | | 12 months or more | | Total | Total |
|---|---|---|---|---|---|---|
| (in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| **At December 31, 2020** | | | | | | |
| U.S. Treasury | $ 1,015 | $ — | $ — | $ — | $ 1,015 | $ — |
| Mortgage-backed securities | 7,494 | (54) | — | — | 7,494 | (54) |
| Other debt securities | 2,987 | (14) | — | — | 2,987 | (14) |
| Bank issued trust preferred securities | — | — | 1,229 | (257) | 1,229 | (257) |
| **Total** | $ 11,496 | $ (68) | $ 1,229 | $ (257) | $ 12,725 | $ (325) |
| | | | | | | |
| (in thousands) | | | | | | |
| **At December 31, 2019** | | | | | | |
| U.S. government and federal agency obligations | $ 6,238 | $ (69) | $ 1,809 | $ (8) | $ 8,047 | $ (77) |
| U.S. government-sponsored enterprises | 5,949 | (47) | 7,488 | (11) | 13,437 | (58) |
| Obligations of states and political subdivisions | 10,729 | (53) | 1,931 | (6) | 12,660 | (59) |
| Mortgage-backed securities | 5,444 | (37) | 40,120 | (391) | 45,564 | (428) |
| Bank issued trust preferred securities | — | — | 1,310 | (176) | 1,310 | (176) |
| **Total** | $ 28,360 | $ (206) | $ 52,658 | $ (592) | $ 81,018 | $ (798) |

The total available for sale portfolio consisted of approximately 308 securities at December 31, 2020. The portfolio included 10 securities having an aggregate fair value of $12.7 million that were in a loss position at December 31, 2020. Securities identified as temporarily

impaired which had been in a loss position for 12 months or longer totaled $1.2 million at fair value at December 31, 2020. The $325,000 aggregate unrealized loss included in accumulated other comprehensive loss at December 31, 2020 was caused by interest rate fluctuations.

The total available for sale portfolio consisted of approximately 322 securities at December 31, 2019. The portfolio included 128 securities having an aggregate fair value of $81.0 million that were in a loss position at December 31, 2019. Securities identified as temporarily impaired which had been in a loss position for 12 months or longer had a fair value of $52.7 million at December 31, 2019. The $798,000 aggregate unrealized loss included in accumulated other comprehensive loss at December 31, 2019 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, 2020 and 2019, respectively. In the absence of changes in credit quality of these investments, the fair value is expected to recover on all debt securities as they approach their maturity date, or re-pricing date or if market yields for such investments decline. In addition, the Company does not have the intent to sell these investments over the period of recovery, and it is not more likely than not that the Company will be required to sell such investment securities.

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

| *(in thousands)* | **2020** | **2019** | **2018** |
|---|---|---|---|
| ***Investment securities gains (losses), net*** | | | |
| **Available for sale securities:** | | | |
| Gains realized on sales | $ 49 | $ 6 | $ 253 |
| Losses realized on sales | (8) | (46) | — |
| Other-than-temporary impairment recognized | — | — | — |
| **Other investment securities:** | | | |
| Fair value adjustments, net | 20 | — | 2 |
| **Investment securities gains (losses), net** | **$ 61** | **$ (40)** | **$ 255** |

During the year ended December 31, 2020, the Company received $5.8 million proceeds from the sale of available for sale debt securities and recognized net securities gains, which include the unrealized net gains related to equity securities, of $61,000. This is compared to $21.5 million and $77.2 million proceeds from the sale of available debt securities and recognized net gains (losses) of $(40,000) and $255,000 for the years ended December 31, 2019 and 2018, respectively.

## (5) Premises and Equipment

A summary of premises and equipment at December 31, 2020 and 2019 is as follows:

| *(in thousands)* | **2020** | **2019** |
|---|---|---|
| Land and land improvements | $ 9,452 | $ 9,433 |
| Buildings and improvements | 35,520 | 34,926 |
| Furniture and equipment | 13,570 | 14,081 |
| Operating leases - right of use asset | 2,594 | 2,425 |
| Construction in progress | 268 | 77 |
| Total | 61,404 | 60,942 |
| Less accumulated depreciation | 26,843 | 25,554 |
| **Premises and equipment, net** | $ 34,561 | $ 35,388 |

Depreciation expense for the years ended December 31, 2020, 2019, and 2018 was as follows:

| *(in thousands)* | **2020** | **2019** | **2018** |
|---|---|---|---|
| Depreciation expense | $ 2,265 | $ 2,062 | $ 1,797 |

## (6) Intangible Assets

*Mortgage Servicing Rights*

At December 31, 2020 the Company was servicing $292.7 million of loans sold to the secondary market compared to $271.4 million and $279.9 million at December 31, 2019 and 2018, respectively. Mortgage loan servicing fees, reported in real estate servicing fees, net, earned on loans sold and serviced for others were $854,000, $778,000, and $821,000, for the years ended December 31, 2020, 2019, and 2018, respectively.

The table below presents changes in mortgage servicing rights (MSRs) for the years ended December 31, 2020, 2019, and 2018.

| *(in thousands)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| **Balance at beginning of period** | $ 2,482 | $ 2,931 | $ 2,713 |
| Originated mortgage servicing rights | 866 | 290 | 245 |
| Changes in fair value: | | | |
| Due to changes in model inputs and assumptions (1) | (422) | (434) | 286 |
| Other changes in fair value (2) | (481) | (305) | (313) |
| Total changes in fair value | (903) | (739) | (27) |
| **Balance at end of period** | $ 2,445 | $ 2,482 | $ 2,931 |

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

Total changes in fair value are reported in real estate servicing fees, net, reported in non-interest income in the Company's consolidated statements of income.

The following key data and assumptions were used in estimating the fair value of the Company's mortgage servicing rights as of December 31, 2020 and 2019:

| | 2020 | 2019 |
|---|---|---|
| Weighted average constant prepayment rate | 15.74 % | 13.42 % |
| Weighted average note rate | 3.55 % | 3.93 % |
| Weighted average discount rate | 7.75 % | 8.61 % |
| Weighted average expected life (in years) | 4.8 | 4.8 |

## (7) Deposits

The aggregate amount of time deposits with balances that met or exceeded the Federal Deposit Insurance Corporation (FDIC) insurance limit of $250,000 was $91.3 million and $104.3 million at December 31, 2020 and 2019, respectively. The Company had brokered deposits totaling $40.2 million and $45.2 million at December 31, 2020 and 2019, respectively.

The scheduled maturities of total time deposits at December 31, 2020 were as follows:

| *(in thousands)* | |
|---|---|
| Due within: | |
| 2021 | $ 191,565 |
| 2022 | 63,025 |
| 2023 | 20,102 |
| 2024 | 1,025 |
| 2025 | 1,589 |
| Thereafter | — |
| **Total** | $ 277,306 |

The Federal Reserve Bank required the Bank to maintain cash or balances of zero at December 31, 2020 compared to $1.3 million at December 31, 2019 to satisfy reserve requirements. Average compensating balances held at correspondent banks were $1.5 million at both December 31, 2020 and 2019. The Bank maintains such compensating balances with correspondent banks to offset charges for services rendered by those banks.

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

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

| *(in thousands)* | **Year End Weighted Rate** | **Average Weighted Rate** | **Average Balance Outstanding** | **Maximum Outstanding at any Month End** | **Balance at December 31,** |
|---|---|---|---|---|---|
| **2020** | | | | | |
| Federal funds purchased | 0.36 % | 0.26 % | $ — | $ — | $ — |
| Short-term repurchase agreements - Bank | 0.24 | 0.43 | 34,026 | 45,154 | 45,154 |
| **Total** | | | $ 34,026 | $ 45,154 | $ 45,154 |
| **2019** | | | | | |
| Federal funds purchased | 2.00 % | 2.65 % | $ 329 | $ 1,950 | $ — |
| Short-term repurchase agreements - Bank | 0.45 | 0.59 | 22,198 | 27,272 | 27,272 |
| **Total** | | | $ 22,527 | $ 29,222 | $ 27,272 |

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 Bank's investment portfolio. Under agreements with unaffiliated banks, the Bank may borrow federal funds up to $50.0 million on an unsecured basis and $15.7 million on a secured basis at December 31, 2020.

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

to repurchase agreements by remaining maturity in the table below are limited to the outstanding balances of the related asset or liability; thus amounts of excess collateral are not shown.

| Repurchase Agreements | Remaining Contractual Maturity of the Agreements | | | |
|---|---|---|---|---|
| *(in thousands)* | Overnight and continuous | Less than 90 days | Greater than 90 days | Total |
| **At December 31, 2020** | | | | |
| U.S. government and federal agency obligations | $ 2,728 | $ — | $ — | $ 2,728 |
| U.S. government-sponsored enterprises | 15,533 | — | — | 15,533 |
| Mortgage-backed securities | 26,893 | — | — | 26,893 |
| **Total** | $ 45,154 | $ — | $ — | $ 45,154 |
| **At December 31, 2019** | | | | |
| U.S. Treasury | $ 754 | $ — | $ — | $ 754 |
| U.S. government-sponsored enterprises | 12,853 | — | — | 12,853 |
| Mortgage-backed securities | 13,665 | — | — | 13,665 |
| **Total** | $ 27,272 | $ — | $ — | $ 27,272 |

## (9) Leases

The Company's leases primarily consist of office space and bank branches with remaining lease terms of generally 1 to 10 years. As of December 31, 2020, operating right-of-use (ROU) assets and liabilities were $2.1 million and $2.1 million, respectively. As of December 31, 2020, the weighted-average remaining lease term on these operating leases is approximately 7.3 years and the weighted-average discount rate used to measure the lease liabilities is approximately 4.0%.

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

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

Operating lease cost, which is comprised of amortization of the ROU asset and the implicit interest accreted on the operating lease liability, is recognized on a straight-line basis over the lease term, and is recorded in net occupancy expense in the consolidated statements of income. The operating lease cost was $348,000 and $288,000 for the years ended December 31, 2020 and 2019, respectively.

At adoption of ASU 2016-02 on January 1, 2019, lease and non-lease components of new lease agreements are accounted for separately. Lease components include fixed payments including rent, real estate taxes and insurance costs and non-lease components include common-area maintenance costs. Leases with an initial term of 12 months or less are not recorded on the balance sheet; the Company recognizes lease expense for these leases on a straight-line basis over the lease term. Operating lease expense for these leases was $108,000 for the year ended December 31, 2020 compared to $163,000 for the year ended December 31, 2019.

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

| **Lease payments due in:** | | **Operating Lease** |
|---|---|---|
| *(in thousands)* | | |
| 2021 | $ | 374 |
| 2022 | | 367 |
| 2023 | | 366 |
| 2024 | | 258 |
| 2025 | | 257 |
| Thereafter | | 830 |
| Total lease payments | | 2,452 |
| Less imputed interest | | (315) |
| Total lease liabilities, as reported | $ | 2,137 |

## (10) Borrowings

Federal Home Loan Bank and other borrowings of the Company consisted of the following:

| | | | 2020 | | 2019 | |
|---|---|---|---|---|---|---|
| *(in thousands)* | **Borrower** | **Maturity Date** | **Year End Balance** | **Year End Weighted Rate** | **Year End Balance** | **Year End Weighted Rate** |
| FHLB advances | The Bank | 2020 | $ — | — % | $ 49,236 | 2.61 % |
| | | 2021 | 29,241 | 2.54 % | 29,241 | 2.52 % |
| | | 2022 | 9,419 | 1.33 % | 4,418 | 2.14 % |
| | | 2023 | 11,000 | 1.05 % | 3,000 | 1.90 % |
| | | 2024 | 11,000 | 1.17 % | 3,000 | 1.93 % |
| | | 2025 | 15,000 | 1.17 % | 8,000 | 2.15 % |
| | | Thereafter | 31,000 | 1.50 % | — | — % |
| Other borrowings | | 2022 | 14 | 4.00 % | 24 | 4.00 % |
| **Total Bank** | | | $ 106,674 | | $ 96,919 | |
| Subordinated notes | The Company | 2034 | $ 25,774 | 2.93 % | $ 25,774 | 4.60 % |
| | | 2035 | 23,712 | 2.06 % | 23,712 | 3.73 % |
| **Total Company** | | | $ 49,486 | | $ 49,486 | |

The Bank is a member of the Federal Home Loan Bank of Des Moines (FHLB) and has access to term financing from the FHLB. These borrowings, which are all fixed rate, are secured under a blanket agreement which assigns all investment in FHLB stock, as well as qualifying first mortgage loans as collateral to secure amounts borrowed by the Bank. As of December 31, 2020, the Bank had $106.7 million in outstanding borrowings with the FHLB. Based upon the collateral pledged to the FHLB at December 31, 2020, the Bank could borrow up to an additional $71.0 million under the agreement.

On March 17, 2005, Exchange Statutory Trust II, a business trust and subsidiary of the Company, issued $23.0 million 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 (2.06% at December 31, 2020). 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 $23.0 million 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 business trust and subsidiary of the Company issued $25.0 million of floating rate TPS to a TPS Pool. The floating rate is equal to the three-month LIBOR rate plus 2.70% and reprices quarterly (2.93% at December 31, 2020). The TPS are fully, irrevocably, and unconditionally guaranteed on a subordinated basis by the Company.

The TPS represent preferred interests in the trust. The Company invested approximately $774,000 in common interests in the trust and the purchaser in the private placement purchased $25.0 million in preferred interests. The proceeds of the TPS were invested in junior subordinated debentures of the Company. 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 TPS mature on March 17, 2034. That maturity date may be shortened if certain conditions are met.

The Exchange Statutory Trusts are not consolidated in the Company's financial statements. Accordingly, the Company does not report the securities issued by the Exchange Statutory Trusts as liabilities, and instead reports the subordinated notes issued by the Company and held by the Exchange Statutory Trusts as liabilities. The amount of the subordinated notes as of December 31, 2020 and 2019 was $49.5 million, respectively. The Company has recorded the investments in the common securities issued by the Exchange Statutory Trusts aggregating $1.2 and $1.3 million at December 31, 2020 and 2019, respectively, and the corresponding obligations under the subordinated notes, as well as the interest income and interest expense on such investments and obligations in its consolidated financial statements.

### (11) Income Taxes

The composition of income tax expense for the years ended December 31, 2020, 2019, and 2018 was as follows:

| *(in thousands)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| **Current:** | | | |
| Federal | $ 4,268 | $ 3,830 | $ 1,175 |
| State | — | — | (181) |
| **Total current** | 4,268 | 3,830 | 994 |
| **Deferred:** | | | |
| Federal | (1,085) | (7) | 674 |
| State | — | — | — |
| **Total deferred** | (1,085) | (7) | 674 |
| **Total income tax expense** | $ 3,183 | $ 3,823 | $ 1,668 |

Applicable income tax expense for financial reporting purposes differs from the amount computed by applying the statutory federal income tax rate for the reasons noted in the table for the years ended December 31, 2020, 2019, and 2018 are as follows:

| | 2020 | | 2019 | | 2018 | |
|---|---|---|---|---|---|---|
| *(in thousands)* | **Amount** | **%** | **Amount** | **%** | **Amount** | **%** |
| **Income before provision for income tax expense** | $ 17,476 | | $ 19,937 | | $ 12,382 | |
| Tax at statutory federal income tax rate | $ 3,670 | 21.00 % | $ 4,187 | 21.00 % | $ 2,600 | 21.00 % |
| Tax Cuts and Jobs Act | — | — | — | — | (343) | (2.77) |
| State restructuring | — | — | — | — | (143) | (1.16) |
| Tax-exempt income, net | (487) | (2.79) | (408) | (2.04) | (432) | (3.49) |
| State income tax, net of federal tax benefit | — | — | — | — | — | — |
| Other, net | — | — | 44 | 0.22 | (14) | (0.11) |
| **Provision for income tax expense** | $ 3,183 | 18.21 % | $ 3,823 | 19.18 % | $ 1,668 | 13.47 % |

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 18.2% for the year ended December 31, 2020 compared to 19.2% and 13.5% for the years ended December 31, 2019 and 2018, respectively.

The decrease in the effective tax rate for the year ended December 31, 2020 compared to the year ended December 31, 2019 was primarily attributable to tax-free revenues having a greater impact on pre-tax income due to the reduced level of earnings in 2020.

The increase in the effective tax rate for the year ended December 31, 2019 compared to the year ended December 31, 2018 was primarily attributable to a one-time benefit recorded in 2018 associated with the finalization of the Company’s analysis of the Tax Cuts and Jobs Act (Tax Act), a one-time benefit recorded in 2018 associated with the Company’s state tax planning initiatives, and the increased earnings and branch sale gain in 2019.

The provisional adjustments recorded in the fourth quarter of 2017 related to the enactment of the Tax Act were finalized during the third quarter of 2018 with the filing of the Company's 2017 tax return, within the one-year measurement period provided under Staff Accounting Bulletin No. 118 in regards to the application of FASB's ASC Topic 740, *Income Taxes*. The finalization of the Company's Tax Act adjustments in 2018 included a $343,000 benefit, while the Company's additional tax planning initiatives included a $143,000 benefit. The total benefits are comprised of $306,000 benefit attributable to the pension contribution and a $180,000 benefit attributable to various accounting method changes made on the Company's 2017 tax return.

The components of deferred tax assets and deferred tax liabilities at December 31, 2020 and 2019 were as follows:

| *(in thousands)* | 2020 | 2019 |
|---|---|---|
| **Deferred tax assets:** | | |
| Allowance for loan losses | $ 2,927 | $ 2,564 |
| Pension | 1,233 | 1,747 |
| Other real estate owned | 550 | 621 |
| Deferred loan fees | 563 | 131 |
| Lease liability | 449 | 467 |
| Intangible assets | 22 | 103 |
| Accrued / deferred compensation | 530 | 399 |
| Other | 368 | 95 |
| **Total deferred tax assets** | $ 6,642 | $ 6,127 |
| **Deferred tax liabilities:** | | |
| Premises and equipment | $ 553 | $ 625 |
| Mortgage servicing rights | 514 | 521 |
| Deferred loan costs | 288 | 273 |
| Right-of-use asset | 443 | 465 |
| Prepaid expenses | 359 | 328 |
| Securities | 900 | 9 |
| Other | 8 | 10 |
| **Total deferred tax liabilities** | 3,065 | 2,231 |
| **Net deferred tax assets** | $ 3,577 | $ 3,896 |

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income of the appropriate character during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning initiatives in making this assessment. In management's opinion, the Company will more likely than not realize the benefits of its deferred tax assets and, therefore, has not established a valuation allowance against its deferred tax assets as of December 31, 2020. Management arrived at this conclusion based upon the level of historical taxable income and projections for future taxable income of the appropriate character over the periods in which the deferred tax assets are deductible. The Company follows ASC Topic 740, Income Taxes, which addresses the accounting for uncertain tax positions.

The Company follows ASC Topic 740, *Income Taxes,* which addresses the accounting for uncertain tax positions. For each of the years ended December 31, 2020 and 2019, respectively, the Company did not have any uncertain tax provisions, and did not record any related tax liabilities.

## (12) Stockholders' Equity

*Accumulated Other Comprehensive Income (Loss)*

The following details the change in the components of the Company's accumulated other comprehensive loss for the years ended December 31, as indicated.

| *(in thousands)* | Unrealized Income (Loss) on Securities (1) | Unrecognized Net Pension and Postretirement Costs (2) | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|
| **Balance, December 31, 2018** | $ (3,455) | $ (2,644) | $ (6,099) |
| Other comprehensive income, before reclassifications | 4,304 | 79 | 4,383 |
| Amounts reclassified from accumulated other comprehensive income (loss) | 40 | (1,455) | (1,415) |
| Other comprehensive income (loss), before tax | 4,344 | (1,376) | 2,968 |
| Income tax (expense) benefit | (912) | 288 | (624) |
| Other comprehensive income (loss), net of tax | 3,432 | (1,088) | 2,344 |
| **Balance, December 31, 2019** | $ (23) | $ (3,732) | $ (3,755) |
| Other comprehensive income, before reclassifications | 4,315 | 214 | 4,529 |
| Amounts reclassified from accumulated other comprehensive income (loss) | (41) | 2,200 | 2,159 |
| Other comprehensive income, before tax | 4,274 | 2,414 | 6,688 |
| Income tax expense | (898) | (507) | (1,405) |
| Other comprehensive income, net of tax | 3,376 | 1,907 | 5,283 |
| **Balance, December 31, 2020** | $ 3,353 | $ (1,825) | $ 1,528 |

(1) The pre-tax amounts reclassified from accumulated other comprehensive income (loss) income are included in gains (losses) on sale of investment securities in the consolidated statements of income.
(2) The pre-tax amounts reclassified from accumulated other comprehensive income (loss) are included in the computation of net periodic pension cost. See Note 13.

## (13) Employee Benefit Plans

***Employee benefits*** charged to operating expenses are summarized in the table below for the years ended December 31, as indicated.

| *(in thousands)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Payroll taxes | $ 1,273 | $ 1,112 | $ 1,156 |
| Medical plans | 1,854 | 1,826 | 2,109 |
| 401(k) match and profit sharing | 1,586 | 1,290 | 956 |
| Periodic pension cost | 1,614 | 1,430 | 1,707 |
| Other | 59 | 63 | 67 |
| **Total employee benefits** | $ 6,386 | $ 5,721 | $ 5,995 |

The Company's profit-sharing plan includes a matching 401(k) 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.

***Other Plans***

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

As of December 31, 2020, the accrued liability was $960,000 and the expense for this plan of $320,000 for both the years ended December 31, 2020 and 2019, respectively, was accrued and recognized over the required service period.

***Pension***

The Company provides a noncontributory defined benefit pension plan for all full-time employees. Beginning January 1, 2018 and for all retrospective periods presented, the Company adopted the guidance under ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Under the new guidance, only the service cost component of the net periodic benefit cost is reported in the same income statement line item as salaries and benefits, and the remaining components are reported as other non-interest expense. An employer is required to recognize the funded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Under the Company's funding policy for the defined benefit pension plan, contributions are made to a trust as necessary to provide for current service and for any unfunded accrued actuarial liabilities over a reasonable period. To the extent that these requirements are fully covered by assets in the trust, a contribution might not be made in a particular year. The Company made a pension contribution of $500,000 on March 25, 2020. Effective July 1, 2017, the Company amended the pension plan to effectuate a "soft freeze" such that no individual hired (or rehired in the case of a former employee) by the Company after September 30, 2017, whether or not such individual is or was a vested member in the plan, will be eligible to be an active member and be entitled to accrue any benefits under the plan.

**Obligations and Funded Status at December 31,**

| *(in thousands)* | **2020** | **2019** |
|---|---|---|
| **Change in projected benefit obligation:** | | |
| Balance, January 1 | $ 34,009 | $ 26,892 |
| Service cost | 1,614 | 1,430 |
| Interest cost | 1,127 | 1,169 |
| Actuarial loss | 933 | 5,164 |
| Benefits paid | (726) | (646) |
| Balance, December 31, | $ 36,957 | $ 34,009 |
| **Change in plan assets:** | | |
| Fair value, January 1 | $ 25,689 | $ 19,672 |
| Actual return on plan assets | 4,725 | 5,164 |
| Employer contribution | 500 | 1,610 |
| Expenses paid | (104) | (111) |
| Benefits paid | (726) | (646) |
| Fair value, December 31, | $ 30,084 | $ 25,689 |
| **Funded status at end of year** | $ (6,873) | $ (8,320) |
| **Accumulated benefit obligation** | $ 30,156 | $ 26,380 |

**Amounts recognized in the statement of financial position consist of the following:**

| *(in thousands)* | **2020** | **2019** |
|---|---|---|
| Noncurrent assets | $ — | $ — |
| Current liabilities | — | — |
| Noncurrent liabilities | (6,873) | (8,320) |
| **Net liability at end of year** | $ (6,873) | $ (8,320) |

***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, as indicated:

| *(in thousands)* | **2020** | **2019** | **2018** |
|---|---|---|---|
| Service cost - benefits earned during the year | $ 1,614 | $ 1,430 | $ 1,707 |
| Interest costs on projected benefit obligations (a) | 1,127 | 1,169 | 1,037 |
| Expected return on plan assets (a) | (1,598) | (1,467) | (1,327) |
| Expected administrative expenses (a) | 110 | 122 | 93 |
| Amortization of prior service cost (a) | 50 | 79 | 79 |
| Amortization of unrecognized net loss (a) | 164 | — | 140 |
| **Net periodic pension cost** | $ 1,467 | $ 1,333 | $ 1,729 |

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

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

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive (loss) income at December 31, 2020 and 2019 are shown below, including amounts recognized in other comprehensive income during the periods. All amounts are shown on a pre-tax basis.

| *(in thousands)* | **2020** | **2019** |
|---|---|---|
| Prior service costs | $ — | $ (49) |
| Net accumulated actuarial net loss | (2,311) | (4,675) |
| Accumulated other comprehensive loss | (2,311) | (4,724) |
| Net periodic benefit cost in excess of cumulative employer contributions | (4,562) | (3,596) |
| **Net amount recognized at December 31, balance sheet** | $ (6,873) | $ (8,320) |
| Net actuarial gain (loss) arising during period | $ 2,200 | $ (1,455) |
| Prior service cost amortization | 50 | 79 |
| Amortization of net actuarial loss | 164 | — |
| **Total recognized in other comprehensive income (loss)** | $ 2,414 | $ (1,376) |
| **Total recognized in net periodic pension cost and other comprehensive (loss) income** | $ (947) | $ 2,709 |

The 2020 actuarial gain was primarily the result of the actual return on assets exceeding the expected asset return and updated assumptions. The 2019 actuarial loss was primarily the result of the decrease in the discount rate.

Assumptions utilized to determine benefit obligations as of December 31, 2020, 2019, and 2018 and to determine pension expense for the years then ended are as follows:

| | 2020 | 2019 | 2018 |
|---|---|---|---|
| Determination of benefit obligation at year end: | | | |
| Discount rate | 2.80 % | 3.45 % | 4.40 % |
| Annual rate of compensation increase | 4.50 % | 4.00 % | 4.00 % |
| Determination of pension expense for year ended: | | | |
| Discount rate for the service cost | 3.45 % | 4.40 % | 3.75 % |
| Annual rate of compensation increase | 4.00 % | 4.00 % | 4.00 % |
| Expected long-term rate of return on plan assets | 6.75 % | 6.75 % | 6.75 % |

The assumed overall expected long-term rate of return on pension plan assets used in calculating 2020 pension expense was 6.75%. Determination of the plan's rate of return is based upon historical returns for equities and fixed income indexes. During the past five years, the Company's plan assets have experienced the following annual returns: 19.7% in 2020, 25.8% in 2019, (6.2)% in 2018, 17.4% in 2017, and 8.2% in 2016. The rate used in plan calculations may be adjusted by management for current trends in the economic environment. With a traditional investment mix of over half of the plan's investments in equities, the actual return for any one plan year may fluctuate significantly with changes in the stock market. Primarily due to a decrease in the discount rate used in the actuarial calculation of plan income, the Company expects to incur $1.1 million of expense in 2021 compared to $1.8 million 2020.

***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 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 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, 2020 and 2019 by asset category was as follows:

| | | Fair Value Measurements | | |
|---|---|---|---|---|
| *(in thousands)* | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **December 31, 2020** | | | | |
| Cash equivalents | $ 666 | $ 666 | $ — | $ — |
| U.S government agency obligations | 311 | — | 311 | — |
| Equity securities | 1,473 | 1,473 | — | — |
| Mutual funds | 27,634 | 27,634 | — | — |
| **Total** | $ 30,084 | $ 29,773 | $ 311 | $ — |
| **December 31, 2019** | | | | |
| Cash equivalents | $ 1,940 | $ 1,940 | $ — | $ — |
| U.S government agency obligations | 300 | — | 300 | — |
| Corporate bonds | 307 | — | 307 | — |
| Equity securities | 1,436 | 1,436 | — | — |
| Mutual funds | 21,706 | 21,706 | — | — |
| **Total** | $ 25,689 | $ 25,082 | $ 607 | $ — |

The following future benefit payments are expected to be paid:

| Year | | Pension benefits |
|---|---|---|
| *(in thousands)* | | |
| 2021 | $ | 871 |
| 2022 | | 1,007 |
| 2023 | | 1,034 |
| 2024 | | 1,037 |
| 2025 | | 1,102 |
| 2026 to 2030 | | 7,403 |

**(14) Stock Compensation**

The Company has one equity compensation plan for its employees pursuant to which options were granted.

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

| | Number of shares December 31, | | | Weighted average exercise price December 31, | | |
|---|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2020 | 2019 | 2018 |
| Outstanding, beginning of year | — | — | 22,615 | $ — | $ — | $ 13.13 |
| Granted | — | — | — | — | — | — |
| Exercised | — | — | (22,615) | — | — | 13.13 |
| Forfeited or expired | — | — | — | — | — | — |
| Outstanding, end of year | — | — | — | $ — | $ — | $ — |
| Exercisable, end of year | — | — | — | $ — | $ — | $ — |

Options have been adjusted to reflect a 4% stock dividend paid on July 1, 2020.

There is no remaining unrecognized compensation expense related to non-vested stock awards. The Plan expired on February 28, 2010, except as to outstanding options under the Plan, and no further options may be granted pursuant to the Plan. During the third quarter of 2018, the remaining 22,615 options to purchase common shares were exercised at a weighted average price of $13.13 per share.

**(15) Earnings per Share**

***Stock Dividend*** On July 1, 2020, the Company paid a special stock dividend of four percent to common shareholders of record at the close of business on June 15, 2020. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect this change.

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

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

| *(dollars in thousands, except per share data)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| **Basic earnings per share:** | | | |
| Net income available to shareholders | $ 14,293 | $ 16,114 | $ 10,714 |
| Average shares outstanding | 6,489,799 | 6,525,684 | 6,518,772 |
| **Basic earnings per share** | $ 2.20 | $ 2.47 | $ 1.64 |
| **Diluted earnings per share:** | | | |
| Net income available to shareholders | $ 14,293 | $ 16,114 | $ 10,714 |
| Average shares outstanding | 6,489,799 | 6,525,684 | 6,518,772 |
| Effect of dilutive stock options | — | — | 5,454 |
| Average shares outstanding including dilutive stock options | 6,489,799 | 6,525,684 | 6,524,226 |
| **Diluted earnings per share** | $ 2.20 | $ 2.47 | $ 1.64 |

Under the treasury stock method, outstanding stock options are dilutive when the average market price of the Company's common stock, when combined with the effect of any unamortized compensation expense, exceeds the option price during the period, except when the Company has a loss from continuing operations available to shareholders. In addition, proceeds from the assumed exercise of dilutive options along with the related tax benefit are assumed to be used to repurchase common shares at the average market price of such stock during the period. There were no shares for the year ended December 31, 2020 that were omitted from the computation of diluted earnings per share as a result of being considered anti-dilutive.

*Repurchase Program*

In the third quarter of 2020, the Company's Board of Directors authorized the purchase of up to $2.5 million market value of the Company's common stock. Management was given discretion to determine the number and pricing of the shares to be purchased, as well as, the timing of any such purchases. As of December 31, 2020, $2.4 million remained for share repurchase pursuant to that authorization.

## (16) 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.

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

In addition, the final rules establish a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement began being phased in over four years beginning in

2016. On January 1, 2016, the first phase of the requirement went into effect at 0.625% of risk-weighted assets, and increased each subsequent year by an additional 0.625 percentage points, to reach its final level of 2.5% of risk weighted assets on January 1, 2019. At December 31, 2019, the capital conservation buffer of 2.5%, effectively raised the minimum required risk-based capital ratios to 7% Common Equity Tier 1 Capital, 8.5% Tier 1 Capital and 10.5% Total Capital on a fully phased-in basis.

Under the Basel III requirements, at December 31, 2020 and December 31, 2019, the Company met all capital adequacy requirements and had regulatory capital ratios in excess of the levels established for well-capitalized institutions, as shown in the following table as of periods indicated:

| | Actual | | Minimum Capital Required - Basel III Fully Phased-In | | Required to be Considered Well-Capitalized | |
|---|---|---|---|---|---|---|
| *(in thousands)* | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| **December 31, 2020** | | | | | | |
| **Total Capital (to risk-weighted assets):** | | | | | | |
| Company | $ 193,220 | 14.97 % | $ 135,518 | 10.50 % | $ — | N.A % |
| Bank | 191,504 | 14.87 | 135,186 | 10.50 | 128,748 | 10.00 |
| **Tier 1 Capital (to risk-weighted assets):** | | | | | | |
| Company | $ 172,591 | 13.37 % | $ 109,705 | 8.50 % | $ — | N.A % |
| Bank | 175,384 | 13.62 | 109,436 | 8.50 | 102,999 | 8.00 |
| **Common Equity Tier 1 Capital (to risk-weighted assets):** | | | | | | |
| Company | $ 129,061 | 10.00 % | $ 90,345 | 7.00 % | $ — | N.A % |
| Bank | 175,384 | 13.62 | 90,124 | 7.00 | 83,686 | 6.50 |
| **Tier 1 leverage ratio (to adjusted average assets):** | | | | | | |
| Company | $ 172,591 | 10.19 % | $ 67,724 | 4.00 % | $ — | N.A % |
| Bank | 175,384 | 10.41 | 67,394 | 4.00 | 84,243 | 5.00 |
| | | | | | | |
| **December 31, 2019** | | | | | | |
| **Total Capital (to risk-weighted assets):** | | | | | | |
| Company | $ 179,430 | 14.89 % | $ 126,511 | 10.50 % | $ — | N.A % |
| Bank | 175,459 | 14.60 | 126,165 | 10.50 | 120,158 | 10.00 |
| **Tier 1 Capital (to risk-weighted assets):** | | | | | | |
| Company | $ 157,139 | 13.04 % | $ 102,414 | 8.50 % | $ — | N.A % |
| Bank | 162,822 | 13.55 | 102,134 | 8.50 | 96,126 | 8.00 |
| **Common Equity Tier 1 Capital (to risk-weighted assets)** | | | | | | |
| Company | $ 118,793 | 9.86 % | $ 84,341 | 7.00 % | $ — | N.A % |
| Bank | 162,822 | 13.55 | 84,110 | 7.00 | 78,102 | 6.50 |
| **Tier 1 leverage ratio:** | | | | | | |
| Company | $ 157,139 | 10.73 % | $ 58,562 | 4.00 % | $ — | N.A % |
| Bank | 162,822 | 11.18 | 58,280 | 4.00 | 72,850 | 5.00 |

## (17) Fair Value Measurements

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

Depending on the nature of the asset or liability, the Company uses various valuation methodologies and assumptions to estimate fair value. The measurement of fair value under US GAAP uses a hierarchy intended to maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows. During the year ended December 31, 2020 there were no transfers into or out of Levels 1-3.

The fair value hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows:

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

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

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

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

***Valuation methods for instruments measured at fair value on a recurring basis***

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

***Available-for-sale securities***

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

***Other investment securities***

Other investment securities include equity securities with readily determinable fair values and other investment securities that do not have readily determinable fair values. Investments in Federal Home Loan Bank (FHLB) stock, and Midwest Independent Bank (MIB) bankers bank stock, that do not have readily determinable fair values, are required for membership in those organizations. Equity securities that are not actively traded are classified in level 2.

Equity securities with readily determinable fair values are recorded at fair value, with changes in fair value reflected in earnings. Equity securities that do not have readily determinable fair values are carried at cost and are periodically assessed for impairment. The Company uses level 1 inputs to value equity securities that are traded in active markets.

***Mortgage servicing rights***

The fair value of mortgage servicing rights is based on the discounted value of estimated future cash flows utilizing contractual cash flows, servicing rates, constant prepayment rate, servicing cost, and discount rate factors. Accordingly, the fair value is estimated based on a valuation model that calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds, market discount rates, cost to service, float earnings rates, and other ancillary income, including late fees. The valuation models estimate the present value of estimated future net servicing income. The Company classifies its servicing rights as Level 3.

| | | Fair Value Measurements | | |
|---|---|---|---|---|
| *(in thousands)* | **Fair Value** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| **December 31, 2020** | | | | |
| **Assets:** | | | | |
| U.S. Treasury | $ 2,798 | $ 2,798 | — | $ — |
| U.S. government and federal agency obligations | 11,929 | — | 11,929 | — |
| U.S. government-sponsored enterprises | 22,874 | — | 22,874 | — |
| Obligations of states and political subdivisions | 58,744 | — | 58,744 | — |
| Mortgage-backed securities | 90,112 | — | 90,112 | — |
| Other debt securities | 10,344 | — | 10,344 | — |
| Bank-issued trust preferred securities | 1,229 | — | 1,229 | — |
| Equity securities | 32 | 32 | — | — |
| Mortgage servicing rights | 2,445 | — | — | 2,445 |
| **Total** | $ 200,507 | $ 2,830 | $ 195,232 | $ 2,445 |
| | | | | |
| **December 31, 2019** | | | | |
| **Assets:** | | | | |
| U.S. Treasury | $ 995 | $ 995 | — | $ — |
| U.S. government and federal agency obligations | 8,047 | — | 8,047 | — |
| U.S. government-sponsored enterprises | 22,283 | — | 22,283 | — |
| Obligations of states and political subdivisions | 33,789 | — | 33,789 | — |
| Mortgage-backed securities | 105,616 | — | 105,616 | — |
| Other debt securities | 3,053 | — | 3,053 | — |
| Bank-issued trust preferred securities | 1,310 | — | 1,310 | — |
| Equity securities | 13 | 13 | — | — |
| Mortgage servicing rights | 2,482 | — | — | 2,482 |
| **Total** | $ 177,588 | $ 1,008 | $ 174,098 | $ 2,482 |

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

| *(in thousands)* | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Mortgage Servicing Rights | |
|---|---|---|
| **Balance at December 31, 2018** | $ | 2,931 |
| Total (losses) or gains (realized/unrealized): | | |
| Included in earnings | | (739) |
| Included in other comprehensive income | | — |
| Purchases | | — |
| Sales | | — |
| Issues | | 290 |
| Settlements | | — |
| **Balance at December 31, 2019** | $ | 2,482 |
| Balance at beginning of period | | |
| Total (losses) or gains (realized/unrealized): | | |
| Included in earnings | | (903) |
| Included in other comprehensive income | | — |
| Purchases | | — |
| Sales | | — |
| Issues | | 866 |
| Settlements | | — |
| **Balance at December 31, 2020** | $ | 2,445 |

***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:

*Collateral dependent impaired loans*

While the overall loan portfolio is not carried at fair value, the Company periodically records nonrecurring adjustments to the carrying value of impaired loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral dependent loans when establishing the allowance for loan losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan. In determining the fair value of real estate collateral, the Company relies on external and internal appraisals of property values depending on the size and complexity of the real estate collateral. The appraisals may be discounted based on the Company's historical knowledge, changes in market conditions from the time of appraisal, or other information available. The Company maintains staff that is trained to perform in-house evaluations and also review third party appraisal reports for reasonableness. In the case of non-real estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgments based on the experience and expertise of internal specialists. Fair values of all loan collateral are regularly reviewed by senior loan committee. Because many of these inputs are not observable, the measurements are classified as Level 3. As of December 31, 2020, the Company identified $32.2 million in impaired loans that had specific allowances for losses aggregating $4.7 million. Related to these loans, there were $164,000 in charge-offs recorded during the year ended December 31, 2020. As of December 31, 2019, the Company identified $3.0 million in impaired loans that had specific allowances for losses aggregating $316,000. Related to these loans, there were $207,000 in charge-offs recorded during the year ended December 31, 2019.

***Other Real Estate Owned and Repossessed Assets***

Other real estate owned (OREO) and repossessed assets consisted of loan collateral that has been repossessed through foreclosure. This collateral is comprised of commercial and residential real estate and other non-real estate property, including autos, manufactured homes, and construction equipment. Subsequent to foreclosure, these assets initially are carried at fair value of the collateral less estimated selling costs. Fair value, when recorded, is generally based upon appraisals by approved, independent state certified appraisers. Like impaired loans, appraisals on OREO may be discounted based on the Company's historical knowledge, changes in market conditions from the time of appraisal or other information available. During the holding period, valuations are updated periodically, and the assets may be written down to reflect a new cost basis. Because many of these inputs are not observable, the measurements are classified as Level 3.

| | | Fair Value Measurements Using | | | |
|---|---|---|---|---|---|
| *(in thousands)* | **Total Fair Value** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | **Total Gains (Losses)*** |
| **December 31, 2020** | | | | | |
| **Assets:** | | | | | |
| Collateral dependent impaired loans: | | | | | |
| Commercial, financial, & agricultural | $ 4,505 | $ — | $ — | $ 4,505 | $ (52) |
| Real estate mortgage - residential | 417 | — | — | 417 | (52) |
| Real estate mortgage - commercial | 22,581 | — | — | 22,581 | (39) |
| Installment and other consumer | — | — | — | — | (21) |
| Total | $ 27,503 | $ — | $ — | $ 27,503 | $ (164) |
| Other real estate and repossessed assets | $ 12,291 | $ — | $ — | $ 12,291 | $ 219 |
| | | | | | |
| **December 31, 2019** | | | | | |
| **Assets:** | | | | | |
| Collateral dependent impaired loans: | | | | | |
| Commercial, financial, & agricultural | $ 379 | $ — | $ — | $ 379 | $ (132) |
| Real estate construction - commercial | 137 | — | — | 137 | — |
| Real estate mortgage - residential | 1,028 | — | — | 1,028 | (45) |
| Real estate mortgage - commercial | 1,119 | — | — | 1,119 | (18) |
| Installment and other consumer | 12 | — | — | 12 | (12) |
| Total | $ 2,675 | $ — | $ — | $ 2,675 | $ (207) |
| Other real estate and repossessed assets | $ 12,781 | $ — | $ — | $ 12,781 | $ (157) |

* 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.

**(18) Fair Value of Financial Instruments**

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

***Loans***

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

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

***Loans Held for Sale***

Loans originated and intended to be sold in the secondary market, generally 1-4 family residential mortgage loans, are carried, in aggregate, at the lower of cost or estimated fair value. The estimated fair value measurements of loans held for sale are management's best estimate of market value, which is primarily based on quoted market prices for similar loans in the secondary market.

***Investment Securities***

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

***Other investment securities***

Other investment securities include equity securities with readily determinable fair values and other investment securities that do not have readily determinable fair values. Investments in Federal Home Loan Bank (FHLB) stock, and Midwest Independent Bank (MIB) bankers bank stock, that do not have readily determinable fair values, are required for membership in those organizations. Equity securities that are not actively traded are classified in level 2.

Equity securities with readily determinable fair values are recorded at fair value, with changes in fair value reflected in earnings. Equity securities that do not have readily determinable fair values are carried at cost and are periodically assessed for impairment. The Company uses level 1 inputs to value equity securities that are traded in active markets.

***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.

***Certificates of Deposit in Other Banks***

Certificates of deposit are other investments made by the Company with other financial institutions that are carried at cost which is equal to fair value.

***Cash Surrender Value – Life Insurance***

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

***Accrued Interest Receivable and Payable***

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

***Deposits***

The fair value of deposits with no stated maturity, such as noninterest-bearing demand, NOW accounts, savings, and money market, is equal to the amount payable on demand. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

***Federal Funds Purchased and Securities Sold under Agreements to Repurchase***

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

***Subordinated Notes and Other Borrowings***

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

***Operating Lease Liabilities***

The fair value of operating lease liabilities are recognized at lease commencement based on the present value of the remaining lease payments using a discount rate that represents the Company's incremental borrowing rate at the lease commencement date.

A summary of the carrying amounts and fair values of the Company's financial instruments at December 31, 2020 and 2019 is as follows:

| | December 31, 2020 | | December 31, 2020 Fair Value Measurements | | |
|---|---|---|---|---|---|
| *(in thousands)* | Carrying amount | Fair value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Net Significant Unobservable Inputs (Level 3) |
| **Assets:** | | | | | |
| Cash and due from banks | $ 19,235 | $ 19,235 | $ 19,235 | $ — | $ — |
| Federal funds sold and overnight interest-bearing deposits | 161,128 | 161,128 | 161,128 | — | — |
| Certificates of deposit in other banks | 9,376 | 9,376 | 9,376 | — | — |
| Available for sale securities | 198,030 | 198,030 | 2,798 | 195,232 | — |
| Other investment securities | 6,353 | 6,353 | 32 | 6,321 | — |
| Loans, net | 1,268,854 | 1,288,677 | — | — | 1,288,677 |
| Loans held for sale | 5,099 | 5,279 | — | — | 5,279 |
| Cash surrender value - life insurance | 2,451 | 2,451 | — | 2,451 | — |
| Accrued interest receivable | 6,640 | 6,640 | 6,640 | — | — |
| Total | $ 1,677,166 | $ 1,697,169 | $ 199,209 | $ 204,004 | $ 1,293,956 |
| **Liabilities:** | | | | | |
| Deposits: | | | | | |
| Non-interest bearing demand | $ 382,492 | $ 382,492 | $ 382,492 | $ — | $ — |
| Savings, interest checking and money market | 723,808 | 723,808 | 723,808 | — | — |
| Time deposits | 277,306 | 279,569 | — | — | 279,569 |
| Federal funds purchased and securities sold under agreements to repurchase | 45,154 | 45,154 | 45,154 | — | — |
| Federal Home Loan Bank advances and other borrowings | 106,674 | 110,121 | — | 110,121 | — |
| Subordinated notes | 49,486 | 40,929 | — | 40,929 | — |
| Operating lease liabilities | 2,137 | 2,137 | | 2,137 | |
| Accrued interest payable | 837 | 837 | 837 | — | — |
| Total | $ 1,587,894 | $ 1,585,047 | $ 1,152,291 | $ 153,187 | $ 279,569 |

| | December 31, 2019 | | December 31, 2019 Fair Value Measurements | | |
|---|---|---|---|---|---|
| (in thousands) | Carrying amount | Fair value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Net Significant Unobservable Inputs (Level 3) |
| **Assets:** | | | | | |
| Cash and due from banks | $ 22,576 | $ 22,576 | $ 22,576 | $ — | $ — |
| Federal funds sold and overnight interest-bearing deposits | 55,545 | 55,545 | 55,545 | — | — |
| Certificates of deposit in other banks | 10,862 | 10,862 | 10,862 | — | — |
| Available-for-sale securities | 175,093 | 175,093 | 995 | 174,098 | — |
| Other investment securities | 5,808 | 5,808 | 13 | 5,795 | — |
| Loans, net | 1,156,320 | 1,148,339 | — | — | 1,148,339 |
| Loans held for sale | 428 | 435 | — | — | 435 |
| Cash surrender value - life insurance | 2,398 | 2,398 | — | 2,398 | — |
| Accrued interest receivable | 6,481 | 6,481 | 6,481 | — | — |
| | $ 1,435,511 | $ 1,427,537 | $ 96,472 | $ 182,291 | $ 1,148,774 |
| **Liabilities:** | | | | | |
| Deposits: | | | | | |
| Non-interest bearing demand | $ 261,166 | $ 261,166 | $ 261,166 | $ — | $ — |
| Savings, interest checking and money market | 614,331 | 614,331 | 614,331 | — | — |
| Time deposits | 311,024 | 311,489 | — | — | 311,489 |
| Federal funds purchased and securities sold under agreements to repurchase | 27,272 | 27,272 | 27,272 | — | — |
| Federal Home Loan Bank advances and other borrowings | 96,919 | 97,833 | — | 97,833 | — |
| Subordinated notes | 49,486 | 43,640 | — | 43,640 | — |
| Operating lease liabilities | 2,224 | 2,224 | — | 2,224 | — |
| Accrued interest payable | 1,136 | 1,136 | 1,136 | — | — |
| | $ 1,363,558 | $ 1,359,091 | $ 903,905 | $ 143,697 | $ 311,489 |

***Off-Balance-Sheet Financial Instruments***

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

***Limitations***

The fair value estimates provided are made at a point in time based on market information and information about the financial instruments. Because no market exists for a portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the fair value estimates.

## (19) Commitments and Contingencies

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

The Company's extent of involvement and maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for financial instruments included on its consolidated balance sheets. At December 31, 2020, no amounts have been accrued for any estimated losses for these financial instruments.

The contractual amount of off-balance-sheet financial instruments as of December 31, 2020 and 2019 is as follows:

| *(in thousands)* | 2020 | 2019 |
|---|---|---|
| Commitments to extend credit | $ 264,528 | $ 240,758 |
| Commitments to originate residential first and second mortgage loans | 51,270 | 3,980 |
| Standby letters of credit | 125,800 | 97,348 |
| **Total** | 441,598 | 342,086 |

### *Commitments*

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These standby letters of credit are primarily issued to support contractual obligations of the Company's customers. The approximate remaining term of standby letters of credit range from one month to five years at December 31, 2020.

### *Pending Litigation*

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

## (20) Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* and all subsequent ASUs that modified Topic 606.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are not in the scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as trust department revenue,

service charges and fees, debit card income, ATM surcharge income, and sales of other real estate owned. However, the recognition of these revenue streams did not change current business practices or result in any changes to the Company's consolidated financial statements.

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

- Service charges on deposit accounts - represents fees generated from a variety of deposit products and services provided to customers under a day-to-day contract. These fees are recognized on a daily or monthly basis.
- Bank card income and fees – represents fees, exchange, and other service charge revenue earned from merchant, debit and credit cards that are recognized when the services are rendered or upon completion. These fees are recognized on a daily or monthly basis.
- Gain on sale of other real estate - represents income recognized at the time of control of a property is transferred to the buyer.

## (21) 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, | |
|---|---|---|
| *(in thousands)* | **2020** | **2019** |
| **Assets** | | |
| Cash and due from bank subsidiaries | $ 2,013 | $ 2,576 |
| Investment in bank-issued trust preferred securities | 1,229 | 1,310 |
| Investment in subsidiaries | 183,020 | 167,196 |
| Deferred tax asset | 1,496 | 1,928 |
| Other assets | 1,076 | 1,329 |
| **Total assets** | $ 188,834 | $ 174,339 |
| | | |
| **Liabilities and Stockholders' Equity** | | |
| Subordinated notes | $ 49,486 | $ 49,486 |
| Other liabilities | 8,759 | 9,815 |
| Stockholders' equity | 130,589 | 115,038 |
| **Total liabilities and stockholders' equity** | $ 188,834 | $ 174,339 |

**Condensed Statements of Income**

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| **Income** | | | |
| Interest and dividends received from subsidiaries | $ 4,946 | $ 8,071 | $ 5,067 |
| Other | — | — | 428 |
| **Total income** | 4,946 | 8,071 | 5,495 |
| **Expenses** | | | |
| Interest on subordinated notes | 1,527 | 2,376 | 2,229 |
| Other | 2,692 | 2,461 | 3,461 |
| **Total expenses** | 4,219 | 4,837 | 5,690 |
| Income before income tax benefit and equity in undistributed income of subsidiaries | 727 | 3,234 | (195) |
| Income tax benefit | 876 | 1,001 | 1,397 |
| Equity in undistributed income of subsidiaries | 12,690 | 11,879 | 9,512 |
| **Net income** | $ 14,293 | $ 16,114 | $ 10,714 |

**Condensed Statements of Cash Flows**

| | For the Years Ended December 31, | | |
|---|---|---|---|
| *(in thousands)* | 2020 | 2019 | 2018 |
| **Cash flows from operating activities:** | | | |
| Net income | $ 14,293 | $ 16,114 | $ 10,714 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed income of subsidiaries | (12,690) | (11,879) | (9,512) |
| Decrease (Increase) in deferred tax asset | 432 | (319) | 370 |
| Other, net | 1,031 | 10 | (116) |
| **Net cash provided by operating activities** | $ 3,066 | $ 3,926 | $ 1,456 |
| **Cash flows from investing activities:** | | | |
| Decrease in investment in subsidiaries, net | $ 307 | $ — | $ 500 |
| **Net cash provided by investing activities** | $ 307 | $ — | $ 500 |
| **Cash flows from financing activities:** | | | |
| Cash dividends paid - common stock | $ (3,030) | $ (2,684) | $ (1,993) |
| Issuance of stock under equity compensation plan | — | — | 135 |
| Purchase of treasury stock | (906) | — | (179) |
| **Net cash used in financing activities** | $ (3,936) | $ (2,684) | $ (2,037) |
| Net increase (decrease) in cash and due from banks | (563) | 1,242 | (81) |
| **Cash and due from banks at beginning of year** | 2,576 | 1,334 | 1,415 |
| **Cash and due from banks at end of year** | $ 2,013 | $ 2,576 | $ 1,334 |

## (22) Quarterly Financial Information *(Unaudited)*

| *(In thousands except per share data)* | First quarter | Second quarter | Third quarter | Fourth quarter | Year to Date |
|---|---|---|---|---|---|
| **Year Ended December 31, 2020** | | | | | |
| Interest income | $ 15,808 | $ 15,721 | $ 15,958 | $ 15,498 | $ 62,985 |
| Interest expense | 3,282 | 2,382 | 2,116 | 1,942 | 9,722 |
| **Net interest income** | 12,526 | 13,339 | 13,842 | 13,556 | 53,263 |
| Provision for loan losses | 3,300 | 900 | 1,200 | 400 | 5,800 |
| Noninterest income | 2,248 | 2,633 | 5,075 | 4,693 | 14,649 |
| Investment gains (losses), net | (1) | 7 | 12 | 43 | 61 |
| Noninterest expense | 10,448 | 11,047 | 11,616 | 11,586 | 44,697 |
| Income tax expense | 157 | 750 | 1,153 | 1,123 | 3,183 |
| **Net income** | $ 868 | $ 3,282 | $ 4,960 | $ 5,183 | $ 14,293 |
| **Net income per share:** | | | | | |
| Basic earnings per share | $ 0.13 | $ 0.50 | $ 0.77 | $ 0.80 | $ 2.20 |
| Diluted earnings per share | 0.13 | 0.50 | 0.77 | 0.80 | 2.20 |
| **Year Ended December 31, 2019** | | | | | |
| Interest income | $ 15,915 | $ 16,184 | $ 15,925 | $ 15,946 | $ 63,970 |
| Interest expense | 4,286 | 4,027 | 3,564 | 3,355 | 15,232 |
| **Net interest income** | 11,629 | 12,157 | 12,361 | 12,591 | 48,738 |
| Provision for loan losses | 150 | 250 | 450 | 300 | 1,150 |
| Noninterest income | 2,091 | 2,121 | 2,424 | 2,301 | 8,937 |
| Investment gains (losses), net | 1 | — | (40) | (1) | (40) |
| Gain on branch sale, net | 2,074 | — | 109 | — | 2,183 |
| Noninterest expense | 9,888 | 9,671 | 9,590 | 9,582 | 38,731 |
| Income tax expense | 1,091 | 837 | 954 | 941 | 3,823 |
| **Net income** | $ 4,666 | $ 3,520 | $ 3,860 | $ 4,068 | $ 16,114 |
| **Net income per share:** | | | | | |
| Basic earnings per share | $ 0.72 | $ 0.54 | $ 0.59 | $ 0.62 | $ 2.47 |
| Diluted earnings per share | 0.72 | 0.54 | 0.59 | 0.62 | 2.47 |

## MARKET PRICE OF AND DIVIDENDS ON EQUITY SECURITIES AND RELATED MATTERS

***Market Price***

The Company's common stock trades on Nasdaq's global select market under the stock symbol of *HWBK*. The following table sets forth the range of high and low bid prices of the Company's common stock by quarter for each quarter in 2020 and 2019 in which the stock was traded.

| | High | Low |
|---|---|---|
| **2020** | | |
| First Quarter | $ 17.84 | $ 16.82 |
| Second Quarter | $ 20.78 | $ 18.91 |
| Third Quarter | $ 18.94 | $ 18.35 |
| Fourth Quarter | $ 22.57 | $ 21.72 |
| | | |
| **2019** | | |
| First Quarter | $ 21.72 | $ 21.49 |
| Second Quarter | $ 26.20 | $ 25.12 |
| Third Quarter | $ 23.41 | $ 22.71 |
| Fourth Quarter | $ 24.52 | $ 24.28 |

***Shares Outstanding***

As of December 31, 2020, the Company had issued 6,769,322 shares of common stock, of which 6,480,108 shares were outstanding. The outstanding shares were held of record by approximately 1,392 shareholders.

***Dividends***

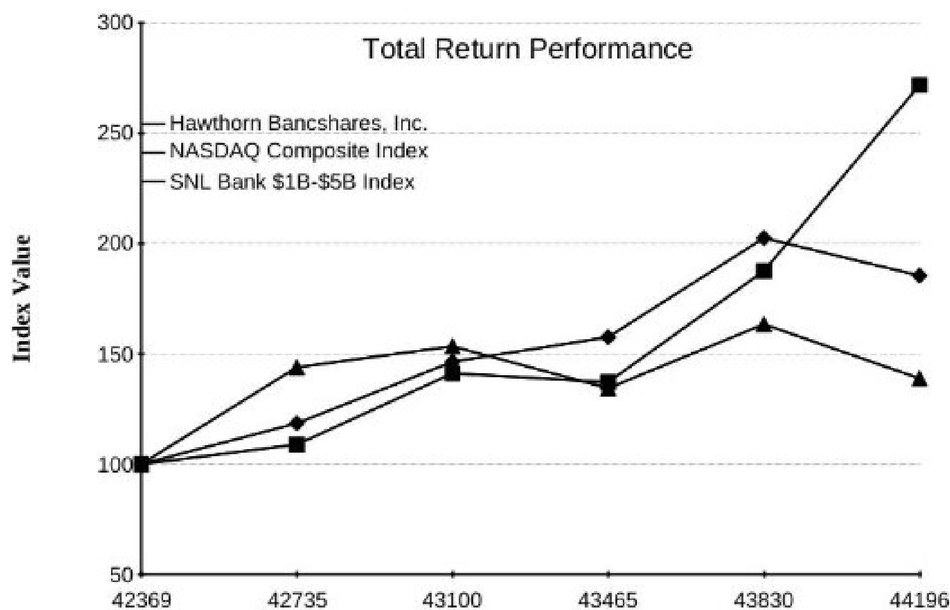
The following table sets forth information on dividends paid by the Company in 2020 and 2019.

| Month Paid | Dividends Paid Per Share |
|---|---|
| January, 2020 | $ 0.12 |
| April, 2020 | 0.12 |
| July, 2020 | 0.12 |
| October, 2020 | 0.12 |
| **Total for 2020** | $ 0.48 |
| | |
| January, 2019 | $ 0.10 |
| April, 2019 | 0.10 |
| July, 2019 | 0.12 |
| October, 2019 | 0.12 |
| **Total for 2019** | $ 0.44 |

The board of directors intends that the Company will continue to pay quarterly dividends. The actual amount of quarterly dividends and the payment, as well as the amount, of any special dividend ultimately will depend on the payment of sufficient dividends by the subsidiary Bank to the Company. The payment by the Bank of dividends to the Company will depend upon such factors as the Bank's financial condition, results of operations and current and anticipated cash needs, including capital requirements.

*Stock Performance Graph*

The following performance graph shows a comparison of cumulative total returns for the Company, the Nasdaq Stock Market (U.S. Companies), and a peer index of financial institutions having total assets of between $1 billion and $5 billion for the period from December 31, 2015, through December 31, 2020. The cumulative total return on investment for each of the periods for the Company, the Nasdaq Stock Market (U.S. Companies) and the peer index is based on the stock price or index at December 31, 2015. The performance graph assumes that the value of an investment in the Company's common stock and each index was $100 at December 31, 2015 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:

| | Year Ending | | | | | |
|---|---|---|---|---|---|---|
| | 12/31/15 | 12/31/16 | 12/31/17 | 12/31/18 | 12/31/19 | 12/31/20 |
| Hawthorn Bancshares, Inc. | $ 100.00 | $ 118.50 | $ 146.38 | $ 157.50 | $ 202.38 | $ 185.33 |
| Nasdaq Composite (U.S. Companies) | $ 100.00 | $ 108.87 | $ 141.13 | $ 137.12 | $ 187.44 | $ 271.64 |
| Index of financial institutions ($1 billion to $5 billion) | $ 100.00 | $ 143.87 | $ 153.37 | $ 134.37 | $ 163.50 | $ 138.81 |

**DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY**

| Name | Position with the Company | Position with Subsidiary Bank | Principal Occupation |
|---|---|---|---|
| David T. Turner | Chairman, Chief Executive Officer, President and Director -Class III | Chairman, Chief Executive Officer, President and Director | Position with Hawthorn Bancshares, Inc. and Hawthorn Bank |
| Kathleen L. Bruegenhemke | Senior Vice President, Chief Risk Officer, Corporate Secretary, and Director-Class I | Senior Vice President, Chief Operating Officer, Chief Risk Officer, Corporate Secretary, and Director | Position with Hawthorn Bancshares, Inc. and Hawthorn Bank |
| Stephen E. Guthrie | Senior Vice President and Chief Financial Officer | Senior Vice President and Chief Financial Officer | Position with Hawthorn Bancshares, Inc. and Hawthorn Bank |
| Kevin L. Riley | Director-Class III | Director | Co-owner, Riley Chevrolet, Buick, GMC, Cadillac, Toyota, Inc., Riley Brothers, LLC, and Riley Brothers II, LLC, Jefferson City, Missouri |
| Frank E. Burkhead | Director-Class II | Director | Owner, Burkhead Wealth Management, Co-owner, Burkhead & Associates, LLC, Pro 356, LLC, and FACT Properties, LLC, Jefferson City, Missouri |
| Philip D. Freeman | Director-Class I | Director | Owner, Freeman Properties, JCMO, LLC, Jefferson City, Missouri |
| Gus S. (Jack) Wetzel III | Director-Class II | Director | Co-owner, Meadows Construction Co, Inc., Meadows Contracting LLC, Meadows Development Co, Village Park Investments, LLC, Meadows Property, LLC, TWC Enterprise, LLC, Wetzel Investments Ltd., and GCSL, LLC all of Clinton, Missouri |
| Jonathan D. Holtaway | Director – Class I | Director | Co-owner, Ategra GP, LLC, and Ategra Capital Management LLC, and Managing Member of Ategra LS500, LP and Ategra Community Financial Institution Fund, LP, all of Vienna, Virginia |

**ANNUAL REPORT ON FORM 10-K**

A copy of the Company's Annual Report on Form 10-K for the year ended December 31, 2020, as filed with the Securities and Exchange Commission, excluding exhibits, will be furnished without charge to shareholders entitled to vote at the 2021 annual meeting of shareholders upon written request to Kathleen L. Bruegenhemke, Corporate Secretary, Hawthorn Bancshares, Inc., 132 East High Street, Jefferson City, Missouri 65101. The Company will provide a copy of any exhibit to the Form 10-K to any such person upon written request and the payment of the Company's reasonable expenses in furnishing such exhibits.

**Exhibit 23**

## Consent of Independent Registered Public Accounting Firm

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

We consent to the incorporation by reference in the registration statement (No. 333-136477) on Form S-8 and the registration statement (No. 333-101415) on Form S-3D of Hawthorn Bancshares, Inc., of our reports dated March 12, 2021, with respect to the consolidated balance sheets of Hawthorn Bancshares, Inc. and Subsidiaries (the Company) as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020, the related notes, and the effectiveness of internal control over financial reporting as of December 31, 2020, which reports appear in the December 31, 2020 annual report on Form 10-K of the Company.

/s/ KPMG LLP

St. Louis, Missouri
March 12, 2021

**Exhibit 31.1**

***CERTIFICATIONS***

I, David T. Turner, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: March 12, 2021

/s/ David T. Turner
David T. Turner
Chairman of the Board, CEO, & President

**Exhibit 31.2**

***CERTIFICATIONS***

I, Stephen E. Guthrie, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: March 12, 2021

/s/ Stephen E. Guthrie

Stephen E. Guthrie
Chief Financial Officer

**Exhibit 32.1**

**Certification of Chief Executive Officer**

In connection with the Annual Report of Hawthorn Bancshares, Inc. (the Company) on Form 10-K for the period ended December 31, 2020 as filed with the Securities and Exchange Commission (the Report), I, David T. Turner, Chairman of the Board, Chief Executive Officer, and President of the Company, hereby certify in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Dated: March 12, 2021

/s/ David T. Turner
David T. Turner
Chairman of the Board, CEO, & President

"A signed original of this written statement required by Section 906 has been provided to Hawthorn Bancshares, Inc. and will be retained by Hawthorn Bancshares, Inc. and furnished to the Securities and Exchange Commission or its staff upon request."

**Exhibit 32.2**

**Certification of Chief Financial Officer**

In connection with the Annual Report of Hawthorn Bancshares, Inc. (the Company) on Form 10-K for the period ended December 31, 2020 as filed with the Securities and Exchange Commission (the Report), I, Stephen E. Guthrie, Chief Financial Officer of the Company, hereby certify in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Dated: March 12, 2021

/s/ Stephen E. Guthrie
Stephen E. Guthrie
Chief Financial Officer

"A signed original of this written statement required by Section 906 has been provided to Hawthorn Bancshares, Inc. and will be retained by Hawthorn Bancshares, Inc. and furnished to the Securities and Exchange Commission or its staff upon request."