2016

ANNUAL REPORT

TO

SHAREHOLDERS

HAWTHORN BANCSHARES, INC.

Jefferson City, Missouri

March 30, 2017

Dear Shareholders:

Net income for 2016 was $7.3 million, or $1.29 per diluted share, compared to $8.6 million, or $1.52 per diluted share, for 2015.

The earnings decrease from the prior year was partially attributable to recoveries of nonaccrual interest recorded in 2015 and a $1.2 million increase in the provision for loan losses versus the prior year caused primarily by the growth in the loan portfolio. Loans increased $109 million, or 12.6%, from the prior year while they were up $51 million, or 5.9%, on average. As loans are our highest earning asset category, we look forward to the benefit this loan growth will provide in future earnings. We also saw deposits increase 6.7% versus the prior year to over $1 billion.

Net interest income for 2016 was $40.3 million compared to $40.8 million for 2015. On a tax equivalent basis, Hawthorn's net interest margin for 2016 was 3.47% compared to 3.69% for 2015.

Non-interest income for 2016 was $8.9 million compared to $9.2 million for 2015. The decrease is primarily the result of a $0.8 million decrease in combined real estate servicing fees and mortgage loan sales income resulting from decreased financing activity in the housing market partially offset by securities gains of $0.6 million recognized in the current year. Non-interest expenses remained relatively unchanged from 2015 at $36.8 million. Real estate foreclosure expenses increased $0.6 million during 2016 primarily due to $0.2 million of net gains on sales of foreclosed properties realized in 2015 versus net expenses of $0.4 million recognized in 2016. Partially offsetting this increase was a decrease of $0.3 million in FDIC assessment expense due to lower assessment rates charged in 2016.

Non-performing loans improved during 2016 to 0.95% of total loans at December 31, 2016, compared to 1.19% at December 31, 2015. During the year ended December 31, 2016, net charge-offs were $0.1 million, or 0.02% of average loans, compared to $0.7 million, or 0.09% of average loans for 2015. As evidenced by this trend of reduced levels of non-performing loans and net charge-offs over the last two years, we believe the overall risk in our loan portfolio is well managed. The allowance for loan losses at December 31, 2016 was $9.9 million, or 1.01% of outstanding loans, and 107.35% of non-performing loans compared to December 31, 2015, when the allowance for loan losses was $8.6 million, or 0.99% of outstanding loans, and 83.75% of non-performing loans.

Our Capital levels at December 31, 2016 continue to exceed regulatory well capitalized thresholds with 9.87% of leverage capital and 13.72% of total risk-based capital.

Asset quality and growth trends are moving in the right direction. We continue to take proactive steps to increase non-interest revenue, reduce costs and improve efficiencies. I am committed to maintaining strong asset quality; further improving earnings performance; sustaining sound and proper capital levels; and paying regular dividends.

Hawthorn's staff, management, Board of Directors and Advisory Board members are committed to the continued growth of our strong community bank and delivering long term value to our shareholders. We appreciate your support and encourage you to continue to use Hawthorn Bank for your banking needs and request that you refer prospective customers to ***your*** bank.

We announced earlier this month that Ms. Kathleen Bruegenhemke had been elected to our board of directors. Ms. Bruegenhemke has served our company, in various capacities, for over 25 years. I'm pleased that she will now be serving in yet another capacity as a member of the board of directors.

I want to thank my fellow Board members for their wise counsel and guidance and thank our employees at every level for their dedication, hard work and teamwork during this past year. Finally, I want to extend my appreciation to our loyal customers and shareholders for their continuing support and confidence in Hawthorn Bancshares.

Sincerely,

David T. Turner,
Chairman & Chief Executive Officer

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 or regulatory changes may adversely affect the business in which the Company and its subsidiaries are engaged, and
- changes may occur in the securities markets.

We have described under the caption *Risk Factors* in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, 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 $1.3 billion in assets at December 31, 2016, 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 (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 communities in and surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, Branson, 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 mortgage lending. The Company has experienced soft loan demand in the communities within which we operate during the current economic slowdown. The Company's income from mortgage brokerage activities is directly dependent on mortgage rates and the level of home purchases and refinancings.

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

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

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

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, 2016. 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.

Income Statement Data

(In thousands, except per share data)	2016	2015	2014	2013	2012
Interest income	$ 46,010	$ 45,756	$ 44,498	$ 45,665	$ 49,114
Interest expense	5,663	4,999	5,044	6,342	7,905
Net interest income	40,347	40,757	39,454	39,323	41,209
Provision for loan losses	1,425	250	0	2,030	8,900
Net interest income after provision for loan losses	38,922	40,507	39,454	37,293	32,309
Non-interest income	8,917	9,166	8,749	10,866	9,726
Non-interest expense	36,807	36,494	36,507	40,763	38,667
Income before income taxes	11,032	13,179	11,696	7,396	3,368
Income tax expense	3,750	4,580	4,042	2,422	546
Net income	7,282	8,599	7,654	4,974	2,822
Preferred stock dividends and accretion of discount	0	0	0	615	1,784
Net income available to common shareholders	$ 7,282	$ 8,599	$ 7,654	$ 4,359	$ 1,038

Per Share Data

	2016	2015	2014	2013	2012
Basic earnings per common share	$ 1.29	$ 1.52	$ 1.35	$ 0.77	$ 0.18
Diluted earnings per common share	1.29	1.52	1.35	0.77	0.18
Dividends paid per share on common stock	0.20	0.20	0.20	0.20	0.20
Book value per share	16.14	15.42	14.23	13.08	13.06
Market price per share	17.70	15.14	13.18	10.80	6.41
Basic weighted average shares of common stock outstanding	5,639,744	5,662,013	5,662,081	5,685,560	5,686,560
Diluted weighted average shares of common stock outstanding	5,639,744	5,662,013	5,662,081	5,685,560	5,686,560

(In thousands)	2016	2015	2014	2013	2012
Balance Sheet Data (at year end)					
Total assets	$ 1,287,048	$ 1,200,921	$ 1,169,731	$ 1,140,122	$ 1,181,606
Net loans	964,143	856,476	852,114	825,828	832,142
Investment securities	224,308	243,091	203,720	209,986	204,171
Total deposits	1,010,666	947,197	969,514	956,471	991,275
Subordinated notes	49,486	49,486	49,486	49,486	49,486
Federal Home Loan Bank advances	92,900	50,000	43,000	24,000	20,126
Common stockholders' equity	91,017	87,286	80,568	74,380	74,243
Total stockholders' equity	91,017	87,286	80,568	74,380	92,220
Balance Sheet Data (average balances)					
Total assets	$ 1,251,741	$ 1,199,061	$ 1,156,911	$ 1,159,127	$ 1,176,384
Net loans	904,069	852,514	839,957	818,525	827,881
Investment securities	243,169	242,740	212,697	224,551	225,119
Total deposits	997,514	975,036	971,777	978,063	971,767
Subordinated notes	49,486	49,486	49,486	49,486	49,486
Federal Home Loan Bank advances	67,212	48,474	29,964	23,256	27,961
Common stockholders' equity	91,401	84,818	78,953	73,259	74,245
Total stockholders' equity	91,401	84,818	78,953	79,875	96,176
Key Ratios					
Earnings Ratios					
Return on average total assets	0.58%	0.72%	0.66%	0.43%	0.24%
Return on average common stockholders' equity	7.97	10.14	9.69	5.95	1.40
Efficiency ratio (3)	74.71	73.10	75.74	81.22	75.91
Asset Quality Ratios					
Allowance for loan losses to loans	1.01%	0.99%	1.06%	1.63%	1.75%
Nonperforming loans to loans (1)	0.95	1.19	4.18	4.21	4.65
Allowance for loan losses to nonperforming loans (1)	107.35	83.75	25.26	38.84	37.70
Allowance for loan losses to nonperforming loans excluding performing TDRs	282.94	194.48	49.72	57.35	47.74
Nonperforming assets to loans and foreclosed assets (2)	2.37	2.98	5.49	5.87	7.23
Net loan charge-offs to average loans	0.02	0.09	0.54	0.38	0.93
Capital Ratios					
Average stockholders' equity to average total assets	7.30%	7.07%	6.82%	6.89%	8.18%
Period-end common stockholders' equity to period-end assets period-end assets	7.07	7.27	6.89	6.52	6.28
Period-end stockholders' equity to period-end assets	7.07	7.27	6.89	6.52	7.80
Total risk-based capital ratio	13.72	14.78	15.78	15.33	16.83
Tier 1 risk-based capital ratio	11.29	12.03	12.38	11.40	13.58
Common equity Tier 1 capital	8.51	9.04	NA	NA	NA
Tier 1 leverage ratio	9.87	9.84	9.42	8.79	10.37

(1) Nonperforming loans consist of nonaccrual loans, troubled debt restructurings, and loans contractually past due 90 days or more and still accruing interest.

(2) Nonperforming 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.

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.

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 write-downs are recorded as other real estate expense, net. The Company establishes a valuation allowance related to other real estate owned on an asset-by-asset basis. The valuation allowance is created during the holding period when the fair value less cost to sell is lower than the cost of the property.

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)	**2016**	**2015**	**2014**	**'16-'15**	**'15-'14**	**'16-'15**	**'15-'14**
Net interest income	$ 40,347	$ 40,757	$ 39,454	$ (410)	$ 1,303	(1.0)%	3.3%
Provision for loan losses	1,425	250	0	1,175	250	470.0	100.0
Non-interest income	8,917	9,166	8,749	(249)	417	(2.7)	4.8
Non-interest expense	36,807	36,494	36,507	313	(13)	0.86	(0.0)
Income before income taxes	11,032	13,179	11,696	(2,147)	1,483	16.3	12.7
Income tax expense	3,750	4,580	4,042	(830)	538	18.1	13.3
Net income	$ 7,282	$ 8,599	$ 7,654	$ (1,317)	$ 945	(15.3)%	12.3%

Consolidated net income decreased $1.3 million to $7.3 million, or $1.29 per diluted share, for the year ended December 31, 2016 compared to $8.6 million, or $1.52 per diluted share, for the year ended December 31, 2015. For the year ended December 31, 2016, the return on average assets was 0.58%, the return on average common stockholders' equity was 7.97%, and the efficiency ratio was 74.71%.

Consolidated net income increased $945,000 to $8.6 million, or $1.52 per diluted share, for the year ended December 31, 2015 compared to $7.7 million, or $1.35 per diluted per share, for the year ended December 31, 2014. For the year ended December 31, 2015, the return on average assets was 0.72%, the return on average common stockholders' equity was 10.14%, and the efficiency ratio was 73.10%.

Net interest income was $40.3 million for the year ended December 31, 2016 compared to $40.8 million and $39.5 million for the years ended December 31, 2015 and 2014, respectively. The net interest margin was 3.47% for the year ended December 31, 2016 compared to 3.69% and 3.72% for the years ended December 31, 2015 and 2014, respectively.

A $1.4 million ***provision for loan losses*** was required for the year ended December 31, 2016 compared to $250,000 and no provision for the years ended December 31, 2015, respectively. The increase over 2015 was primarily due to an increase in loans and using a sixteen quarter look-back period compared to twelve quarters in the prior years. The increase for 2015 over 2014 was primarily due to an increase in specific reserves related to two loan relationships.

The Company's net charge-offs for the year ended December 31, 2016, were $143,000, or 0.02% of average loans compared to $745,000, or 0.09% of average loans for the year ended December 31, 2015, and $4.6 million, or 0.54% of average loans for the year ended December 31, 2014.

Non-performing loans totaled $9.2 million, or 0.95% of total loans, at December 31, 2016 compared to $10.3 million, or 1.19% of total loans at December 31, 2015, and $36.0 million, or 4.18% of total loans, at December 31, 2014.

Non-interest income decreased $249,000, or 2.7%, for the year ended December 31, 2016 compared to the year ended December 31, 2015, and increased $417,000, or 4.8%, for the year ended December 31, 2015 compared to the year ended December 31, 2014. These changes are discussed in greater detail below under Non-interest Income.

Non-interest expense increased $313,000, or 0.9%, for the year ended December 31, 2016 compared to the year ended December 31, 2015, and decreased $13,000, or 0.0%, for the year ended December 31, 2015, compared to the year ended December 31, 2014. 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, 2016, 2015, and 2014, respectively.

(In thousands)	2016			2015			2014		
	Average Balance	**Interest Income/ Expense (1)**	**Rate Earned/ Paid (1)**	**Average Balance**	**Interest Income/ Expense (1)**	**Rate Earned/ Paid (1)**	**Average Balance**	**Interest Income/ Expense (1)**	**Rate Earned/ Paid (1)**
ASSETS									
Loans: (2) (3)									
Commercial	$ 161,177	$ 7,383	4.57%	$ 155,127	$ 7,316	4.72%	$ 144,847	$ 6,862	4.74%
Real estate construction - residential	17,671	803	4.53	15,215	968	6.36	22,047	956	4.34
Real estate construction - commercial	43,759	2,016	4.59	42,919	2,169	5.05	58,785	2,539	4.32
Real estate mortgage - residential	253,614	11,544	4.54	248,335	11,612	4.68	232,785	11,124	4.78
Real estate mortgage - commercial	410,672	19,152	4.65	379,538	18,333	4.83	375,177	17,894	4.77
Consumer	26,280	1,161	4.41	20,952	1,076	5.14	18,938	1,054	5.57
Total loans	$ 913,173	$42,059	4.59%	$ 862,086	$41,474	4.81%	$ 852,579	$40,429	4.74%
Investment securities:									
U.S. Treasury	$ 0	$ 0	0.00%	$ 0	$ 0	0.00%	$ 286	$ 4	1.40%
U.S. government and federal agency obligations	48,551	582	1.20	74,820	999	1.34	64,997	918	1.41
Obligations of states and political subdivisions	32,836	836	2.54	34,408	1,077	3.13	33,655	1,138	3.38
Mortgage-backed securities	153,024	2,597	1.69	126,810	2,497	1.97	109,550	2,415	2.20
Total Available-for-sale securities	$ 234,411	$ 4,015	1.71%	$ 236,038	$ 4,573	1.94%	$ 208,488	$ 4,475	2.15%
Other investments & securities	8,758	317	3.61	6,702	216	3.22	4,209	80	1.90
Federal funds sold and interest bearing deposits in other financial institutions	15,526	80	0.51	14,022	38	0.27	10,350	28	0.27
Total interest earning assets	$1,171,868	$46,471	3.95%	$1,118,848	$46,301	4.14%	$1,075,626	$45,012	4.18%
All other assets	88,977			89,785			93,906		
Allowance for loan losses	(9,104)			(9,572)			(12,621)		
Total assets	$1,251,741			$1,199,061			$1,156,911		
LIABILITIES AND STOCKHOLDERS' EQUITY									
NOW accounts	$ 195,098	$ 607	0.31%	$ 198,288	$ 479	0.24%	$ 197,785	$ 507	0.26%
Savings	96,130	49	0.05	89,367	49	0.05	82,676	57	0.07
Commercial	630	3	0.47	0	0	0.00	0	0	0.00
Money market	186,356	500	0.27	174,146	443	0.25	163,844	404	0.25
Time deposits of $100,000 and over	142,688	981	0.69	137,295	867	0.63	141,868	940	0.66
Other time deposits	159,598	927	0.58	175,092	1,090	0.62	196,153	1,384	0.71
Total interest bearing deposits	$ 780,500	$ 3,067	0.39%	$ 774,188	$ 2,928	0.38%	$ 782,326	$ 3,292	0.42%
Federal funds purchased and securities sold under agreements to repurchase	36,539	64	0.17	30,925	55	0.18	20,223	21	0.10
Subordinated notes	49,486	1,494	3.01	49,486	1,293	2.61	49,486	1,264	2.55
Federal Home Loan Bank Advances	67,212	1,038	1.54	48,474	723	1.49	29,964	467	1.56
Total borrowings	$ 153,237	$ 2,596	1.69%	$ 128,885	$ 2,071	1.61%	$ 99,673	$ 1,752	1.76%
Total interest bearing liabilities	$ 933,737	$ 5,663	0.60%	$ 903,073	$ 4,999	0.55%	$ 881,999	$ 5,044	0.57%
Demand deposits	217,014			200,848			189,451		
Other liabilities	9,589			10,322			6,508		
Total liabilities	1,160,340			1,114,243			1,077,958		
Stockholders' equity	91,401			84,818			78,953		
Total liabilities and stockholders' equity	$1,251,741			$1,199,061			$1,156,911		
Net interest income (FTE)		$40,808			$41,302			$39,968	
Net interest spread			3.35%			3.59%			3.61%
Net interest margin			3.47%			3.69%			3.72%

(1) Interest income and yields are presented on a fully taxable equivalent basis using the federal statutory income tax rate of 34%, net of nondeductible interest expense. Such adjustments totaled $461,000, $545,000 and $514,000 for the years ended December 31, 2016, 2015 and 2014, 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, 2016, compared to December 31, 2015, and for the years ended December 31, 2015 compared to December 31, 2014. 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.

	2016			2015		
		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	$ 67	$ 280	$ (213)	$ 454	$ 485	$ (31)
Real estate construction - residential	(165)	140	(305)	12	(351)	363
Real estate construction - commercial	(153)	41	(194)	(370)	(756)	386
Real estate mortgage - residential	(68)	244	(312)	488	731	(243)
Real estate mortgage - commercial	819	1,467	(648)	439	209	230
Consumer	85	249	(164)	22	107	(85)
Investment securities:						
U.S. Treasury	-	-	-	(4)	(2)	(2)
U.S. government and federal agency						
obligations	(417)	(323)	(94)	81	133	(52)
Obligations of states and political subdivisions	(241)	(47)	(194)	(61)	25	(86)
Mortgage-backed securities	100	473	(373)	82	356	(274)
Other investments & securities, at cost	101	72	29	136	62	74
Federal funds sold and interest bearing deposits in other financial institutions	42	4	38	10	10	-
Total interest income	170	2,600	(2,430)	1,289	1,009	280
Interest expense:						
NOW accounts	128	(8)	136	(28)	1	(29)
Savings	-	4	(4)	(8)	4	(12)
Commercial	3	-	3	-	-	-
Money market	57	32	25	39	26	13
Time deposits of $100,000 and over	114	35	79	(73)	(29)	(44)
Other time deposits	(163)	(92)	(71)	(294)	(139)	(155)
Federal funds purchased and securities sold under agreements to repurchase	9	10	(1)	34	14	20
Subordinated notes	201	-	201	29	-	29
Federal Home Loan Bank advances	315	288	27	256	276	(20)
Total interest expense	664	269	395	(45)	153	(198)
Net interest income on a fully taxable equivalent basis	$(494)	$2,331	$(2,825)	$1,334	$ 856	$ 478

(1) Interest income and yields are presented on a fully taxable equivalent basis using the federal statutory income tax rate of 34%, net of nondeductible interest expense. Such adjustments totaled $461,000, $545,000 and $514,000 for the years ended December 31, 2016, 2015 and 2014, 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, 2016 compared to the year ended December 31, 2015 reflected a decrease in net interest income, on a tax equivalent basis, of $494,000, or 1.20%, and financial results for the year ended December 31, 2015 compared to the year ended December 31, 2014 reflected an increase of $1.3 million, or 3.34%.

Measured as a percentage of average earning assets, the net interest margin (expressed on a fully taxable equivalent basis) decreased to 3.47% for the year ended December 31, 2016, compared to 3.69% and 3.72% for the years ended December 31, 2015 and 2014, respectively.

The decrease in the net interest income and the net interest margin in 2016 over 2015 were primarily due to a contraction in the net interest spread caused primarily by a decrease in the yield on investment securities maturing at higher historical rates, new replacement securities yielding lower current market rates, and an increase in FHLB advances to support asset growth. The increase in net interest income for 2015 over 2014 was primarily due to an increase in average earning assets and the decrease in the net interest margin was primarily due to a decrease in the rates earned on investment securities.

Average interest-earning assets increased $53.0 million, or 4.74%, to $1.17 billion for the year ended December 31, 2016 compared to $1.12 billion for the year ended December 31, 2015, and average interest bearing liabilities increased $30.7 million, or 3.40%, to $933.7 million for the year ended December 31, 2016 compared to $903.1 million for the year ended December 31, 2015.

Average interest-earning assets increased $43.2 million, or 4.02%, to $1.12 billion for the year ended December 31, 2015 compared to $1.08 billion for the year ended December 31, 2014, and average interest bearing liabilities increased $21.1 million, or 2.39%, to $903.1 million for the year ended December 31, 2015 compared to $882.0 million for the year ended December 31, 2014.

Total interest income (expressed on a fully taxable equivalent basis) increased to $46.5 million for the year ended December 31, 2016 compared to $46.3 million and $45.0 million for the years ended December 31, 2015 and 2014, respectively. The Company's rates earned on interest earning assets were 3.95% for the year ended December 31, 2016 compared to 4.14% and 4.18% for the years ended December 31, 2015 and 2014, respectively.

Interest income on loans increased to $42.1 million for the year ended December 31, 2016 compared to $41.5 million and $40.4 million for the years ended December 31, 2015 and 2014, respectively.

Average loans outstanding increased $51.1 million, or 5.9%, to $913.2 million for the year ended December 31, 2016 compared to $862.1 million for the year ended December 31, 2015. The average yield on loans receivable decreased to 4.59% during the year ended December 31, 2016 compared to 4.81% for the year ended December 31, 2015.

Average loans outstanding increased $9.5 million, or 1.1%, to $862.1 million for the year ended December 31, 2015 compared to $852.6 million for the year ended December 31, 2014. The average yield on loans receivable increased to 4.81% during the year ended December 31, 2015 compared to 4.74% for the year ended December 31, 2014. See the *Lending and Credit Management* section for further discussion of changes in the composition of the lending portfolio.

Total interest expense was $5.7 million for the year ended December 31, 2016 compared to $5.0 million for both the years ended December 31, 2015 and 2014. The Company's rates paid on interest bearing liabilities was 0.60% for the year ended December 31, 2016 compared to 0.55% and 0.57% for the years ended December 31, 2015 and 2014, respectively. See the *Liquidity Management* section for further discussion.

Interest expense on deposits was $3.1 million for the year ended December 31, 2016 compared to $2.9 million and $3.3 million for the years ended December 31, 2015 and 2014, respectively.

Average interest bearing deposits increased $6.3 million, or 0.82%, to $780.5 million for the year ended December 31, 2016 compared to $774.2 million for the year ended December 31, 2015. The average cost of deposits increased to 0.39% during the year ended December 31, 2016 compared to 0.38% for the year ended December 31, 2015.

Average interest bearing deposits decreased $8.1 million, or 1.0%, to $774.2 million for the year ended December 31, 2015 compared to $782.3 million for the year ended December 31, 2014. The average cost of deposits decreased to 0.38% during the year ended December 31, 2015 compared to 0.42% for the year ended December 31, 2014.

Interest expense on borrowings was $2.6 million for year ended December 31, 2016 compared to $2.1 million and $1.8 million for both the ended December 31, 2015 and 2014, respectively. Average borrowings were $153.2 million for the year ended December 31, 2016 compared to $128.9 million and $99.7 million for the years ended December 31, 2015 and 2014, respectively. See the *Liquidity Management* section for further discussion.

Non-interest Income and Expense

Non-interest income for the years ended December 31, 2016, 2015, and 2014 was as follows:

				$ Change		% Change	
(In thousands)	**2016**	**2015**	**2014**	**'16-'15**	**'15-'14**	**'16-'15**	**'15-'14**
Non-interest Income							
Service charges and other fees	$3,400	$3,477	$3,743	$ (77)	$(266)	(2.2)%	(7.1)%
Bank card income and fees	2,547	2,455	2,368	92	87	3.7	3.7
Trust department income	952	929	844	23	85	2.5	10.1
Real estate servicing fees, net	325	573	319	(248)	254	(43.3)	79.6
Gain on sales of mortgage loans, net	851	1,386	1,093	(535)	293	(38.6)	26.8
Gain on sale of investment securities	602	8	20	594	(12)	NM	(60.0)
Other	240	338	362	(98)	(24)	(29.0)	(6.6)
Total non-interest income	$8,917	$9,166	$8,749	$(249)	$ 417	(2.7)%	4.8%
Non-interest income as a % of total revenue *	18.1%	18.4%	18.2%				
Total revenue per full time equivalent employee	$151.1	$146.0	$144.8				

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

Total non-interest income decreased $249,000, or 2.7%, to $8.9 million for the year ended December 31, 2016 compared to $9.2 million for the year ended December 31, 2015, and increased $417,000, or 4.8%, to $9.2 million for the year ended December 31, 2015 compared to $8.7 million for the year ended December 31, 2014.

Service charges and other fees decreased $77,000, or 2.2%, to $3.4 million for the year ended December 31, 2016 compared to the year ended December 31, 2015, and decreased $266,000, or 7.1% to $3.5 million for the year ended December 31, 2015 compared to the year ended December 31, 2014. The decrease was primarily due to a decrease in nonsufficient service charge fees collected for both periods.

Real estate servicing fees, net of the change in valuation of mortgage serving rights decreased $248,000, or 43.3%, to $325,000 for the year ended December 31, 2016 compared to the year ended December 31, 2015, and increased $254,000, or 79.6%, to $573,000 for the year ended December 31, 2015 compared to the year ended December 31, 2014.

Mortgage loan servicing fees earned on loans sold were $854,000 for the year ended December 31, 2016 compared to $873,000 and $895,000 for the years ended 2015 and 2014, respectively. Total realized losses included in earnings attributable to the change in unrealized gains or losses related to assets serviced were $529,000 for the year ended December 31, 2016 compared to $301,000 and $576,000 for the years ended December 31, 2015 and 2014, respectively. The Company was servicing $294.4 million of mortgage loans at December 31, 2016 compared to $312.1 million and $313.9 million at December 31, 2015 and 2014, respectively.

Gain on sales of mortgage loans decreased $535,000, or 38.6%, to $851,000 for the year ended December 31, 2016 compared to the year ended December 31, 2015, and increased $293,000, or 26.8%, to $1.4 million for the year ended December 31, 2015 compared to the year ended December 31, 2014. The Company sold loans of $37.9 million for the year ended December 31, 2016 compared to $51.5 million and $36.6 million for the years ended December 31, 2015 and 2014, respectively.

Gain on sale of investment securities During the year ended December 31, 2016, the Company received $60.7 million from proceeds on sales of available-for-sale debt securities and recognized gains of $602,000, compared to $720,000 from proceeds on sales of available-for-sale debt securities and recognized net gains of $8,000 during the year ended December 31, 2015, and $5.3 million from proceeds on sales of available-for-sale debt securities and recognized gains of $20,000 for the year ended December 31, 2014. These transactions were 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.

Non-interest expense for the years ended December 31, 2016, 2015, and 2014 was as follows:

				$ Change		**% Change**	
(In thousands)	**2016**	**2015**	**2014**	**'16-'15**	**'15-'14**	**'16-'15**	**'15-'14**
Non-interest Expense							
Salaries	$15,623	$15,319	$15,729	$ 304	$ (410)	2.0%	(2.6)%
Employee benefits	5,227	5,473	4,648	(246)	825	(4.5)	17.7
Occupancy expense, net	2,751	2,792	2,660	(41)	132	(1.5)	5.0
Furniture and equipment expense	1,783	1,844	1,823	(61)	21	(3.3)	1.2
Processing expense, network and bank card expense	3,309	3,363	3,203	(54)	160	(1.6)	5.0
Legal, examination, and professional fees	1,301	1,321	1,159	(20)	162	(1.5)	14.0
FDIC insurance assessment	567	867	933	(300)	(66)	(34.6)	(7.1)
Advertising and promotion	1,083	1,111	1,274	(28)	(163)	(2.5)	(12.8)
Postage, printing, and supplies	1,054	1,120	1,117	(66)	3	(5.9)	0.3
Real estate foreclosure expense (gains), net	370	(223)	845	593	(1,068)	265.9	(126.4)
Loan expenses	609	423	303	186	120	44.0	39.6
Other	3,130	3,084	2,813	46	271	1.5	9.6
Total non-interest expense	$36,807	$36,494	$36,507	$ 313	$ (13)	0.9%	(0.0)%
Efficiency ratio *	74.7%	73.1%	75.7%				
Efficiency ratio **	74.9%	73.6%	74.0%				
Salaries and benefits as a % of total non-interest expense	56.6%	57.0%	55.8%				
Number of full-time equivalent employees	326	342	333				

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

** Does not include other real estate expense and gain on sale of investments

Total non-interest expense increased $313,000, or 0.9%, to $36.8 million for the year ended December 31, 2016 compared to 2015. Non-interest expense was $36.5 million for both the years ended December 31, 2015 and 2014.

Salaries increased $304,000, or 2.0%, for the year ended December 31, 2016 compared to the year ended December 31, 2015, and decreased $410,000, or 2.6%, for the year ended December 31, 2015 compared to the year ended December 31, 2014. The increase for the year ended 2016 over 2015 was primarily due to cost of living and merit salary increases, partially offset by an increase in deferred loan costs. The decrease for the year ended 2015 over 2014 was primarily due to a decrease in the accrual estimate for the 2015 incentive program to be paid in 2016 and an increase in deferred loan costs.

Employee benefits decreased $246,000, or 4.5%, for the year ended December 31, 2016 compared to the year ended December 31, 2015, and increased $825,000, or 17.7%, for the year ended December 31, 2015 compared to the year ended December 31, 2014. The decrease for the year ended 2016 over 2015 was primarily due to a decrease in 401(k) profit-sharing and pension expenses, and medical plan premiums, which was due to a change in the Company's health insurance plan effective July 1 , 2016. The increase for the year ended 2015 over 2014 was primarily due to an increase in 401(k) profit-sharing and pension expenses.

FDIC insurance assessment decreased $300,000, or 34.6%, for the year ended December 31, 2016 compared to December 31, 2015, and decreased $66,000, or 7.1%, for the year ended December 31, 2015 compared to the year ended December 31, 2014. In February 2011, the FDIC adopted a rule that requires large institutions to bear the burden of raising the reserve ratio form 1.15% to 1.35% in accordance with the Dodd-Frank Act. The quarter after the reserve ratio reached 1.15%, lower assessment rates, surcharges, and new pricing for small intuitions under $10 billion became effective July 1, 2016 and appeared on the December 31, 2016 invoicing. Once the reserve ratio reaches 1.38%, small institutions, such as Hawthorn, will receive credits to offset their contribution to raising the reserve ratio to 1.35%.

Real estate foreclosure expense and (gains), net increased $593,000, or 265.9%, for the year ended December 31, 2016 compared to the year ended December 31, 2015, and decreased $1.1 million, or 126.4%, for the year ended December 31, 2015 compared to the year ended December 31, 2014.

Net gains recognized on other real estate owned were $21,000 for the year ended December 31, 2016, compared to net gains of $671,000 and a net loss of $ 371,000 for the years ended December 31, 2015 and 2014, respectively. Expenses to maintain foreclosed properties were $391,000 for the year ended December 31, 2016, compared to $448,000 and $474,000 for the years ended December 31, 2015 and 2014, respectively.

Loan expenses increased $186,000, or 44.0%, for the year ended December 31, 2016 compared to December 31, 2015, and increased $120,000, or 39.6%, for the year ended December 31, 2015 compared to the year ended December 31, 2017. The increase in 2016 over 2015 primarily related to new application product fees for a home equity promotion.

Other non-interest expense increased $46,000, or 1.5%, for the year ended December 31, 2016 compared to the year ended December 31, 2015, and increased $271,000, or 9.6%, for the year ended December 31, 2015 compared to the year ended December 31, 2014. The increase in 2015 over 2014 was primarily due to an impairment write-down on a building held for sale partially offset by the loss recorded due to employee fraud that management discovered during the third quarter 2014.

Comparing fourth quarter 2016 to third quarter 2016

Consolidated net income available to shareholders' increased to $2.0 million for the fourth quarter 2016 compared to $1.9 million for the third quarter 2016. ***Net interest income*** increased to $10.4 million for the fourth quarter 2016 compared to $10.1 for the third quarter of 2016 with $1.2 billion in average interest earning assets for both periods.

A $450,000 ***provision for loan losses*** was required for the fourth quarter 2016 compared to $300,000 for the third quarter of 2016. Net charge-offs for the fourth quarter 2016 were $34,000, or 0.00% of average loans, compared to $222,000, or 0.02% of average loans for the third quarter 2016.

Non-interest income increased to $2.4 million for the fourth quarter 2016 compared to $2.1 million for the third quarter of 2016. The increase primarily resulted from an increase in real estate servicing fees partially offset by a decrease in gain on sale of investment securities. Mortgage loan servicing fees earned on loans sold were $200,000 for the fourth quarter 2016 compared to $233,000 for the third quarter 2016. Total net gains (losses) included in earnings attributable to the change in unrealized gains or losses related to assets serviced were $160,000 for the fourth quarter 2016 compared to $(237,000) for the third quarter 2016. The Company's loans sold were $9.1 million for the fourth 2016 compared to $11.2 million for the third quarter of 2016.

Non-interest expense increased to $9.3 million for the fourth quarter 2016 compared to $9.1 million for the third quarter 2016. This increase primarily resulted from an increase in real estate foreclosure expense,

legal fees, salaries and employee benefits, advertising and promotion, and loan collection expenses, partially offset by a decrease in FDIC insurance assessment. Net losses recognized on other real estate owned were $43,000 for the fourth quarter 2016 compared to net gains of $17,000 for the third quarter 2016, and expenses to maintain foreclosed properties were $95,000 for the fourth quarter 2016 compared to $66,000 for the third quarter 2016. The decrease in the FDIC assessment was primarily a result of lower assessment rates, surcharges, and new pricing for small intuitions under $10 billion that became effective July 1, 2016 and appeared on the December 31, 2016 invoicing.

Comparing fourth quarter 2016 to fourth quarter 2015

Consolidated net income available to shareholders remained unchanged at $2.0 million for both the fourth quarter 2016 and 2015. ***Net interest income*** increased to $10.4 million for the fourth quarter 2016 compared to $10.2 million for the fourth quarter 2015 with $1.2 billion and $1.1 billion in average interest earning assets for the fourth quarter 2016 and 2015, respectively.

A $450,000 ***provision for loan losses*** was required for the fourth quarter 2016 compared to no provision for the fourth quarter 2015. Net charge-offs for the fourth quarter 2016 were $34,000, or 0.00% of average loans, compared to $642,000, or 0.07% of average loans for the fourth quarter 2015.

Non-interest income was consistent at $2.4 million for both fourth quarter 2016 and 2015. Increases primarily resulted from an increase in net real estate servicing fees, bank card income and fees, and were partially offset by decreases in gain on sale of mortgage loans, net, and other income primarily due to a legal settlement received on a foreclosed property in 2015. Mortgage loan servicing fees earned on loans sold were $200,000 for the fourth quarter 2016 compared to $225,000 for the fourth quarter 2015. Total net gains (losses) included in earnings attributable to the change in unrealized gains or losses related to assets serviced were $160,000 for the fourth quarter 2016 compared to $(9,000) for the fourth quarter 2015. The Company's loans sold were $9.1 million for the fourth quarter 2016 compared to $11.4 million for the fourth quarter of 2015.

Non-interest expense decreased to $9.3 million for the fourth quarter 2016 compared to $9.5 million for the fourth quarter 2015. This decrease primarily resulted from a decrease in processing, network, and bank card expense, FDIC insurance assessment, and other non-interest expense. These decreases were partially offset by an increase in salary expense and loan expenses. The decrease in processing, network, and bank card expenses were primarily due to expenses incurred to increase debit card security in 2015. The decrease in the FDIC assessment was primarily a result of lower assessment rates, surcharges, and new pricing for small intuitions under $10 billion that became effective July 1, 2016 and appeared on the December 31, 2016 invoicing. The decrease in other non-interest expenses for the fourth quarter 2016 over the fourth quarter 2015 primarily related to decreases in telephone and internet expenses, meals and entertainment expenses, and year-end donations. The increase in salary expense for the fourth quarter 2016 over the fourth quarter 2015 primarily related to merit salary increases.

Income taxes

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 34.0% for the year ended December 31, 2016 compared to 34.8% and 34.6% for the years ended December 31, 2015 and 2014, respectively. The decrease in the effective tax rate in 2016 over 2015 and 2014 is primarily due to an immaterial return to provision adjustment recorded during the first quarter 2016.

Lending and Credit Management

Interest earned on the loan portfolio is a primary source of interest income for the Company. Net loans represented 74.9% of total assets as of December 31, 2016 compared to 71.3% as of December 31, 2015.

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)	**2016**	**2015**	**2014**	**2013**	**2012**
Commercial, financial, and agricultural	$ 182,881	$ 149,091	$ 154,834	$ 141,845	$ 134,275
Real estate construction - residential	18,907	16,895	18,103	21,008	22,177
Real estate construction - commercial	55,653	33,943	48,822	55,076	43,486
Real estate mortgage - residential	259,900	256,086	247,117	225,630	221,310
Real estate mortgage - commercial	426,470	385,869	372,321	375,686	400,536
Installment loans to individuals	30,218	23,196	20,016	20,302	25,200
Total loans	$ 974,029	$ 865,080	$ 861,213	$ 839,547	$ 846,984
Percent of categories to total loans:					
Commercial, financial, and agricultural	18.8%	17.2%	18.0%	16.9%	15.9%
Real estate construction - residential	1.9	2.0	2.1	2.5	2.6
Real estate construction - commercial	5.7	3.9	5.7	6.6	5.1
Real estate mortgage - residential	26.7	29.6	28.7	26.9	26.1
Real estate mortgage - commercial	43.8	44.6	43.2	44.7	47.3
Installment loans to individuals	3.1	2.7	2.3	2.4	3.0
Total	100.0%	100.0%	100.0%	100.0%	100.0%

The Company extends credit to its local community market through traditional real estate mortgage products. The Company does not participate in extending credit to sub-prime residential real estate markets. The Company does not lend funds for 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, 2016, 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	$ 77,693	$ 70,339	$ 34,849	$ 182,881
Real estate construction - residential	18,386	521	-	18,907
Real estate construction - commercial	29,141	22,256	4,256	55,653
Real estate mortgage - residential	54,475	89,196	116,229	259,900
Real estate mortgage - commercial	84,512	226,231	115,727	426,470
Installment loans to individuals	10,921	18,177	1,120	30,218
Total loans	$ 275,128	$ 426,720	$ 272,181	$ 974,029
Loans with fixed rates	197,978	347,181	77,572	622,731
Loans with floating rates	77,150	79,539	194,609	351,298
Total loans	$ 275,128	$ 426,720	$ 272,181	$ 974,029

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, 2016, the Company sold approximately $37.9 million of loans to investors compared to $51.5 million and $36.6 million for the years ended December 31, 2015 and 2014, respectively. At December 31, 2016, the Company was servicing approximately $294.4 million of loans sold to the secondary market compared to $312.1 million at December 31, 2015, and $313.9 million at December 31, 2014.

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. Currently, loans in excess of $2.0 million in aggregate and all adversely classified credits identified by management are reviewed. In addition, all other loans are reviewed on a sample basis. 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, delinquencies, current economic conditions, loan risk ratings and industry concentration. Management believes, but there can be no assurance, that these procedures keep management informed of potential problem loans. Based upon these procedures, both the allowance and provision for loan losses are adjusted to maintain the allowance at a level considered necessary by management to provide for probable losses inherent in the loan portfolio.

Nonperforming Assets

The following table summarizes nonperforming assets at the dates indicated:

(In thousands)	2016	2015	2014	2013	2012
Nonaccrual loans:					
Commercial, financial, and agricultural	$ 982	$ 308	$ 5,279	$ 1,684	$ 1,335
Real estate construction - residential	0	0	1,751	2,204	2,497
Real estate construction - commercial	50	102	2,096	6,251	7,762
Real estate mortgage - residential	1,888	2,322	4,419	4,165	5,330
Real estate mortgage - commercial	420	1,542	4,465	9,074	13,938
Installment loans to individuals	89	144	233	302	219
Total	$ 3,429	$ 4,418	$ 18,243	$ 23,680	$ 31,081
Loans contractually past - due 90 days or more and still accruing:					
Commercial, financial, and agricultural	$ 0	$ 1	$ 0	$ 0	$ 0
Real estate construction - commercial	0	0	56	0	0
Real estate mortgage - residential	54	0	0	129	0
Real estate mortgage - commercial	0	0	0	100	0
Installment loans to individuals	11	5	2	14	6
Total	$ 65	$ 6	$ 58	$ 243	$ 6
Performing troubled debt restructurings	5,715	5,850	17,720	11,395	8,282
Total nonperforming loans	9,209	10,274	36,021	35,318	39,369
Other real estate owned and repossessed assets - net	14,162	15,992	11,885	14,867	23,592
Total nonperforming assets	$ 23,371	$ 26,266	$ 47,906	$ 50,185	$ 62,961
Loans	$974,029	$865,080	$861,213	$839,547	$846,984
Allowance for loan losses to loans	1.01%	0.99%	1.06%	1.63%	1.75%
Nonperforming loans to loans	0.95%	1.19%	4.18%	4.21%	4.65%
Allowance for loan losses to nonperforming loans	107.35%	83.75%	25.26%	38.84%	37.70%
Allowance for loan losses to nonperforming loans, excluding performing TDR's	282.94%	194.48%	49.72%	57.35%	47.74%
Nonperforming assets to loans, other real estate owned and repossessed assets - net	2.37%	2.98%	5.49%	5.87%	7.23%

Total nonperforming assets were $23.4 million at December 31, 2016 compared to $26.3 million at December 31, 2015. Nonperforming loans, defined as loans on non-accrual status, loans 90 days or more past due and still accruing, and TDRs totaled $9.2 million, or 0.95%, of total loans at December 31, 2016 compared to $10.3 million, or 1.19%, of total loans at December 31, 2015. Non-accrual loans included $619,000 and $527,000 of loans classified as TDRs at December 31, 2016 and 2015, respectively.

As of December 31, 2016, approximately $4.0 million compared to $5.7 million at December 31, 2015, of loans classified as substandard, not included in the nonperforming asset table, were identified as potential problem loans having more than normal risk which raised doubts as to the ability of the borrower to comply with present loan repayment terms. Management believes the general allowance was sufficient to cover the risks and probable losses related to such loans at December 31, 2016 and December 31, 2015, respectively.

Total non-accrual loans at December 31, 2016 decreased $989,000, or 22.0%, to $3.4 million compared to $4.4 million at December 31, 2015. The decrease in non-accrual loans primarily consisted of decreases in real estate mortgage residential and commercial loans, partially offset by an increase in commercial, financial, and agricultural loans. The decrease in non-accrual loans primarily resulted from the sale of collateral, transfers of impaired loans to other real estate owned and repossessed assets, and four loan relationships that returned to performing status.

Loans past due 90 days and still accruing interest at December 31, 2016, were $65,000 compared to $6,000 at December 31, 2015. Other real estate owned and repossessed assets at December 31, 2016 were $14.2 million compared to $16.0 million at December 31, 2015. During the year ended December 31, 2016, $2.2 million of nonaccrual loans, net of charge-offs taken, moved to other real estate owned and repossessed assets compared to $5.8 million for the year ended December 31, 2015.

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

	December 31, 2016			December 31, 2015		
(In thousands)	**Number of contracts**	**Recorded Investment**	**Specific Reserves**	**Number of contracts**	**Recorded Investment**	**Specific Reserves**
Performing TDRs						
Commercial, financial and agricultural	8	$ 635	$ 11	8	$ 697	$ 67
Real estate mortgage - residential	8	3,582	99	7	3,615	630
Real estate mortgage - commercial	3	1,498	123	3	1,538	0
Total performing TDRs	19	$ 5,715	$ 233	18	$ 5,850	$ 697
Nonperforming TDRs						
Real estate mortgage - residential	6	$ 430	$ 58	0	$ 0	$ 0
Real estate mortgage - commercial	2	189	119	4	527	213
Total nonperforming TDRs	8	$ 619	$ 177	4	$ 527	$ 213
Total TDRs	27	$ 6,334	$ 410	22	$ 6,377	$ 910

At December 31, 2016, loans classified as TDRs totaled $6.3 million, with $410,000 of specific reserves, of which $619,000 were classified as nonperforming TDRs and $5.7 million were classified as performing TDRs. This is compared to $6.4 million of loans classified as TDRs, with $1.0 million of specific reserves, of which $527,000 were classified as nonperforming TDRs and $5.9 million were classified as performing TDRs at December 31, 2015. 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. The net decrease in total TDRs from December 31, 2015 to December 31, 2016 was primarily due to approximately $580,000 of payments received, partially offset by $569,000 of new loans designated as TDRs during the year ended December 31, 2016.

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)	2016	2015	2014	2013	2012
Allocation of allowance for loan losses at end of year:					
Commercial, financial, and agricultural	$ 2,753	$ 2,153	$ 1,779	$ 2,374	$ 1,937
Real estate construction - residential	108	59	171	931	732
Real estate construction - commercial	413	644	466	631	1,711
Real estate mortgage - residential	2,385	2,439	2,527	2,959	3,387
Real estate mortgage - commercial	3,793	2,935	3,846	6,523	6,834
Installment loans to individuals	274	273	270	294	239
Unallocated	160	101	40	7	2
Total	$ 9,886	$ 8,604	$ 9,099	$13,719	$ 14,842

The allowance for loan losses was $9.9 million, or 1.01%, of loans outstanding at December 31, 2016 compared to $8.6 million, or 0.99%, of loans outstanding at December 31, 2015. The ratio of the allowance for loan losses to nonperforming loans, excluding performing TDRs, was 282.94% at December 31, 2016, compared to 194.48% at December 31, 2015.

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

(In thousands)	2016	2015	2014	2013	2012
Allocation of allowance for loan losses:					
Individually evaluated for impairment - specific reserves	$ 1,080	$ 1,540	$ 1,749	$ 4,796	$ 4,020
Collectively evaluated for impairment - general reserves	8,806	7,064	7,350	8,923	10,822
Total	$ 9,886	$ 8,604	$ 9,099	$13,719	$ 14,842

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, 2016, $1.1 million of the Company's allowance for loan losses was allocated to impaired loans totaling approximately $9.1 million compared to $1.5 million of the Company's allowance for loan losses allocated to impaired loans totaling approximately $10.3 million at December 31, 2015. Management determined that $2.1 million, or 23%, of total impaired loans required no reserve allocation at December 31, 2016 compared to $4.5 million, or 44%, at December 31, 2015 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. Beginning in the first quarter of 2016, the Company began to lengthen its look-back period with the intent to increase such period from three to five years over the next two years. The Company believes that the five-year look-back period, which is consistent with the Company's practices prior to the start of the economic recession in 2008, 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.

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.

Provision

A $1.4 million provision was required for the year ended December 31, 2016 compared to a $250,000 provision for the year ended December 31, 2015, and no provision for the year ended December 31, 2014. The increase was primarily due to using a sixteen quarter look-back period compared to twelve quarters in the prior year, as discussed above, in addition to an increase in loans.

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

(In thousands)	2016	2015	2014	2013	2012
Analysis of allowance for loan losses:					
Balance beginning of year	$ 8,604	$ 9,099	$ 13,719	$ 14,842	$ 13,809
Charge-offs:					
Commercial, financial, and agricultural	389	1,131	1,285	895	1,760
Real estate construction - residential	-	-	349	119	-
Real estate construction - commercial	1	15	491	633	-
Real estate mortgage - residential	495	379	408	812	977
Real estate mortgage - commercial	147	363	2,890	1,301	5,466
Installment loans to individuals	258	302	405	420	586
Total charge-offs	1,290	2,190	5,828	4,180	8,789
Recoveries:					
Commercial, financial, and agricultural	299	672	319	340	161
Real estate construction - residential	-	322	181	-	67
Real estate construction - commercial	502	-	-	5	23
Real estate mortgage - residential	60	138	202	111	158
Real estate mortgage - commercial	140	165	320	368	248
Installment loans to individuals	146	148	186	203	265
Total recoveries	1,147	1,445	1,208	1,027	922
Net charge-offs	**143**	**745**	**4,620**	**3,153**	**7,867**
Provision for loan losses	1,425	250	-	2,030	8,900
Balance end of year	$ 9,886	$ 8,604	$ 9,099	$ 13,719	$ 14,842

Net Loan Charge-offs

The Company's net charge-offs were $143,000, or 0.02% of average loans, for the year ended December 31, 2016 compared to net charge-offs of $745,000, or 0.09% of average loans, for the year ended December 31, 2015, and $4.6 million, or 0.54% of average loans for the year ended December 31, 2014. Although loan charge-offs decreased during the year ended 2016 over the year 2015, loan recoveries also decreased from the prior year. One commercial loan and one real estate residential construction loan

recovery were received during the first and second quarters 2015 compared to a significant commercial real estate construction loan recovery received from the sale of collateral during the second quarter 2016.

Investment Portfolio

The Company classifies its debt and equity securities into one of the following two categories:

Held-to-Maturity includes investments in debt securities that the Company has the positive intent and ability to hold until maturity. Available-for-Sale — includes investments in debt and equity securities not classified as held to maturity or trading (i.e., investments that the Company has no present plans to sell in the near-term but may be sold in the future under different circumstances). The Company's investment portfolio consists of available-for-sale securities.

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

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, 2016, the investment portfolio classified as available-for-sale represented 16.7% of total consolidated assets. Future levels of held-to-maturity and available-for-sale investment securities can be expected to vary depending upon liquidity and interest sensitivity needs as well as other factors.

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

(In thousands)	**2016**	**2015**
U.S. government and federal agency obligations	$ 13,364	$ -
Government sponsored enterprises	32,459	73,497
Obligations of states and political subdivisions	42,032	32,706
Mortgaged-backed securities	126,657	128,851
Total available for sale debt securities	$ 214,512	$ 235,054

As of December 31, 2016, 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. government and federal agency obligations	$ -	$ -	$ 8,438	$ 4,926	$ 13,364	1.64%
Government sponsored enterprises	2,002	29,483	974	-	32,459	1.23
States and political subdivisions (2)	2,725	18,491	19,213	1,603	42,032	2.38
Mortgage-backed securities (1)	1,982	99,710	23,514	1,451	126,657	1.92
Total available-for-sale debt securities	$ 6,709	$ 147,684	$ 52,139	$ 7,980	$ 214,512	1.90%
Weighted average yield	1.55%	1.78%	2.35%	1.24%	1.90%	

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, 2016 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 34%.

At December 31, 2016, $28.6 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.

The following non-marketable securities are restricted securities which, lacking a market, are carried at cost. These securities are reported in other assets. At December 31, 2016, $5.1 million of the total included Federal Home Loan Bank (Des Moines) stock held by the Bank in accordance with debt and regulatory requirements. Other non-marketable securities include a $1.5 million equity investment in the Company's unconsolidated Exchange Statutory Trusts and $3.0 million in a subordinated debt equity security. See Note 8 to the Company's consolidated financials for further explanation of the Exchange Statutory Trusts.

(In thousands)	2016	2015
Federal Home Loan Bank of Des Moines stock	$ 5,149	$ 3,390
Subordinated debt equity security	3,000	3,000
Midwest Independent Bank stock	151	151
Federal Agricultural Mortgage Corporation stock	10	10
Investment in unconsolidated trusts	1,486	1,486
Total non-marketable investment securities	$ 9,796	$ 8,037

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)	2016	2015
Federal funds sold and other overnight interest-bearing deposits	$ 1,406	$ 7,893
Available for sale investment securities	214,512	235,054
Total	$ 215,918	$ 242,947

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 $214.5 million at December 31, 2016 and included an unrealized net loss of $3.1 million. The portfolio includes projected maturities and mortgage-backed securities pay-downs of approximately $6.7 million over the next twelve months, which offer resources to meet either new loan demand or reductions in the Company's deposit base.

The Company pledges portions of its investment securities portfolio to secure public fund deposits, federal funds purchase lines, securities sold under agreements to repurchase, borrowing capacity at the Federal Reserve Bank, and for other purposes required by law. The Company's unpledged securities in the available for sale portfolio totaled approximately $46.9 million and $52.4 million at December 31, 2016 and 2015, respectively.

Total investment securities pledged for these purposes were as follows:

(In thousands)	**2016**	**2015**
Investment securities pledged for the purpose of securing:		
Federal Reserve Bank borrowings	$ 9,211	$ 3,481
Federal funds purchased and securities sold under agreements to repurchase	43,054	66,911
Other deposits	115,330	112,282
Total pledged, at fair value	$ 167,595	$ 182,674

Liquidity is available from the Company's base of core customer deposits, defined as demand, interest checking, savings, and money market deposit accounts. At December 31, 2016, such deposits totaled $704.7 million and represented 69.7% of the Company's total deposits. These core deposits are normally less volatile and are often tied to other products of the Company through long lasting relationships. Time deposits and certificates of deposit of $100,000 and over totaled $305.9 million at December 31, 2016. These accounts are normally considered more volatile and higher costing representing 30.3% of total deposits at December 31, 2016.

Core deposits at December 31, 2016 and 2015 were as follows:

(In thousands)	**2016**	**2015**
Core deposit base:		
Non-interest bearing demand	$ 235,975	$ 208,035
Interest checking	177,414	176,124
Savings and money market	291,317	264,956
Total	$ 704,706	$ 649,115

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, 2016, under agreements with these unaffiliated banks, the Bank may borrow up to $39.0 million in federal funds on an unsecured basis and $18.0 million on a secured basis. There were $992,000 federal funds purchased outstanding at December 31, 2016. 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, 2016, there was $30.0 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, 2016.

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, 2016, the Bank had $92.9 million in outstanding borrowings with the FHLB. In addition, the Company has $49.5 million at December 31, 2016 in outstanding subordinated notes issued to wholly-owned grantor trusts, funded by preferred securities issued by the trusts.

Borrowings outstanding at December 31, 2016 and 2015 were as follows:

(In thousands)	2016	2015
Borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	$ 31,015	$ 56,834
Federal Home Loan Bank advances	92,900	50,000
Subordinated notes	49,486	49,486
Other borrowings	492	0
Total	$ 173,893	$ 156,320

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.

	2016				2015			
(In thousands)	FHLB	Federal Reserve Bank	Federal Funds Purchased Lines	Total	FHLB	Federal Reserve Bank	Federal Funds Purchased Lines	Total
Advance equivalent	$ 314,602	$ 9,015	$ 48,028	$ 371,645	$ 257,513	$ 3,412	$ 45,175	$ 306,100
Advances outstanding	(92,900)	0	0	(92,900)	(50,000)	0	0	(50,000)
Total available	$ 221,702	$ 9,015	$ 48,028	$ 278,745	$ 207,513	$ 3,412	$ 45,175	$ 256,100

At December 31, 2016, loans with a market value of $403.6 million were pledged to the Federal Home Loan Bank as collateral for borrowings and letters of credit. At December 31, 2016, investments with a market value of $20.5 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 $27.0 million at December 31, 2016 compared to $28.4 million at December 31, 2015. The $1.4 million decrease 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, 2016. Cash flow provided from operating activities consists mainly of net income adjusted for certain non-cash items. Operating activities provided cash flow of $13.5 million for the year ended December 31, 2016.

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 $94.2 million. The cash outflow primarily consisted of $113.4 million purchases of investment securities and a $112.3 million increase in the loan portfolio, partially offset by $69.7 million in proceeds from investment maturities, calls, and pay-downs, $60.7 million in proceeds from sales of investment securities, and $4.1 million in proceeds received from sales of other real estate owned and repossessed assets.

Financing activities provided cash of $79.3 million, resulting primarily from a $42.9 million net advance from Federal Home Loan Bank, $35.5 million increase in interest-bearing transaction accounts and in time deposits, and $27.9 million increase in demand deposits, partially offset by a $25.3 million decrease in federal funds purchased and securities sold. Future short-term liquidity needs arising from daily operations are not expected to vary significantly during 2016.

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 $258.7 million in unused loan commitments and standby letters of credit as of December 31, 2016. 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 $1.1 million for both the years ended December 31, 2016 and 2015. A large portion of the Company's liquidity is obtained from the Bank in the form of dividends. The Bank declared and paid $0 and $1.0 million in dividends to the Company during the years ended December 31, 2016 and 2015, respectively. At December 31, 2016 and 2015, the Company had cash and cash equivalents totaling $3.9 million and $5.0 million, respectively.

Capital Management

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

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

In addition, the final rules establish a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement will be phased in over four years beginning in 2016. The capital conservation buffer requirement effectively raises the minimum required risk-based capital ratios to 7% Common Equity Tier 1 Capital, 8.5% Tier 1 Capital and 10.5% Total Capital on a fully phased-in basis.

Under the Basel III requirements, at December 31, 2016, 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:

	2016	2015	2014	2013	2012	Minimum Ratios required for Capital Adequacy Guidelines *	Minimum Ratios for Well-Capitalized Under Prompt Corrective Action Banks
Risk-based capital ratios:							
Total capital ratio	13.72%	14.78%	15.78%	15.33%	16.83%	8.0%	10.0%
Tier I capital ratio	11.29	12.03	12.38	11.40	13.58	6.0	8.0
Common Equity Tier I capital ratio	8.51	9.04	NA	NA	NA	4.5	6.5
Tier I leverage ratio	9.87	9.84	9.42	8.79	10.37	4.0	5.0

* effective January 1, 2015

Preferred Stock On December 19, 2008, the Company announced its participation in the U.S. Treasury Department's Capital Purchase Program (CPP), a voluntary program that provides capital to financially healthy banks. Participation in this program included the Company's issuance of 30,255 shares of senior preferred stock (with a par value of $1,000 per share) and a ten year warrant to purchase approximately 287,133 shares of common stock. On May 9, 2012, the Company redeemed 12,000 of the 30,255 shares of preferred stock issued under the U.S. Treasury's CPP program for a total purchase price of $12.1 million, and on May 15, 2013, the remaining 18,255 shares were redeemed for a total purchase price of $18.5 million.

On June 11, 2013, the common stock warrant issued under the U.S. Treasury Department's CPP program was repurchased by the Company for a total purchase price of $540,000, or $1.88 per warrant share. The purchase price was based on the fair value of the warrant as agreed upon by the Company and the Treasury. The repurchase of the warrant ended the Company's participation in the U.S. Treasury Department's CPP.

Stock Dividend For the eighth consecutive year, on July 1, 2016, the Company distributed a four percent stock dividend to common shareholders of record at the close of business on June 15, 2016. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect the stock dividend.

Repurchase Program On August 6, 2015, the Board of Directors authorized a share repurchase plan to purchase through open market transactions $2.0 million market value of the Company's common stock. As of December 31, 2016, the Company repurchased a total of 43,893 shares of common stock pursuant to the plan at an average price of $14.95 per share, including 41,738 shares of common stock repurchased pursuant to the plan during the year ended December 31, 2016 at an average price of $14.92 per share.

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

The required payments of time deposits and other borrowed money, not including interest, at December 31, 2016 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	$305,960	$217,970	$75,137	$12,853	$-
Other borrowed money	93,392	41,392	37,000	15,000	-

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, 2016 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	$161,306	$115,003	$22,279	$6,064	$17,960
Commitments to originate residential first and second mortgage loans	3,175	3,175	-	-	-
Standby letters of credit	1,466	1,068	398	-	-
Total	$165,947	$119,246	$22,677	$6,064	$17,960

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

Interest Sensitivity

Market risk arises from exposure to changes in interest rates and other relevant market rate or price risk. The Company faces market risk in the form of interest rate risk through transactions other than trading activities. The Company uses financial modeling techniques to measure interest rate risk. These techniques measure the sensitivity of future earnings due to changing interest rate environments. Guidelines established by the Company's Asset/Liability Committee and approved by the board of directors are used to monitor exposure of earnings at risk. General interest rate movements are used to develop sensitivity as the Company feels it has no primary exposure to specific points on the yield curve. At December 31, 2016, the Company's rate shock scenario models indicated that annual net interest income could change by as much as -15.03% or -18.63% should interest rates rise or fall, respectively, 400 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.

The following table represents estimated interest rate sensitivity and periodic and cumulative gap positions calculated as of December 31, 2016. Significant assumptions used for this table included: loans will repay at historic repayment rates; certain interest-bearing demand accounts are interest sensitive due to immediate repricing, and fixed maturity deposits will not be withdrawn prior to maturity. A significant variance in actual results from one or more of these assumptions could materially affect the results reflected in the table.

(In thousands)	Year 1	Year 2	Year 3	Year 4	Year 5	Over 5 Years or No stated Maturity	Total
ASSETS							
Investment securities	$ 39,891	$ 43,045	$ 39,858	$ 32,964	$ 16,448	$ 42,306	$ 214,512
Federal funds sold and other over-night interest-bearing deposits	1,406	-	-	-	-	-	1,406
Other investments and securities, at cost	6,796	-	-	3,000	-	-	9,796
Loans	339,871	149,077	158,190	115,818	108,153	102,920	974,029
Total	$ 387,964	$ 192,122	$ 198,048	$151,782	$124,601	$145,226	$1,199,743
LIABILITIES							
Savings, interest checking, and money market deposits	$ 277,413	$ -	$ 191,318	$ -	$ -	$ -	$ 468,731
Time deposits	217,969	50,330	24,808	6,363	6,490		305,960
Federal funds purchased and securities sold under agreements to repurchase	31,015	-	-	-	-	-	31,015
Subordinated notes	49,486	-	-	-	-	-	49,486
FHLB advances and other borrowings	41,392	27,000	10,000	11,000	4,000	-	93,392
Total	$ 617,275	$ 77,330	$ 226,126	$ 17,363	$ 10,490	$ -	$ 948,584
Interest-sensitivity GAP							
Periodic GAP	$(229,311)	$ 114,792	$ (28,078)	$134,419	$114,111	$145,226	$ 251,159
Cumulative GAP	$(229,311)	$(114,519)	$(142,597)	$ (8,178)	$105,933	$251,159	$ 251,159
Ratio of interest-earning assets to interest-bearing liabilities							
Periodic GAP	0.63	2.48	0.88	8.74	11.88	NM	1.26
Cumulative GAP	0.63	0.84	0.85	0.99	1.11	1.26	1.26

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 year ended December 31, 2016.

Impact of New Accounting Standards

Revenue from Contracts with Customers The FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, in May 2014. The ASU supersedes revenue recognition requirements in Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance identifies specific steps that entities should apply in order to achieve this principle. The amendments are effective for interim and annual periods beginning January 1, 2018 and must be applied retrospectively.

In March 2016, the FASB began to issue targeted guidance to clarify specific implementation issues of ASU 2014-09. The FASB issued ASU 2016-08, *Principal versus Agent Considerations (Reporting Revenue Gross versus Ne*t), which provides guidance on determining an entity's role in providing goods and services as a principal versus an agent, and whether it controls each specified good or service before it is transferred to the customer. In April 2016, ASU 2016-10, *Identifying Performance Obligations and Licensing*, was issued which clarifies the guidance related to whether goods or services are distinct within the contract and therefore are a performance obligation, and clarifies the timing and pattern of revenue recognition for licenses of intellectual property. The effective date and transition requirements of these ASUs are the same as those of ASU 2014-09.

In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients*. The amendments in this update address narrow-scope improvements to the accounting guidance on collectability, noncash consideration, and completed contracts at transition. Additionally, the amendments in this Update provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. The amendments also included a rescission issued in May 2016, ASU 2016-11, *Revenue Recognition and Derivatives and Hedging: Rescission of SEC Guidance Because of ASU 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 Emerging Task Force meeting*, and relates to revenue and expense recognition for freight services in process, accounting for shipping and handling fees and costs, and accounting for consideration given by a vendor to a customer.

The FASB continues to issue additional ASU's clarifying the revenue recognition guidance for certain implementation issues. Under the ASU 2014-09 and related amendments, the guidance is effective for periods beginning January 1, 2018 and must be applied retroactively, whether through a full restatement of prior periods or a cumulative adjustment upon adoption of the ASU. The Company expects that the ASU will require a change in how the Company recognizes trust department revenue, bank card revenue, and real-estate sales; however these changes are not expected to have a significant impact on the Company's consolidated financial statements. The Company continues to assess the impact of the ASU's adoption on these non-interest income components and expects to adopt in the first quarter of 2018.

Debt Instruments The FASB issued ASU 2016-06, *Contingent Put and Call Options in Debt Instruments*, in March 2016. The ASU clarifies the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. Under the new guidance, the embedded options should be assessed solely in accordance with a four-step decision sequence, with no additional assessment of whether the triggering event is indexed to interest rates or credit risk. The amendments are effective January 1, 2017 and are not expected to have a significant effect on the Company's consolidated financial statements.

Financial Instruments The FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, in January 2016. The amendments require all equity investments to be measured at fair value with changes in the fair value recognized through net income, other than those accounted for under the equity method of accounting or those that result in the consolidation of the investee. Additionally, these amendments require presentation in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk for those liabilities measured at fair value. The amendments also require use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes. These amendments are effective for interim and annual periods beginning January 1, 2018. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements, including potential changes to the Company's note disclosure of the fair value of its loan portfolio.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The revised accounting guidance will remove all recognition thresholds and will require a company to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. It also amends the credit loss measurement guidance for available-for-sale debt securities and beneficial interests in securitized financial assets. This new accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2019. While the Company generally expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, the Company cannot determine 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 is continuing to evaluate the impact of the ASU's adoption on the Company's consolidated financial statements.

Leases In February 2016, the FASB issued ASU 2016-02, *Leases*, in order to increase transparency and comparability by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU primarily affects lessee accounting, which requires the lessee to recognize a right-of-use asset and a liability to make lease payments for those leases classified as operating leases under previous GAAP. For leases with a term of 12 months or less, an election by class of underlying asset not to recognize lease assets and lease liabilities is permitted. The ASU also provides additional guidance as to the definition of a lease, identification of lease components, and sale and leaseback transactions. The amendments in the ASU are effective for interim and annual periods beginning January 1, 2019. The Company will adopt this ASU in the first quarter of 2019 and is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

Liabilities The FASB issued ASU 2016-04, *Recognition of Breakage for Certain Prepaid Store-Value Products*, in March 2016, in order to address current and potential future diversity in practice related to the derecognition of a prepaid store-value product liability. Such products include prepaid gift cards issued on a specific payment network and redeemable at network-accepting merchant locations, prepaid telecommunication cards, and traveler's checks. The amendments require that the portion of the dollar value of prepaid stored-value products that is ultimately unredeemed (that is, the breakage) be accounted for consistent with the breakage guidance for stored-value product transactions provided in ASC Topic 606 – Revenue from Contracts with Customers. These amendments are effective for interim and annual periods beginning January 1, 2018. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

Stock Compensation The FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, in March 2016, in order to reduce complexity in this area and improve the usefulness of information provided to users. Amendments which will affect public companies include the recognition of excess tax benefits and deficiencies in income tax expense or benefit in the income statement, guidance as to the classification of excess tax benefits on the statement of cash flows, an election to account for award forfeitures as they occur, and the ability to withhold taxes up to the maximum statutory rate in the applicable jurisdictions without triggering liability classification of the award. The amendments are effective January 1, 2017. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

Statement of Cash Flows The FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, in August 2016, in order to address concerns regarding diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. In particular, this ASU addresses eight specific cash flow issues in an effort to reduce this diversity in practice: (1) debt prepayment or debt extinguishment costs; (2) settlement of zero-coupon bonds; (3) contingent consideration payments made after a business combination; (4) proceeds from the settlement of insurance claims; (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (6) distributions received from equity method investees; (7) beneficial interests in securitization transactions; and (8) separately identifiable cash flows and application of the predominance principle. The amendments are effective for annual periods beginning after December 15, 2017, and for interim periods within those annual periods. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

The FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, in November 2016. The ASU addresses the current diversity in the classification and presentation of changes in restricted cash on the statement of cash flows. The ASU requires that amounts described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning and end of period amounts shown on the statement of cash flows. Disclosures are to be provided on the nature of restrictions on cash and cash equivalents. When presented in more than one line item within the statement of financial position, the entity shall disclose the amounts, disaggregated by line item, of cash, cash equivalents, restricted cash, and restricted cash equivalents reported within the statement of financial position. The amendments are effective January 1, 2018 and are not expected to have a significant effect 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.

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KPMG LLP
Suite 900
10 South Broadway
St. Louis, MO 63102-1761

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Hawthorn Bancshares, Inc. and subsidiaries as of December 31, 2016 and 2015, and 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, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hawthorn Bancshares, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2016, 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), Hawthorn Bancshares, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 30, 2017 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP

St. Louis, Missouri
March 30, 2017

KPMG LLP is a Delaware limited liability partnership,
the U.S. member firm of KPMG International Cooperative
("KPMG International"), a Swiss entity.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

(In thousands, except per share data)	December 31, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$ 25,589	$ 20,484
Federal funds sold and other overnight interest-bearing deposits	1,406	7,893
Cash and cash equivalents	26,995	28,377
Investment in available-for-sale securities, at fair value	214,512	235,054
Other investments and securities, at cost	9,796	8,037
Total investment securities	224,308	243,091
Loans	974,029	865,080
Allowances for loan losses	(9,886)	(8,604)
Net loans	964,143	856,476
Premises and equipment - net	35,522	36,389
Mortgage servicing rights	2,584	2,847
Other real estate owned and repossessed assets - net	14,162	15,992
Accrued interest receivable	5,183	4,853
Cash surrender value - life insurance	2,409	2,348
Other assets	11,742	10,548
Total assets	$ 1,287,048	$ 1,200,921
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Non-interest bearing demand	$ 235,975	$ 208,035
Savings, interest checking and money market	468,731	441,080
Time deposits $100,000 and over	152,256	132,244
Other time deposits	153,704	165,838
Total deposits	1,010,666	947,197
Federal funds purchased and securities sold under agreements to repurchase	31,015	56,834
Federal Home Loan Bank advances and other borrowings	93,392	50,000
Subordinated notes	49,486	49,486
Accrued interest payable	498	382
Other liabilities	10,974	9,736
Total liabilities	1,196,031	1,113,635
Stockholders' equity:		
Common stock, $1 par value, authorized 15,000,000 shares; issued 5,822,357 and 5,605,203 shares, respectively	5,822	5,605
Surplus	41,498	38,549
Retained earnings	51,671	48,700
Accumulated other comprehensive loss, net of tax	(3,801)	(2,018)
Treasury stock; 205,750 and 164,013 shares, at cost, respectively	(4,173)	(3,550)
Total stockholders' equity	91,017	87,286
Total liabilities and stockholders' equity	$ 1,287,048	$ 1,200,921

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, 2016	2015	2014
INTEREST INCOME			
Interest and fees on loans	$ 41,854	$ 41,267	$ 40,274
Interest on investment securities:			
Taxable	3,238	3,554	3,394
Nontaxable	521	681	722
Federal funds sold and other overnight interest-bearing deposits	80	38	28
Dividends on other securities	317	216	80
Total interest income	46,010	45,756	44,498
INTEREST EXPENSE			
Interest on deposits:			
Savings, interest checking and money market	1,158	970	968
Time deposit accounts $100,000 and over	981	867	940
Other time deposits	928	1,090	1,384
Interest on federal funds purchased and securities sold under agreements to repurchase	64	56	21
Interest on subordinated notes	1,494	1,293	1,264
Interest on Federal Home Loan Bank advances	1,038	723	467
Total interest expense	5,663	4,999	5,044
Net interest income	40,347	40,757	39,454
Provision for loan losses	1,425	250	0
Net interest income after provision for loan losses	38,922	40,507	39,454
NON-INTEREST INCOME			
Service charges and other fees	3,400	3,477	3,743
Bank card income and fees	2,547	2,455	2,368
Trust department income	952	929	844
Real estate servicing fees, net	325	573	319
Gain on sale of mortgage loans, net	851	1,386	1,093
Gain on sale of investment securities	602	8	20
Other	240	338	362
Total non-interest income	8,917	9,166	8,749
NON-INTEREST EXPENSE			
Salaries and employee benefits	20,850	20,792	20,377
Occupancy expense, net	2,751	2,792	2,660
Furniture and equipment expense	1,783	1,844	1,823
Processing, network, and bank card expense	3,309	3,363	3,203
Legal, examination, and professional fees	1,301	1,321	1,159
FDIC insurance assessment	567	867	933
Advertising and promotion	1,083	1,111	1,274
Postage, printing, and supplies	1,054	1,120	1,117
Real estate foreclosure (gains) expense, net	370	(223)	845
Loan expenses	609	423	303
Other	3,130	3,084	2,813
Total non-interest expense	36,807	36,494	36,507
Income before income taxes	11,032	13,179	11,696
Income tax expense	3,750	4,580	4,042
Net income	$ 7,282	$ 8,599	$ 7,654
Basic earnings per share	$ 1.29	$ 1.52	$ 1.35
Diluted earnings per share	$ 1.29	$ 1.52	$ 1.35

See accompanying notes to the consolidated financial statements.

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

	Years Ended December 31,		
(In thousands)	**2016**	**2015**	**2014**
Net income	$ 7,282	$ 8,599	$ 7,654
Other comprehensive loss, net of tax			
Securities available for sale:			
Unrealized (loss) gain on investment securities available-for-sale, net of tax	(972)	(800)	1,717
Adjustment for gain on sales of investment securities, net of tax	(373)	(5)	(12)
Defined benefit pension plans:			
Net (loss) gain arising during the year, net of tax	(487)	3	(2,212)
Amortization of prior service cost included in net periodic pension cost, net of tax	49	12	48
Total other comprehensive loss	(1,783)	(790)	(459)
Total comprehensive income	$ 5,499	$ 7,809	$ 7,195

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 (Loss) Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2013	$ 5,195	$ 33,385	$ 40,086	$ (769)	$ (3,517)	$ 74,380
Net income	0	0	7,654	0	0	7,654
Other comprehensive loss	0	0	0	(459)	0	(459)
Stock based compensation expense	0	20	0	0	0	20
Stock dividend	201	2,496	(2,697)	0	0	0
Cash dividends declared, common stock	0	0	(1,027)	0	0	(1,027)
Balance, December 31, 2014	$ 5,396	$ 35,901	$ 44,016	$ (1,228)	$ (3,517)	$ 80,568
Net income	0	0	8,599	0	0	8,599
Other comprehensive loss	0	0	0	(790)	0	(790)
Stock based compensation expense	0	10	0	0	0	10
Stock dividend	209	2,638	(2,847)	0	0	0
Purchase of treasury stock	0	0	0	0	(33)	(33)
Cash dividends declared, common stock	0	0	(1,068)	0	0	(1,068)
Balance, December 31, 2015	$ 5,605	$ 38,549	$ 48,700	$ (2,018)	$ (3,550)	$ 87,286
Net income	0	0	7,282	0	0	7,282
Other comprehensive loss	0	0	0	(1,783)	0	(1,783)
Stock based compensation expense	0	17	0	0	0	17
Stock dividend	217	2,932	(3,149)	0	0	0
Purchase of treasury stock	0	0	0	0	(623)	(623)
Cash dividends declared, common stock	0	0	(1,162)	0	0	(1,162)
Balance, December 31, 2016	$ 5,822	$ 41,498	$ 51,671	$ (3,801)	$ (4,173)	$ 91,017

See accompanying notes to the consolidated financial statements.

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

	Years Ended December 31,		
(In thousands)	**2016**	**2015**	**2014**
Cash flows from operating activities:			
Net income	$ 7,282	$ 8,599	$ 7,654
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,425	250	0
Depreciation expense	1,782	1,810	1,758
Net amortization of investment securities, premiums, and discounts	1,903	1,317	1,058
Stock based compensation expense	17	10	20
Change in fair value of mortgage servicing rights	529	301	576
Gain on sale of investment securities	(602)	(8)	(20)
Gain on sales and dispositions of premises and equipment	(1)	(8)	(60)
Gain on sales and dispositions of other real estate owned and repossessed assets	(207)	(156)	(188)
Provision for other real estate owned	213	17	585
(Increase) decrease in accrued interest receivable	(330)	(37)	183
Increase in cash surrender value - life insurance	(61)	(64)	(71)
Decrease (increase) in other assets	10	1,212	(479)
Decrease (increase) in income tax receivable	307	621	(826)
Increase (decrease) in accrued interest payable	116	9	(53)
Increase in other liabilities	387	911	966
Origination of mortgage loans for sale	(36,017)	(51,307)	(35,434)
Proceeds from the sale of mortgage loans	37,896	51,503	36,623
Gain on sale of mortgage loans, net	(851)	(1,386)	(1,093)
Other, net	(267)	(252)	2,355
Net cash provided by operating activities	13,531	13,342	13,554
Cash flows from investing activities:			
Net increase in loans	(112,353)	(9,226)	(28,357)
Purchase of available-for-sale debt securities	(113,357)	(102,367)	(48,942)
Proceeds from maturities of available-for-sale debt securities	51,855	36,143	23,702
Proceeds from calls of available-for-sale debt securities	17,855	26,840	28,605
Proceeds from sales of available-for-sale debt securities	60,720	720	5,334
Proceeds from sales of FHLB stock	0	1,600	439
Purchases of FHLB stock	(1,759)	(4,915)	(1,160)
Purchases of premises and equipment	(1,262)	(872)	(1,342)
Proceeds from sales of premises and equipment	9	11	65
Proceeds from sales of other real estate owned and repossessed assets	4,057	1,836	4,560
Net cash used by investing activities	(94,235)	(50,230)	(17,096)
Cash flows from financing activities:			
Net increase in demand deposits	27,940	335	20,318
Net increase (decrease) in interest-bearing transaction accounts	27,651	(1,051)	22,974
Net increase (decrease) in time deposits	7,878	(21,601)	(30,249)
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(25,327)	38,864	(13,114)
Repayment of FHLB advances	(24,000)	(85,000)	(10,000)
FHLB advances	66,900	92,000	29,000
Purchase of treasury stock	(623)	(33)	0
Cash dividends paid - common stock	(1,097)	(1,058)	(1,017)
Net cash provided by financing activities	79,322	22,456	17,912
Net (decrease) increase in cash and cash equivalents	(1,382)	(14,432)	14,370
Cash and cash equivalents, beginning of year	28,377	42,809	28,439
Cash and cash equivalents, end of year	$ 26,995	$ 28,377	$ 42,809
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 5,547	$ 4,992	$ 5,097
Income taxes	$ 3,760	$ 3,509	$ 2,265
Supplemental schedule of noncash investing and financing activities:			
Other real estate and repossessions acquired in settlement of loans	$ 2,233	$ 5,804	$ 1,975

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, Branson, 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 and March of 2010, the Company formed Hawthorn Real Estate, LLC, and Real Estate Holdings of Missouri, LLC, respectively (the Real Estate Companies); both are wholly owned subsidiaries of the Company. The consolidated financial statements include the accounts of the Company, Hawthorn Bank (the Bank), and the Real Estate Companies. 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 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

The Bank originates certain loans, which are sold in the secondary market. These loans are classified as held for sale upon origination based on management's intent to sell and are accounted for at the lower of adjusted 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 $162,000 at December 31, 2016 compared to $1.2 million loans held for sale at December 31, 2015.

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. 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 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. Beginning in the first quarter of 2016, the Company began to lengthen its look-back period with the intent to increase such period from three to five years over the next two years. The Company believes that the five-year look-back period, which is consistent with the Company's practices prior to the start of the economic recession in 2008, 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.

Investment in Debt and Equity Securities

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

Premiums and discounts are amortized using the interest method over the lives of the respective securities, with consideration of historical and estimated 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.

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 improve-ments 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 may retain 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 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 economic 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 statement 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 changed 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 write-downs are recorded as other real estate expense. The Company establishes a valuation allowance related to other real estate owned on an asset-by-asset basis. The valuation allowance is created during the holding period when the fair value less cost to sell is lower than the cost of the property.

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. Judgment is required in addressing the Company's future tax consequences of events that have been recognized in the consolidated financial statements or tax returns such as realization of the effects of temporary differences, net operating loss carry forwards and changes in tax laws or interpretations thereof. A valuation allowance is established when in the judgment of management, it is more likely than not that such deferred tax assets will not become realizable. In this case, the Company would adjust the recorded value of our deferred tax asset, which would result in a direct charge to income tax expense in the period that the determination was made. Likewise, the Company would reverse the valuation allowance when it is expected to realize the deferred tax asset. 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, 2016, 2015, and 2014.

Trust Department

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

Consolidated Statements of Cash Flows

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

Stock-Based Compensation

The Company's stock-based employee compensation plan is described in Note 12, Stock Compensation. In accordance with FASB ASC Topic 718, *Compensation – Stock Compensation*, the Company measures the cost of the stock-based compensation based on the grant-date fair value of the award, recognizing the cost over the requisite service period. The fair value of an award is estimated using the Black-Scholes option-pricing model. The expense recognized is based on an estimation of the number of awards for which the requisite service is expected to be rendered, and is included in salaries and employee benefits in the accompanying Consolidated Statements of Income. The standard also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows.

Treasury Stock

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

Reclassifications

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

The following represents significant new accounting principles adopted in 2016:

Consolidation The FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*, in February 2015. The amendment substantially changes the way reporting entities are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the new amendment. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, eliminate the presumption that a general partner should consolidate a limited partnership, and affect the consolidation analysis of reporting entities that are involved with VIEs. The amendments were effective for interim and annual periods beginning January 1, 2016. The adoption did not have a significant effect on the Company's consolidated financial statements.

Intangible Assets The FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, in April 2015. The amendments provide guidance to customers about whether a cloud computing arrangement includes a software license. Arrangements containing a license should be recorded as consistent with the acquisition of software licenses, whereas arrangements that do not include a software license should be recorded as consistent with the accounting for service contracts. These amendments were effective for interim and annual periods beginning January 1, 2016. The adoption did not have a significant effect on the Company's consolidated financial statements.

(2) Loans and Allowance for Loan Losses

Loans

A summary of loans, by major class within the Company's loan portfolio, at December 31, 2016 and 2015 is as follows:

(in thousands)	2016	2015
Commercial, financial, and agricultural	$ 182,881	$ 149,091
Real estate construction - residential	18,907	16,895
Real estate construction - commercial	55,653	33,943
Real estate mortgage - residential	259,900	256,086
Real estate mortgage - commercial	426,470	385,869
Installment and other consumer	30,218	23,196
Total loans	$ 974,029	$ 865,080

The Bank grants real estate, commercial, installment, and other consumer loans to customers located within the communities surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, Branson 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, 2016, loans with a carrying value of $491.1 million, or $403.6 million fair value, 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, are summarized as follows:

(in thousands)	
Balance at December 31, 2015	$ 3,376
New loans	64
Amounts collected	(167)
Balance at December 31, 2016	$ 3,273

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 is a summary of the allowance for loan losses for the years ended December 31, 2016, 2015, and 2014:

(in thousands)	Commercial, Financial, & Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment Loans to Individuals	Un-allocated	Total
Balance at December 31, 2013	**$ 2,374**	**$ 931**	**$ 631**	**$ 2,959**	**$ 6,523**	**$ 294**	**$ 7**	**$ 13,719**
Additions:								
Provision for loan losses	371	(592)	326	(226)	(107)	195	33	0
Deductions:								
Loans charged off	1,285	349	491	408	2,890	405	0	5,828
Less recoveries on loans	(319)	(181)	0	(202)	(320)	(186)	0	(1,208)
Net loans charged off	966	168	491	206	2,570	219	0	4,620
Balance at December 31, 2014	**$ 1,779**	**$ 171**	**$ 466**	**$ 2,527**	**$ 3,846**	**$ 270**	**$ 40**	**$ 9,099**
Additions:								
Provision for loan losses	833	(434)	193	153	(713)	157	61	250
Deductions:								
Loans charged off	1,131	0	15	379	363	302	0	2,190
Less recoveries on loans	(672)	(322)	0	(138)	(165)	(148)	0	(1,445)
Net loans charged off	459	(322)	15	241	198	154	0	745
Balance at December 31, 2015	**$ 2,153**	**$ 59**	**$ 644**	**$ 2,439**	**$ 2,935**	**$ 273**	**$ 101**	**$ 8,604**
Additions:								
Provision for loan losses	690	49	(732)	381	865	113	59	1,425
Deductions:								
Loans charged off	389	0	1	495	147	258	0	1,290
Less recoveries on loans	(299)	0	(502)	(60)	(140)	(146)	0	(1,147)
Net loans charged off	90	0	(501)	435	7	112	0	143
Balance at December 31, 2016	**$ 2,753**	**$ 108**	**$ 413**	**$ 2,385**	**$ 3,793**	**$ 274**	**$ 160**	**$ 9,886**

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

The following table provides the balance in the allowance for loan losses at December 31, 2016 and 2015, and the related loan balance by impairment methodology.

(in thousands)	Commercial, Financial, and Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment Loans to Individuals	Un-allocated	Total
December 31, 2016								
Allowance for loan losses:								
Individually evaluated for impairment	$ 469	$ 0	$ 7	$ 319	$ 277	$ 8	$ 0	$ 1,080
Collectively evaluated for impairment	2,284	108	406	2,066	3,516	266	160	8,806
Total	**$ 2,753**	**$ 108**	**$ 413**	**$ 2,385**	**$ 3,793**	**$ 274**	**$160**	**$ 9,886**
Loans outstanding:								
Individually evaluated for impairment	$ 1,617	$ 0	$ 49	$ 5,471	$ 1,918	$ 89	$ 0	$ 9,144
Collectively evaluated for impairment	181,264	18,907	55,604	254,429	424,552	30,129	0	964,885
Total	**$182,881**	**$18,907**	**$55,653**	**$259,900**	**$426,470**	**$30,218**	**$ 0**	**$974,029**
December 31, 2015								
Allowance for loan losses:								
Individually evaluated for impairment	$ 285	$ 0	$ 15	$ 955	$ 266	$ 19	$ 0	$ 1,540
Collectively evaluated for impairment	1,868	59	629	1,484	2,669	254	101	7,064
Total	**$ 2,153**	**$ 59**	**$ 644**	**$ 2,439**	**$ 2,935**	**$ 273**	**$101**	**$ 8,604**
Loans outstanding:								
Individually evaluated for impairment	$ 1,005	$ 0	$ 102	$ 5,936	$ 3,081	$ 144	$ 0	$ 10,268
Collectively evaluated for impairment	148,086	16,895	33,841	250,150	382,788	23,052	0	854,812
Total	**$149,091**	**$16,895**	**$33,943**	**$256,086**	**$385,869**	**$23,196**	**$ 0**	**$865,080**

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 $9.1 million and $10.3 million at December 31, 2016 and 2015, 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, 2016 and 2015, $4.5 million and $6.4 million, respectively, of impaired loans were evaluated based on the fair value less estimated selling costs of the loan's collateral. Once the impairment amount is calculated, a specific reserve allocation is recorded. At December 31, 2016, $1.1 million of the Company's allowance for loan losses was allocated to impaired loans totaling $9.1 million compared to $1.5 million of the Company's allowance for loan losses allocated to impaired loans totaling approximately $10.3 million at December 31, 2015. Management determined that $2.1 million, or 23%, of total impaired loans required no reserve allocation at December 31, 2016 compared to $4.5 million, or 44%, at December 31, 2015 primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

The categories of impaired loans at December 31, 2016 and 2015 are as follows:

(in thousands)	2016	2015
Non-accrual loans	$ 3,429	$ 4,418
Performing TDRs	5,715	5,850
Total impaired loans	$ 9,144	$ 10,268

The following tables provide additional information about impaired loans at December 31, 2016 and 2015, 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, 2016			
With no related allowance recorded:			
Commercial, financial and agricultural	$ 564	$ 706	$ 0
Real estate - residential	1,550	1,557	0
Total	$ 2,114	$ 2,263	$ 0
With an allowance recorded:			
Commercial, financial and agricultural	$ 1,053	$ 1,078	$ 469
Real estate - construction commercial	49	56	7
Real estate - residential	3,921	3,990	319
Real estate - commercial	1,918	1,988	277
Consumer	89	116	8
Total	$ 7,030	$ 7,228	$ 1,080
Total impaired loans	$ 9,144	$ 9,491	$ 1,080

(in thousands)	Recorded Investment	Unpaid Principal Balance	Specific Reserves
December 31, 2015			
With no related allowance recorded:			
Commercial, financial and agricultural	$ 448	$ 450	$ 0
Real estate - residential	1,645	1,712	0
Real estate - commercial	2,446	2,572	0
Total	$ 4,539	$ 4,734	$ 0
With an allowance recorded:			
Commercial, financial and agricultural	$ 557	$ 572	$ 285
Real estate - construction commercial	102	115	15
Real estate - residential	4,291	4,320	955
Real estate - commercial	635	884	266
Consumer	144	182	19
Total	$ 5,729	$ 6,073	$ 1,540
Total impaired loans	$ 10,268	$ 10,807	$ 1,540

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, 2016 and 2015:

	2016		2015	
(in thousands)	**Average Recorded Investment**	**Interest Recognized For the Period Ended**	**Average Recorded Investment**	**Interest Recognized For the Period Ended**
With no related allowance recorded:				
Commercial, financial and agricultural	$ 669	$ 13	$ 2,949	$ 39
Real estate - construction residential	0	0	536	0
Real estate - construction commercial	0	0	1,105	0
Real estate - residential	1,713	52	2,331	37
Real estate - commercial	353	0	5,169	119
Consumer	0	0	7	1
Total	$ 2,735	$ 65	$ 12,097	$ 196
With an allowance recorded:				
Commercial, financial and agricultural	$ 899	$ 23	$ 1,356	$ 22
Real estate - construction commercial	51	0	52	0
Real estate - residential	3,553	114	4,625	110
Real estate - commercial	1,842	83	1,161	0
Consumer	109	0	183	0
Total	$ 6,454	$ 220	$ 7,377	$ 132
Total impaired loans	$ 9,189	$ 285	$ 19,474	$ 328

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 $285,000 and $328,000, for the years ended December 31, 2016 and 2015, 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. 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, 2016 and 2015.

(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, 2016					
Commercial, Financial, and Agricultural	$ 181,609	$ 290	$ 0	$ 982	$ 182,881
Real Estate Construction - Residential	18,681	226	0	0	18,907
Real Estate Construction - Commercial	55,603	0	0	50	55,653
Real Estate Mortgage - Residential	254,758	3,200	54	1,888	259,900
Real Estate Mortgage - Commercial	425,260	790	0	420	426,470
Installment and Other Consumer	29,920	198	11	89	30,218
Total	$ 965,831	$ 4,704	$ 65	$ 3,429	$ 974,029
December 31, 2015					
Commercial, Financial, and Agricultural	$ 148,597	$ 185	$ 1	$ 308	$ 149,091
Real Estate Construction - Residential	16,895	0	0	0	16,895
Real Estate Construction - Commercial	33,776	65	0	102	33,943
Real Estate Mortgage - Residential	251,253	2,511	0	2,322	256,086
Real Estate Mortgage - Commercial	383,684	643	0	1,542	385,869
Installment and Other Consumer	22,840	207	5	144	23,196
Total	$ 857,045	$ 3,611	$ 6	$ 4,418	$ 865,080

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 that may result in the deterioration of the repayment exits or the Company's credit position 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 which are accruing interest are classified as performing TDRs. Loans classified as TDRs which are not accruing interest are classified as nonperforming TDRs and are included with all other nonaccrual loans for presentation purposes. It is the Company's policy to discontinue the accrual of interest income on loans when management believes that the collection of interest or principal is doubtful. Loans are placed on *non-accrual* status when (1) deterioration in the financial condition of the borrower exists for which payment of full principal and interest is not expected, or (2) payment of principal or interest has been in default for a period of 90 days or more and the asset is not both well secured and in the process of collection. Subsequent interest payments received on such loans are applied to principal if any doubt exists as to the collectability of such principal; otherwise, such receipts are recorded as interest income on a cash basis.

The following table presents the risk categories by class at December 31, 2016 and 2015.

(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, 2016							
Watch	$ 10,295	$ 665	$ 1,113	$ 16,577	$ 44,611	$ 0	$ 73,261
Substandard	798	640	0	2,159	426	24	4,047
Performing TDRs	635	0	0	3,582	1,498	0	5,715
Non-accrual	982	0	50	1,888	420	89	3,429
Total	$ 12,710	$ 1,305	$ 1,163	$ 24,206	$ 46,955	$ 113	$ 86,452
At December 31, 2015							
Watch	$ 8,663	$ 1,267	$ 1,296	$ 22,191	$ 24,303	$ 186	$ 57,906
Substandard	421	0	37	3,737	1,485	36	5,716
Performing TDRs	697	0	0	3,615	1,538	0	5,850
Non-accrual	308	0	102	2,322	1,542	144	4,418
Total	$ 10,089	$ 1,267	$ 1,435	$ 31,865	$ 28,868	$ 366	$ 73,890

Troubled Debt Restructurings

At December 31, 2016, loans classified as TDRs totaled $6.3 million, of which $619,000 were classified as nonperforming TDRs and included in non-accrual loans and $5.7 million were classified as performing TDRs. At December 31, 2015, TDRs totaled $6.4 million, of which $527,000 were classified as nonperforming TDRs included in non-accrual loans and $5.9 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 $410,000 and $1.0 million related to TDRs were allocated to the allowance for loan losses at December 31, 2016 and 2015, respectively.

The following table summarizes loans that were modified as TDRs during the years ended December 31, 2016 and 2015.

	2016			**2015**		
		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	0	$ 0	$ 0	2	$ 250	$ 229
Real estate mortgage - residential	7	536	536	1	519	374
Real estate mortgage - commercial	0	0	0	4	1,273	1,249
Total	7	$ 536	$ 536	7	$ 2,042	$ 1,852

(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, 2016, seven loans meeting the TDR criteria were modified compared to seven loans during the year ended December 31, 2015.

Upon default of a TDR, which is considered to be 90 days or more past due under the modified terms, impairment is measured based on the fair value of the underlying collateral less applicable selling costs. The impairment amount is either charged off as a reduction to the allowance for loan losses, provided for as a

specific reserve within the allowance for loan losses, or in the process of foreclosure. There were three TDRs that defaulted during the year ended December 31, 2016 within twelve months of its modification date compared to no loans during the year ended December 31, 2015. Two of the loans have been charged off and one is in the process of an insurance settlement.

(3) Real Estate and Other Assets Acquired in Settlement of Loans

(in thousands)	2016	2015
Commercial	$ 809	$ 1,445
Real estate construction - commercial	12,380	12,380
Real estate mortgage - residential	647	477
Real estate mortgage - commercial	3,439	4,923
Repossessed assets	16	0
Total	$ 17,291	$ 19,225
Less valuation allowance for other real estate owned	(3,129)	(3,233)
Total other real estate owned and foreclosed assets	$ 14,162	$ 15,992

Changes in the net carrying amount of other real estate owned and repossessed assets for the years ended December 31, 2014 2015, and 2016, respectively, were as follows:

Balance at December 31, 2014	$ 15,140
Additions	5,804
Proceeds from sales	(1,836)
Charge-offs against the valuation allowance for other real estate owned, net	(39)
Net gain on sales	156
Balance at December 31, 2015	$ 19,225
Additions	2,233
Proceeds from sales	(4,057)
Charge-offs against the valuation allowance for other real estate owned, net	(317)
Net gain on sales	207
Total other real estate owned and repossessed assets	$ 17,291
Less valuation allowance for other real estate owned	(3,129)
Balance at December 31, 2016	$ 14,162

At December 31, 2016, $162,000 of consumer mortgage loans secured by residential real estate properties were in the process of foreclosure compared to $390,000 at December 31, 2015.

Activity in the valuation allowance for other real estate owned in settlement of loans for the years ended December 31, 2016, 2015 and 2014, respectively, is summarized as follows:

(in thousands)	2016	2015	2014
Balance, beginning of year	$ 3,233	$ 3,255	$ 4,675
Provision for other real estate owned	213	17	585
Charge-offs	(317)	(39)	(2,005)
Balance, end of year	$ 3,129	$ 3,233	$ 3,255

(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, 2016 and 2015 are shown below:

(in thousands)	Total Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2016				
U.S. government and federal agency obligations	$ 13,667	$ 0	$ (303)	$ 13,364
Government sponsored enterprises	32,786	2	(329)	32,459
Obligations of states and political subdivisions	42,666	123	(757)	42,032
Mortgage-backed securities:				
Residential - government agencies	127,527	124	(1,995)	125,656
Commercial - government agencies	989	12	0	1,001
Total mortgage-backed securities	128,516	136	(1,995)	126,657
Total available-for-sale securities	$ 217,635	$ 261	$ (3,384)	$ 214,512
December 31, 2015				
Government sponsored enterprises	$ 73,605	$ 127	$ (235)	$ 73,497
Obligations of states and political subdivisions	32,224	493	(11)	32,706
Mortgage-backed securities:				
Residential - government agencies	129,193	432	(1,768)	127,857
Commercial - government agencies	986	8	0	994
Total mortgage-backed securities	130,179	440	(1,768)	128,851
Total available-for-sale securities	$ 236,008	$ 1,060	$ (2,014)	$ 235,054

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

Other Investments and securities primarily consist of Federal Home Loan Bank stock, subordinated debt equity securities, and the Company's interest in statutory trusts. These securities are reported at cost in other assets in the amount of $9.8 million and $8.0 million as of December 31, 2016 and 2015, respectively.

Debt securities with carrying values aggregating approximately $167.6 million and $182.7 million at December 31, 2016 and December 31, 2015, 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 availabe-for-sale at December 31, 2016, 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	$ 4,725	$ 4,726
Due after one year through five years	48,405	47,973
Due after five years through ten years	29,363	28,626
Due after ten years	6,626	6,530
Total	89,119	87,855
Mortgage-backed securities	128,516	126,657
Total available for sale securities	$217,635	$214,512

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, 2016 and December 31, 2015 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, 2016						
U.S. government and federal agency obligations	$ 13,365	$ (303)	$ 0	$ 0	$ 13,365	$ (303)
Government sponsored enterprises	29,432	(329)	0	0	29,432	(329)
Obligations of states and political subdivisions	32,318	(757)	0	0	32,318	(757)
Mortgage-backed securities:						
Residential - government agencies	109,772	(1,848)	3,742	(147)	113,514	(1,995)
Total	**$ 184,887**	**$ (3,237)**	**$ 3,742**	**$ (147)**	**$ 188,629**	**$ (3,384)**

(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At December 31, 2015						
Government sponsored enterprises	$ 43,539	$ (222)	$ 1,002	$ (13)	$ 44,541	$ (235)
Obligations of states and political subdivisions	2,571	(6)	718	(5)	3,289	(11)
Mortgage-backed securities:						
Residential - government agencies	56,095	(620)	43,576	(1,148)	99,671	(1,768)
Total	**$ 102,205**	**$ (848)**	**$45,296**	**$(1,166)**	**$ 147,501**	**$ (2,014)**

The total available for sale portfolio consisted of approximately 298 securities at December 31, 2016. The portfolio included 209 securities having an aggregate fair value of $188.6 million that were in a loss position at December 31, 2016. Securities identified as temporarily impaired which had been in a loss position for 12 months or longer had a fair value of $3.7 million at December 31, 2016. The $3.4 million aggregate unrealized loss included in accumulated other comprehensive income at December 31, 2016 was caused by interest rate fluctuations.

The total available for sale portfolio consisted of approximately 316 securities at December 31, 2015. The portfolio included 111 securities having an aggregate fair value of $147.5 million that were in a loss position at December 31, 2015. Securities identified as temporarily impaired which had been in a loss position for 12 months or longer had a fair value of $45.3 million at December 31, 2015. The $2.0 million aggregate unrealized loss included in accumulated other comprehensive income at December 31, 2015 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, 2016 and 2015, 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)	2016	2015	2014
Gains realized on sales	$ 623	$ 8	$ 86
Losses realized on sales	(21)	0	(66)
Other-than-temporary impairment recognized	0	0	0
Investment securities gains	$ 602	$ 8	$ 20

(5) Premises and Equipment

A summary of premises and equipment at December 31, 2016 and 2015 is as follows:

(in thousands)	2016	2015
Land and land improvements	$ 9,952	$ 10,165
Buildings and improvements	35,657	35,588
Furniture and equipment	13,473	12,906
Construction in progress	271	94
Total	59,353	58,753
Less accumulated depreciation	23,831	22,364
Premises and equipment, net	$ 35,522	$ 36,389

Depreciation expense for the years ended December 31, 2016, 2015, and 2014 was as follows:

(in thousands)	2016	2015	2014
Depreciation expense	$ 1,782	$ 1,810	$ 1,758

(6) Intangible Assets

Mortgage Servicing Rights

At December 31, 2016 and 2015, respectively, the Company serviced mortgage loans for others totaling $294.4 million and $312.1 million, respectively. Mortgage loan servicing fees, reported as non-interest income, earned on loans sold were $854,000, $873,000, and $895,000, for the years ended December 31, 2016, 2015, and 2014, respectively.

The table below presents changes in mortgage servicing rights (MSRs) for the years ended December 31, 2016, 2015, and 2014.

(in thousands)	2016	2015	2014
Balance at beginning of year	$ 2,847	$ 2,762	$ 3,036
Originated mortgage servicing rights	266	386	302
Changes in fair value:			
Due to change in model inputs and assumptions (1)	108	372	66
Other changes in fair value (2)	(637)	(673)	(642)
Balance at end of year	$ 2,584	$ 2,847	$ 2,762

(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.

The following key data and assumptions were used in estimating the fair value of the Company's mortgage servicing rights as of the years ended December 31, 2016 and 2015:

	2016	2015
Weighted-Average Constant Prepayment Rate	10.68%	9.58%
Weighted-Average Note Rate	3.85%	3.92%
Weighted-Average Discount Rate	9.69%	9.16%
Weighted-Average Expected Life (in years)	5.60	5.90

(7) Deposits

The scheduled maturities of total time deposits as of the years ended December 31, 2016 and 2015 were as follows:

(in thousands)	2016	2015
Due within:		
One year	$ 217,970	$ 201,418
Two years	50,330	56,026
Three years	24,807	29,030
Four years	6,363	6,022
Five years	6,490	5,586
Thereafter	0	0
Total	$ 305,960	$ 298,082

At December 31, 2016 and 2015, the Company had certificates and other time deposits in denominations of $100,000 or more with maturities as follows:

(in thousands)	2016	2015
Due within:		
Three months or less	$ 50,270	$ 39,122
Over three months through six months	34,500	30,704
Over six months through twelve months	40,249	30,432
Over twelve months	27,237	31,986
Total	$ 152,256	$ 132,244

Total time deposits of more than $250,000 totaled $72.2 million and $56.4 million at December 31, 2016 and 2015, respectively.

The Federal Reserve Bank required the Bank to maintain cash or balances of $1.6 million at December 31, 2016 and 2015 to satisfy reserve requirements. Average compensating balances held at correspondent banks were $570,000 and $865,000 at December 31, 2016 and 2015, respectively. The Bank maintains such compensating balances with correspondent banks to offset charges for services rendered by those banks.

(8) Borrowings

Federal Funds Purchased and Securities Sold under Agreements to Repurchase (Repurchase Agreements)

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

(in thousands)	Year End Weighted Rate	Average Weighted Rate	Average Balance Outstanding	Maximum Outstanding at any Month End	Balance at December 31,
2016					
Federal funds purchased	0.95%	0.65%	$ 346	$ 992	$ 992
Short-term repurchase agreements	0.20	0.17	36,193	56,710	30,023
Total			$36,539	$57,702	$31,015
2015					
Federal funds purchased	0.70%	0.41%	$ 659	$ 937	$ 0
Short-term repurchase agreements	0.10	0.17	30,266	58,464	56,834
Total			$30,925	$59,401	$56,834

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 $39.0 million on an unsecured basis and $18.0 million on a secured basis at December 31, 2016.

Subordinated Notes and Other Borrowings

Other borrowings of the Company consisted of the following:

(in thousands)			2016		2015	
	Borrower	**Maturity Date**	**Year End Balance**	**Year End Weighted Rate**	**Year End Balance**	**Year End Weighted Rate**
FHLB advances	The Bank	2016	$ 0	na%	$ 8,000	0.67%
		2017	40,900	0.90%	5,000	1.07%
		2018	27,000	1.80%	22,000	1.93%
		2019	10,000	1.50%	4,000	1.79%
		2020	11,000	1.95%	11,000	1.95%
		2021	4,000	1.71%		
Other borrowings		2017	492	1.05%	0	na%
Total Bank			$93,392		$50,000	
Subordinated notes	The Company	2034	$25,774	3.69%	$25,774	3.23%
		2035	23,712	2.82%	23,712	2.36%
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 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. The outstanding balance of $92.9 million includes $10.0 million, which the FHLB may call for early payment within the next year. Based upon the collateral pledged to the FHLB at December 31, 2016, the Bank could borrow up to an additional $221.7 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 (2.82% at December 31, 2016). 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 (3.69% at December 31, 2016). The TPS are fully, irrevocably, and unconditionally guaranteed on a subordinated basis by the Company. The proceeds of the TPS were invested in junior subordinated debentures of the 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, 2016 and 2015 was $49.5 million, respectively. The Company has recorded the investments in the common securities issued by the Exchange Statutory Trusts aggregating $1.5 million, 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.

(9) Income Taxes

The composition of income tax expense for the years ended December 31, 2016, 2015, and 2014 was as follows:

(in thousands)	2016	2015	2014
Current:			
Federal	$ 3,578	$ 3,619	$ 1,105
State	489	496	137
Total current	4,067	4,115	1,242
Deferred:			
Federal	(267)	391	2,353
State	(50)	74	447
Total deferred	(317)	465	2,800
Total income tax expense	$ 3,750	$ 4,580	$ 4,042

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, 2016, 2015, and 2014 are as follows:

(in thousands)	2016		2015		2014	
	Amount	%	Amount	%	Amount	%
Income before provision for income tax expense	$ 11,032		$ 13,179		$ 11,696	
Tax at statutory federal income tax rate	$ 3,751	34.00%	$ 4,481	34.00%	$ 3,977	34.00%
Tax-exempt income	(314)	(2.85)	(369)	(2.80)	(348)	(2.98)
State income tax, net of federal tax benefit	290	2.63	376	2.85	385	3.30
Other, net	23	0.21	92	0.70	28	0.24
Provision for income tax expense	$ 3,750	33.99%	$ 4,580	34.75%	$ 4,042	34.56%

The components of deferred tax assets and deferred tax liabilities at December 31, 2016 and 2015 are as follows:

(in thousands)	2016	2015
Deferred tax assets:		
Allowance for loan losses	$ 3,756	$ 3,269
Impairment of other real estate owned	1,192	1,226
Goodwill	1,088	1,437
Available-for-sale securities	1,187	363
Nonaccrual loan interest	469	640
Core deposit intangible	422	556
Pension	1,415	1,242
Deferred taxes on pension	1,143	874
Deferred compensation	148	138
Other	402	342
Total deferred tax assets	$ 11,222	$ 10,087
Deferred tax liabilities:		
Premises and equipment	$ 765	$ 938
Mortgage servicing rights	968	1,064
Assets held for sale	50	49
Other	6	13
Total deferred tax liabilities	1,789	2,064
Net deferred tax assets	$ 9,433	$ 8,023

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, taxable income available in carryback years, and tax planning strategies in making this assessment. With the exception of certain capital losses generated during 2013 and 2014, it is management's opinion that the Company will more likely than not realize the benefits of these temporary differences as of December 31, 2016 and, therefore, only established a valuation reserve against the Company's capital loss carry forward. Management arrived at this conclusion based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible. As indicated above, the Company generated approximately $219,000 of capital losses during 2013 and 2014 as a result of disposing of certain limited partnership interests. The capital losses will expire between 2018 and 2019, and it is management's opinion that the Company will not more likely than not generate the capital gain income necessary to utilize the capital loss carry forwards before the capital losses expire. As such, the Company has established an $83,000 valuation reserve against its capital loss carry forward deferred tax asset.

The Company follows ASC Topic 740, *Income Taxes,* which addresses the accounting for uncertain tax positions. As of December 31, 2016, 2015, and 2014 the Company did not have any uncertain tax provisions.

(10) Stockholders' Equity

Accumulated Other Comprehensive (Loss) Income

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

(in thousands)	Unrealized Loss on Securities (1)	Unrecognized Net Pension and Postretirement Costs (2)	Accumulated Other Comprehensive (Loss) Income
Balance, December 31, 2014	$ 214	$ (1,442)	$ (1,228)
Other comprehensive (loss) income, before reclassifications	(1,291)	144	(1,147)
Amounts reclassified from accumulated other comprehensive (loss) income	(8)	5	(3)
Current period other comprehensive (loss) income, before tax	(1,299)	149	(1,150)
Deferred tax adjustment	0	(77)	(77)
Income tax benefit (expense)	494	(57)	437
Current period other comprehensive (loss) income, net of tax	(805)	15	(790)
Balance, December 31, 2015	$ (591)	$ (1,427)	$ (2,018)
Other comprehensive (loss) income, before reclassifications	(1,566)	79	(1,487)
Amounts reclassified from accumulated other comprehensive (loss) income	(602)	(786)	(1,388)
Current period other comprehensive loss, before tax	(2,168)	(707)	(2,875)
Income tax benefit	823	269	1,092
Current period other comprehensive loss, net of tax	(1,345)	(438)	(1,783)
Balance, December 31, 2016	$ (1,936)	$ (1,865)	$ (3,801)

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

(2) The pre-tax amounts reclassified from accumulated other comprehensive income are included in the computation of net periodic pension cost. See Note 11.

(11) 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)	2016	2015	2014
Payroll taxes	$ 1,122	$ 1,102	$ 1,081
Medical plans	1,881	1,928	1,974
401(k) match	346	325	310
Pension plan	1,227	1,391	960
Profit-sharing	479	563	201
Other	172	164	122
Total employee benefits	$ 5,227	$ 5,473	$ 4,648

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

Pension

The Company provides a noncontributory defined benefit pension plan for all full-time employees. 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 $772,000 of contributions to the defined benefit plan for the current plan year. There is an $842,000 minimum required contribution for the 2017 plan year, and the Company has determined it will make a $1.2 million contribution by September 2017.

Obligations and Funded Status at December 31,

(in thousands)	2016	2015
Change in projected benefit obligation:		
Balance, January 1	$ 20,601	$ 19,977
Service cost	1,179	1,325
Interest cost	956	838
Actuarial (loss) gain	961	(1,084)
Benefits paid	(464)	(455)
Balance, December 31	$ 23,233	$ 20,601
Change in plan assets:		
Fair value, January 1	$ 15,031	$ 14,933
Actual return on plan assets	1,251	(75)
Employer contribution	772	716
Expenses paid	(88)	(88)
Benefits paid	(464)	(455)
Fair value, December 31	$ 16,502	$ 15,031
Funded status at end of year	$ (6,732)	$ (5,570)
Accumulated benefit obligation	$ 18,586	$ 16,550

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)	2016	2015	2014
Service cost - benefits earned during the year	$ 1,179	$ 1,325	$ 981
Interest costs on projected benefit obligations	956	838	732
Expected return on plan assets	(1,057)	(957)	(872)
Expected administrative expenses	70	40	40
Amortization of prior service cost	79	79	79
Amortization of unrecognized net loss	0	66	0
Net periodic pension expense	$ 1,227	$ 1,391	$ 960

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive loss at December 31, 2016 and 2015 are shown below, including amounts recognized in other comprehensive income during the periods. All amounts are shown on a pre-tax basis.

(in thousands)	2016	2015
Prior service costs	$ (285)	$ (364)
Net accumulated actuarial net loss	(2,723)	(1,937)
Accumulated other comprehensive loss	(3,008)	(2,301)
Net periodic benefit cost in excess of cumulative employer contributions	(3,724)	(3,269)
Net amount recognized at December 31, balance sheet	$ (6,732)	$ (5,570)
Net gain (loss) arising during period	$ (786)	5
Prior service cost amortization	79	79
Amortization of net actuarial loss	0	65
Total recognized in other comprehensive income (loss)	$ (707)	$ 149
Total recognized in net periodic pension cost and other comprehensive income	$ 1,934	$ 1,242

The estimated prior service cost for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic cost in 2016 is $79,000. During 2016, there is no estimated amount of actuarial loss subject to amortization into net periodic pension cost.

Assumptions utilized to determine benefit obligations as of December 31, 2016, 2015 and 2014 and to determine pension expense for the years then ended are as follows:

	2016	2015	2014
Determination of benefit obligation at year end:			
Discount rate	4.40%	4.70%	4.25%
Annual rate of compensation increase	4.00%	3.78%	3.78%
Determination of pension expense for year ended:			
Discount rate for the service cost	4.70%	4.25%	5.00%
Annual rate of compensation increase	3.78%	3.78%	3.73%
Expected long-term rate of return on plan assets	7.00%	7.00%	7.00%

The assumed overall expected long-term rate of return on pension plan assets used in calculating 2016 pension expense was 7.0%. 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: 8.2% in 2016, -.0.4% in 2015, 8.3% in 2014, 19.1% in 2013, and 11.4% in 2012. 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. Due to a decrease in the discount rate and the expected return on asset assumption used in the actuarial calculation of plan income, the Company expects to incur $1.4 million of expense in 2017 compared to $1.2 million 2016.

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's long-term investment target mix for the plan is 70% equity securities, 25% fixed income, and 5% money market funds. 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, 2016 and 2015 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, 2016				
Cash equivalents	$ 1,362	$ 1,362	$ 0	$ 0
U.S gov't agency obligations	2,376	0	2,376	0
Mutual funds	12,764	12,764	0	0
Total	$ 16,502	$ 14,126	$ 2,376	$ 0
December 31, 2015				
Cash equivalents	$ 1,663	$ 1,663	$ 0	$ 0
U.S gov't agency obligations	1,802	0	1,802	0
Mutual funds	11,566	11,566	0	0
Total	$ 15,031	$ 13,229	$ 1,802	$ 0

The following future benefit payments are expected to be paid:

Year	Pension benefits
(in thousands)	
2017	$ 630
2018	677
2019	802
2020	873
2021	1,036
2022 to 2026	5,970

(12) Stock Compensation

The Company's stock option plan provides for the grant of options to purchase up to 553,361 shares of the Company's common stock to officers and other key employees of the Company and its subsidiaries.

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

	Number of shares December 31			Weighted average exercise price December 31			Weighted average Contractual Term (in years)			Aggregate Intrinsic Value ($000)		
	2016	2015	2014	2016	2015	2014	2016	2015	2014	2016	2015	2014
Outstanding, beginning of year	65,270	104,400	136,653	$ 20.68	$ 20.73	$ 21.46						
Granted	0	0	0	0.00	0.00	0.00						
Exercised	0	0	0	0.00	0.00	0.00						
Forfeited or expired	(20,812)	(39,130)	(32,253)	21.89	20.82	23.81						
Outstanding, end of year	44,458	65,270	104,400	$ 20.11	$ 20.68	$ 20.73	0.99	1.41	1.93	$49,828	$0.00	$0.00
Exercisable, end of year	43,189	57,487	92,336	$ 20.25	$ 21.39	$ 21.11	0.97	1.24	1.75	$46,859	$0.00	$0.00

Options have been adjusted to reflect a 4% stock dividend paid on July 1, 2016.

Total stock-based compensation expense for the years ended December 31, 2016, 2015, and 2014 was $17,000, $10,000, and $20,000, respectively. As of December 31, 2016, the total unrecognized compensation expense related to non-vested stock awards was $20,000 and the related weighted average period over which it is expected to be recognized is approximately 0.38 years. No stock options were granted during the years presented above.

(13) Earnings per Share

Stock Dividend On July 1, 2016, the Company paid a special stock dividend of four percent to common shareholders of record at the close of business on June 15, 2016. 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.

	2016	2015	2014
Basic earnings per common share:			
Net income available to shareholders	$ 7,282	$ 8,599	$ 7,654
Basic earnings per share	$ 1.29	$ 1.52	$ 1.35
Diluted earnings per common share:			
Net income available to shareholders	$ 7,282	$ 8,599	$ 7,654
Average shares outstanding	5,639,744	5,662,013	5,662,081
Effect of dilutive stock options	0	0	0
Average shares outstanding including dilutive stock options	5,639,744	5,662,013	5,662,081
Diluted earnings per share	$ 1.29	$ 1.52	$ 1.35

Under the treasury stock method, outstanding stock options are dilutive when the average market price of the Company's common stock, when combined with the effect of any unamortized compensation expense, exceeds the option price during the period, except when the Company has a loss from continuing operations available to common 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.

The following options to purchase shares during the years ended December 31, 2016, 2015 and 2014 were not included in the respective computations of diluted earnings per share because the exercise price of the option, when combined with the effect of the unamortized compensation expense, was greater than the average market price of the common shares and were considered anti-dilutive.

	2016	2015	2014
Anti-dilutive shares - option shares	44,458	65,270	104,400

Repurchase Program On August 6, 2015, the Board of Directors authorized a share repurchase plan to purchase through open market transactions $2.0 million market value of the Company's common stock. The Company repurchased 41,738 and 2,155 shares of common stock pursuant to the plan at an average price of $14.92 and $15.39 per share for the years ended December 31, 2016 and 2015, respectively.

The table below shows activity in the outstanding shares of the Company's common stock during the past three years. Shares in the table below are presented on a historical basis and have not been restated for the annual 4% stock dividends.

	Number of shares December 31		
	2016	**2015**	**2014**
Outstanding, beginning of year	5,441,190	5,233,986	5,032,679
Issuance of stock:			
4% stock dividend	217,155	209,359	201,307
Purchase of treasury stock	(41,738)	(2,155)	0
Outstanding, end of year	5,616,607	5,441,190	5,233,986

Except as noted in the above table, all share and per share amounts in this note have been restated for the 4% common stock dividend distributed in 2016.

(14) Capital Requirements

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

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

In addition, the final rules establish a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement will be phased in over four years beginning in 2016. On January 1, 2016, the first phase of the requirement went into effect at 0.625% of risk-weighted assets, and the requirement will increase 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. Once fully phase in , the capital conservation buffer requirement effectively raises the minimum required risk-based capital ratios to 7% Common Equity Tier 1 Capital, 8.5% Tier 1 Capital and 10.5% Total Capital on a fully phased-in basis.

Under the Basel III requirements, at December 31, 2016 and December 31, 2015, the Company met all capital adequacy requirements and had regulatory capital ratios in excess of the levels established for well-capitalized institutions, as shown in the following table as of periods indicated:

	Actual		Required for Capital Adequacy Purposes		Well-Capitalized Under Prompt Corrective Action Provision	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2016						
Total Capital (to risk-weighted assets):						
Company	$ 152,864	13.72%	$ 89,118	8.00%	$ N.A.	N.A.%
Bank	148,304	13.36	88,804	8.00	111,005	10.00
Tier I Capital (to risk-weighted assets):						
Company	$ 125,779	11.29%	$ 66,839	6.00%	$ N.A.	N.A.%
Bank	138,258	12.46	66,603	6.00	88,804	8.00
Common Equity Tier I Capital (to risk-weighted assets)						
Company	$ 94,818	8.51%	$ 50,129	4.50%	$ N.A.	N.A.%
Bank	138,258	12.46	49,952	4.50	72,153	6.50
Tier I leverage ratio:						
Company	$ 125,779	9.87%	$ 50,998	4.00%	$ N.A.	N.A.%
Bank	138,258	10.88	50,810	4.00	63,513	5.00
(in thousands)						
December 31, 2015						
Total Capital (to risk-weighted assets):						
Company	$ 146,068	14.78%	$ 79,066	8.00%	$ N.A.	N.A.%
Bank	137,572	13.98	78,718	8.00	98,398	10.00
Tier I Capital (to risk-weighted assets):						
Company	$ 118,875	12.03%	$ 59,299	6.00%	$ N.A.	N.A.%
Bank	128,808	13.09	59,039	6.00	78,718	8.00
Common Equity Tier I Capital (to risk-weighted assets)						
Company	$ 89,304	9.04%	$ 44,475	4.50%	$ N.A.	N.A.%
Bank	128,808	13.09	44,279	4.50	63,959	6.50
Tier I leverage ratio:						
Company	$ 118,875	9.84%	$ 48,314	4.00%	$ N.A.	N.A.%
Bank	128,808	10.73	48,025	4.00	60,031	5.00

(15) Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain financial and nonfinancial assets and liabilities. The FASB ASC Topic 820, *Fair Value Measurement,* defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The standard applies whenever other standards require (permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, FASB clarified the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. As of December 31, 2015 and 2014 there were no transfers into or out of Levels 1-3.

The fair value hierarchy is as follows:

Level 1 – Inputs are unadjusted quoted prices for identical assets or liabilities in active markets.

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.

ASC Topic 820 also provides guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased and on identifying circumstances when a transaction may not be considered orderly.

The Company is required to disclose assets and liabilities measured at fair value on a recurring basis separate from those measured at fair value on a nonrecurring basis. 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. Securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs.

Mortgage servicing rights

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

		Fair Value Measurements		
(in thousands)	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
December 31, 2016				
Assets:				
U.S. government and federal agency obligations	$ 13,364	$ 0	13,364	$ 0
Government sponsored enterprises	32,459	0	32,459	0
Obligations of states and political subdivisions	42,032	0	42,032	0
Mortgage-backed securities	126,657	0	126,657	0
Mortgage servicing rights	2,584	0	0	2,584
Total	$ 217,096	$ 0	$214,512	$ 2,584

		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, 2015				
Assets:				
Government sponsored enterprises	$ 73,497	$0	73,497	$ 0
Obligations of states and political subdivisions	32,706	0	32,706	0
Mortgage-backed securities	128,851	0	128,851	0
Mortgage servicing rights	2,847	0	0	2,847
Total	$237,901	$0	$235,054	$2,847

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, 2014	$ 2,762
Total gains or losses (realized/unrealized):	
Included in earnings	(301)
Included in other comprehensive income	0
Purchases	0
Sales	0
Issues	386
Settlements	0
Balance at December 31, 2015	$ 2,847
Total gains or losses (realized/unrealized):	
Included in earnings	(529)
Included in other comprehensive income	0
Purchases	0
Sales	0
Issues	266
Settlements	0
Balance at December 31, 2016	$ 2,584

The change in valuation of mortgage servicing rights arising from inputs and assumptions increased $108,000 and $372,000 for the years ended December 31, 2016 and 2015, respectively.

Quantitative Information about Level 3 Fair Value Measurements

	Valuation Technique	Unobservable Inputs	Input Value	
			2016	**2015**
Mortgage servicing rights	Discounted cash flows	Weighted-Average Constant Prepayment Rate	10.68%	9.58%
		Weighted-Average Note Rate	3.85%	3.92%
		Weighted-Average Discount Rate	9.69%	9.16%
		Weighted-Average Expected Life (in years)	5.60	5.90

Valuation methods for instruments measured at fair value on a nonrecurring basis

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

Impaired Loans

The Company does not record loans at fair value on a recurring basis other than loans that are considered impaired. The net carrying value of impaired loans is generally based on fair values of the underlying collateral obtained through independent appraisals or internal evaluations, or by discounting the total expected future cash flows. Once the fair value of the collateral has been determined and any impairment amount calculated, a specific reserve allocation is made. Because many of these inputs are not observable, the measurements are classified as Level 3. As of December 31, 2016, the Company identified $7.0 million in impaired loans that had specific allowances for losses aggregating $1.1million. Related to these loans, there was $1.0 million in charge-offs recorded during the year ended December 31, 2016. As of December 31, 2015, the Company identified $5.7 million in impaired loans that had specific allowances for losses aggregating $1.5 million. Related to these loans, there was $1.9 million in charge-offs recorded during the year ended December 31, 2015.

Other Real Estate Owned and Repossessed Assets

Other real estate owned and repossessed assets consisted of loan collateral that has been repossessed through foreclosure. This collateral comprises of commercial and residential real estate and other non-real estate property, including autos, manufactured homes, and construction equipment. Other real estate owned assets are recorded as held for sale initially at the lower of the loan balance or fair value of the collateral less estimated selling costs. 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. 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, 2016					
Assets:					
Impaired loans:					
Commercial, financial, & agricultural	$ 584	$ 0	$ 0	$ 584	$ (421)
Real estate construction - residential	0	0	0	0	0
Real estate construction - commercial	42	0	0	42	0
Real estate mortgage - residential	3,602	0	0	3,602	(316)
Real estate mortgage - commercial	1,641	0	0	1,641	(257)
Consumer	81	0	0	81	(35)
Total	$ 5,950	$ 0	$ 0	$ 5,950	$ (1,029)
Other real estate owned and repossessed assets	$ 14,162	$ 0	$ 0	$ 14,162	$ 25
December 31, 2015					
Assets:					
Impaired loans:					
Commercial, financial, & agricultural	$ 272	$ 0	$ 0	$ 272	$ (920)
Real estate construction - residential	0	0	0	0	0
Real estate construction - commercial	87	0	0	87	(10)
Real estate mortgage - residential	3,336	0	0	3,336	(567)
Real estate mortgage - commercial	369	0	0	369	(322)
Consumer	125	0	0	125	(66)
Total	$ 4,189	$ 0	$ 0	$ 4,189	$ (1,885)
Other real estate owned and repossessed assets	$ 15,992	$ 0	$ 0	$ 15,992	$ 118

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

(16) Fair Value of Financial Instruments

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

Loans

The fair values of loans are estimated by discounting the expected future cash flows using the current rates at which similar loans could be made to borrowers with similar credit ratings and for the same remaining maturities. The net carrying amount of impaired loans is generally based on the fair values of collateral obtained through independent appraisals or internal evaluations, or by discounting the total expected future cash flows. This method of estimating fair value does not incorporate the exit-price concept of fair value prescribed by ASC Topic 820.

Investment Securities

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

Federal Home Loan Bank (FHLB) Stock

Ownership of equity securities of FHLB is restricted and there is no established market for their resale. The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold, Cash, and Due from Banks

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

Mortgage Servicing Rights

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

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.

Securities Sold under Agreements to Repurchase and Interest-bearing Demand Notes to U.S. Treasury

For securities sold under agreements to repurchase and interest-bearing demand notes to U.S. Treasury, the carrying amount is a reasonable estimate of fair value, as such instruments reprice in a short time period.

Subordinated Notes and Other Borrowings

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

A summary of the carrying amounts and fair values of the Company's financial instruments at December 31, 2016 and 2015 is as follows:

	December 31, 2016		December 31, 2016 Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Net Significant Unobservable Inputs (Level 3)
(in thousands)	Carrying amount	Fair value			
Assets:					
Cash and due from banks	$ 25,589	$ 25,589	$ 25,589	$ 0	$ 0
Federal funds sold and overnight interest-bearing deposits	1,406	1,406	1,406	0	0
Investment in available-for-sale securities	214,512	214,512	0	214,512	0
Loans, net	964,143	959,929	0	0	959,929
Investment in FHLB stock	5,149	5,149	0	5,149	0
Mortgage servicing rights	2,584	2,584	0	0	2,584
Cash surrender value - life insurance	2,409	2,409	0	2,409	0
Accrued interest receivable	5,183	5,183	5,183	0	0
	$ 1,220,975	$ 1,216,761	$ 32,178	$ 222,070	$ 962,513
Liabilities:					
Deposits:					
Non-interest bearing demand	$ 235,975	$ 235,975	$ 235,975	$ 0	$ 0
Savings, interest checking and money market	468,731	468,731	468,731	0	0
Time deposits	305,960	304,334	0	0	304,334
Federal funds purchased and securities sold under agreements to repurchase	31,015	31,015	31,015	0	0
Subordinated notes	49,486	33,712	0	33,712	0
Other borrowings	93,392	93,209	0	93,209	0
Accrued interest payable	498	498	498	0	0
	$ 1,185,057	$ 1,167,474	$ 736,219	$ 126,921	$ 304,334

	December 31, 2015		December 31, 2015 Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Net Significant Unobservable Inputs (Level 3)
(in thousands)	Carrying amount	Fair value			
Assets:					
Cash and due from banks	$ 20,484	$ 20,484	$ 20,484	$ 0	$ 0
Federal funds sold and overnight interest-bearing deposits	7,893	7,893	7,893	0	0
Investment in available-for-sale securities	235,054	235,054	0	235,054	0
Loans, net	856,476	854,775	0	0	854,775
Investment in FHLB stock	3,390	3,390	0	3,390	0
Mortgage servicing rights	2,847	2,847	0	0	2,847
Cash surrender value - life insurance	2,348	2,348	0	2,348	0
Accrued interest receivable	4,853	4,853	4,853	0	0
	$ 1,133,345	$ 1,131,644	$ 33,230	$240,792	$ 857,622
Liabilities:					
Deposits:					
Non-interest bearing demand	$ 208,035	$ 208,035	$ 208,035	$ 0	$ 0
Savings, interest checking and money market	441,080	441,080	441,080	0	0
Time deposits	298,082	298,323	0	0	298,323
Federal funds purchased and securities sold under agreements to repurchase	56,834	56,834	56,834	0	0
Subordinated notes	49,486	40,821	0	40,821	0
Federal Home Loan Bank advances	50,000	52,340	0	52,340	0
Accrued interest payable	382	382	382	0	0
	$ 1,103,899	$ 1,097,815	$ 706,331	$ 93,161	$ 298,323

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.

(17) Repurchase Reserve Liability

The Company's repurchase reserve liability for estimated losses incurred on sold loans was $160,000 at both December 31, 2016 and 2015. This liability represents management's estimate of the potential repurchase or make-whole liability for residential mortgage loans originated for sale that may arise from representation and warranty claims that could relate to a variety of issues, including but not limited to, misrepresentation of facts, appraisal issues, or program requirements that may not meet investor guidelines. At December 31, 2016, the Company accrued $2,000 for the reimbursement of expenses incurred on one repurchase loss remitted in April 2016 compared to $40,000 accrued for the expenses on one repurchase loss remitted in April 2015 of the prior year. At December 31, 2016, the Company was servicing 2,877 loans sold to the secondary market with a balance of approximately $294.4 million compared to 3,024 loans sold with a balance of approximately $312.1 million at December 31, 2015.

(in thousands)	**2016**	**2015**	**2014**
Balance at beginning of year	$ 160	$ 160	$ 160
Provision for repurchase liability	2	40	0
Reimbursement of expenses	(2)	(40)	0
Balance at end of year	$ 160	$ 160	$ 160

(18) 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, 2016, 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, 2016 and 2015 is as follows:

(in thousands)	**2016**	**2015**
Commitments to extend credit	$253,375	$161,306
Commitments to originate residential first and second mortgage loans	2,626	3,175
Standby letters of credit	2,745	1,466
Total	$258,746	$165,947

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, 2016.

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.

(19) 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)	**2016**	**2015**
Assets		
Cash and due from bank subsidiaries	$ 3,945	$ 4,971
Investment in equity securities	1,486	1,486
Investment in subsidiaries	139,686	134,099
Deferred tax asset	2,558	2,116
Other assets	23	7
Total assets	$ 147,698	$ 142,679
Liabilities and Stockholders' Equity		
Subordinated notes	$ 49,486	$ 49,486
Other liabilities	7,195	5,907
Stockholders' equity	91,017	87,286
Total liabilities and stockholders' equity	$ 147,698	$ 142,679

Condensed Statements of Income

	For the Years Ended December 31,		
	2016	**2015**	**2014**
Income			
Interest and dividends received from subsidiaries	$ 46	$ 1,039	$ 2,538
Total income	46	1,039	2,538
Expenses			
Interest on subordinated notes	1,494	1,293	1,264
Other	2,039	2,138	1,730
Total expenses	3,533	3,431	2,994
Income before income tax benefit and equity in undistributed income of subsidiaries	(3,487)	(2,392)	(456)
Income tax benefit	1,337	1,065	1,100
Equity in undistributed income of subsidiaries	9,432	9,926	7,010
Net income	$ 7,282	$ 8,599	$ 7,654

HAWTHORN BANCSHARES, INC.
AND SUBSIDIARIES

Condensed Statements of Cash Flows

	For the Years Ended December 31,		
(in thousands)	**2016**	**2015**	**2014**
Cash flows from operating activities:			
Net income	$ 7,282	$ 8,599	$ 7,654
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed income of subsidiaries	(9,432)	(9,926)	(7,010)
Stock based compensation expense	17	10	20
Increase in deferred tax asset	(442)	(127)	(1,415)
Other, net	769	732	1,942
Net cash (used) provided by operating activities	$ (1,806)	$ (712)	$ 1,191
Cash flows from investing activities:			
Investment in subsidiary	$ 2,500	$ 5,750	$ 400
Net cash provided by investing activities	$ 2,500	$ 5,750	$ 400
Cash flows from financing activities:			
Cash dividends paid - common stock	$ (1,097)	$ (1,058)	$ (1,017)
Purchase of treasury stock	(623)	(33)	0
Net cash used in financing activities	$ (1,720)	$ (1,091)	$ (1,017)
Net (decrease) increase in cash and due from banks	(1,026)	3,947	574
Cash and due from banks at beginning of year	4,971	1,024	450
Cash and due from banks at end of year	$ 3,945	$ 4,971	$ 1,024

HAWTHORN BANCSHARES, INC.
AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2016, 2015, and 2014

(20) 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, 2016					
Interest income	$ 11,176	$ 11,350	$ 11,607	$ 11,877	$ 46,010
Interest expense	1,328	1,379	1,459	1,497	5,663
Net interest income	9,848	9,971	10,148	10,380	40,347
Provision for loan losses	250	425	300	450	1,425
Noninterest income	2,448	1,949	2,125	2,395	8,917
Noninterest expense	9,083	9,353	9,086	9,285	36,807
Income tax expense	965	730	1,003	1,052	3,750
Net income	$ 1,998	$ 1,412	$ 1,884	$ 1,988	$ 7,282
Net income per share:					
Basic earnings per share	$ 0.35	$ 0.25	$ 0.33	$ 0.35	$ 1.29
Diluted earnings per share	0.35	0.25	0.33	0.35	1.29
Year Ended December 31, 2015					
Interest income	$ 11,198	$ 11,214	$ 11,829	$ 11,515	$ 45,756
Interest expense	1,220	1,230	1,271	1,278	4,999
Net interest income	9,978	9,984	10,558	10,237	40,757
Provision for loan losses	0	250	0	0	250
Noninterest income	1,987	2,461	2,337	2,381	9,166
Noninterest expense	8,708	9,267	8,978	9,541	36,494
Income tax expense	1,119	1,001	1,377	1,083	4,580
Net income	$ 2,138	$ 1,927	$ 2,540	$ 1,994	$ 8,599
Net income per share:					
Basic earnings per share	$ 0.38	$ 0.34	$ 0.45	$ 0.35	$ 1.52
Diluted earnings per share	0.38	0.34	0.45	0.35	1.52

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 2016 and 2015 in which the stock was traded.

	High	Low
2016		
First Quarter	$ 15.19	$ 13.41
Second Quarter	$ 15.35	$ 13.36
Third Quarter	$ 15.70	$ 13.56
Fourth Quarter	$ 17.70	$ 13.85
2015		
First Quarter	$ 13.87	$ 11.56
Second Quarter	$ 16.90	$ 12.42
Third Quarter	$ 14.32	$ 12.61
Fourth Quarter	$ 15.34	$ 12.57

Shares Outstanding

As of December 31, 2016, the Company had issued 5,822,357 shares of common stock, of which 5,616,607 shares were outstanding. The outstanding shares were held of record by approximately 1,500 shareholders.

Dividends

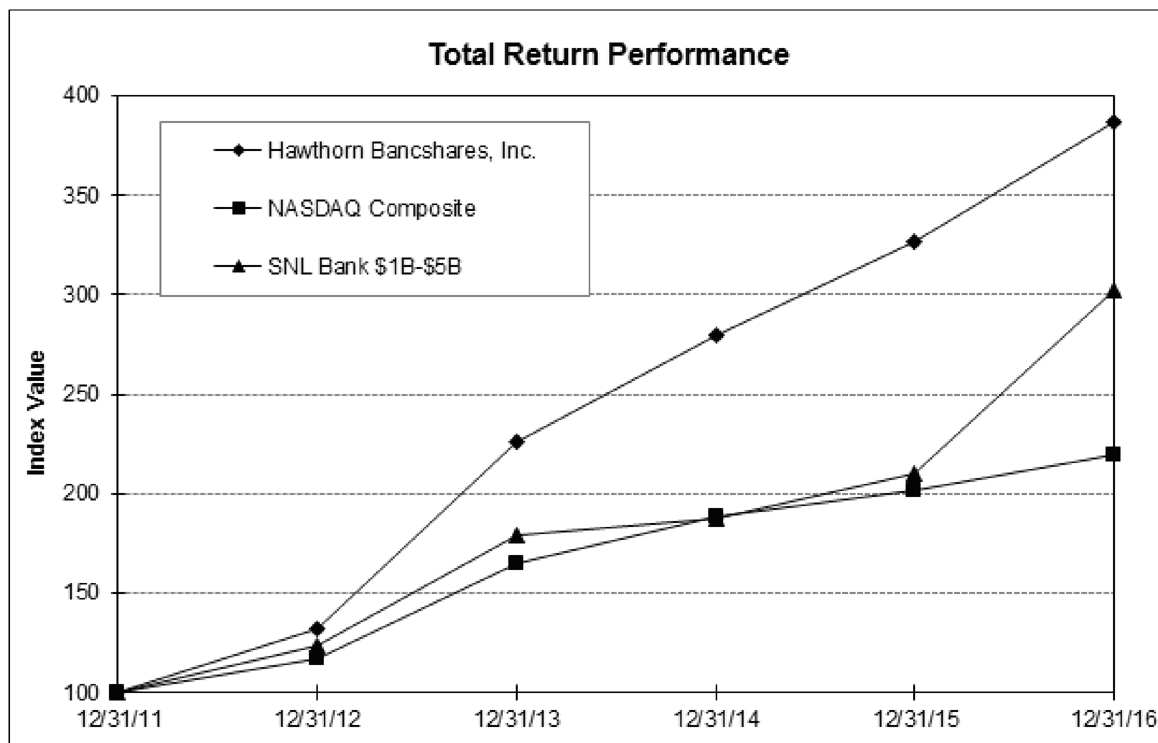
The following table sets forth information on dividends paid by the Company in 2016 and 2015.

Month Paid	Dividends Per Share
January, 2016	$ 0.05
April, 2016	0.05
July, 2016	0.05
October, 2016	0.05
Total for 2016	$ 0.20
January, 2015	$ 0.05
April, 2015	0.05
July, 2015	0.05
October, 2015	0.05
Total for 2015	$ 0.20

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, 2011, through December 31, 2016. 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, 2011. The performance graph assumes that the value of an investment in the Company's common stock and each index was $100 at December 31, 2011 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:

	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Hawthorn Bancshares, Inc.	$ 100.00	$ 132.04	$ 226.06	$ 279.83	$ 326.22	$ 386.58
Nasdaq Composite (U.S. Companies)	$ 100.00	$ 117.45	$ 164.50	$ 188.84	$ 201.98	$ 219.89
Index of financial institutions ($1 billion to $5 billion)	$ 100.00	$ 123.31	$ 179.31	$ 187.48	$ 209.86	$ 301.92

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
Kevin L. Riley	Director-Class III	Director	Co-owner, Riley Chevrolet, Buick, GMC Cadillac, and Riley Toyota Scion, 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
Philip D. Freeman	Director-Class I	Director	Owner, Freeman Properties, JCMO, LLC, Jefferson City, Missouri
W. Bruce Phelps	Chief Financial Officer	Senior Vice President and Chief Financial Officer	Position with Hawthorn Bancshares, Inc. and Hawthorn Bank
Kathleen L. Bruegenhemke	Senior Vice President, Corporate Secretary, and Director	Senior Vice President, Columbia Market President, and Director	Position with Hawthorn Bancshares, Inc. and Hawthorn Bank

ANNUAL REPORT ON FORM 10-K

A copy of the Company's Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the Securities and Exchange Commission, excluding exhibits, will be furnished without charge to shareholders entitled to vote at the 2016 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.