ADAPTEC INC
Form S-3/A
December 07, 2004

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As filed with the Securities and Exchange Commission on December 7, 2004

Registration No. 333-119266

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

AMENDMENT NO. 2
TO
FORM S-3

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

ADAPTEC, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**94-2748530**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

Adaptec, Inc.
691 S. Milpitas Blvd.
Milpitas, California 95035
(408) 945-8600
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

Robert N. Stephens
President and Chief Executive Officer
691 S. Milpitas Blvd.
Milpitas, California 95035
(408) 945-8600
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:
Daniel J. Winnike, Esq.
Scott J. Leichtner, Esq.
Melanie P. Grace, Esq.
Fenwick & West LLP
801 California Street
Mountain View, California 94041

Approximate date of commencement of proposed sale to the public:
From time to time after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. ý

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amounts to be Registered	Proposed Maximum Offering Price per Unit(1)	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee
Common stock, $0.001 par value(2)	500,000	$7.65	$3,825,000	$485(3)

(1) Estimated solely for the purpose of calculating the registration fee in accordance with Rule 457(c) under the Securities Act of 1933 and based upon the average of the high and low sales prices for such stock as reported by The Nasdaq National Market on September 22, 2004.

(2) This Registration Statement also covers rights to purchase shares of the Registrant's Series A Preferred Stock (the "Rights") that are attached to all shares of the Registrant's common stock. Until the occurrence of certain prescribed events, the Rights are not exercisable, are evidenced by the certificates for common stock and will be transferable along with and only with the common stock. The value attributable to the Rights, if any, is reflected in the value of the common stock.

(3) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. The selling stockholder may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion, Dated December 7, 2004

PROSPECTUS

500,000 SHARES

COMMON STOCK

This prospectus relates to the resale by International Business Machines Corporation of up to an aggregate of 500,000 shares of common stock of Adaptec, Inc. that are issuable upon the exercise of two warrants. We issued these warrants on June 29, 2004 and August 10, 2004 in connection with strategic transactions that we entered into with the selling stockholder. We will not receive any proceeds from the sale of shares offered by the selling stockholder. See "Selling Stockholder" and "Plan of Distribution."

Our common stock is listed on the Nasdaq National Market under the symbol "ADPT." The shares of common stock to be offered under this prospectus will be sold as described under "Plan of Distribution." On December 6, 2004, the closing sale price of our common stock was $7.90 per share.

Investing in our common stock involves a high degree of risk. Please carefully consider the "Risk Factors" beginning on page 2 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is , 2004.

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In connection with this offering, no person is authorized to give any information or to make any representations not contained or incorporated by reference in this prospectus. If information is given or representations are made, you may not rely on that information or representations as having been authorized by us. This prospectus is neither an offer to sell nor a solicitation of an offer to buy any securities other than those registered by this prospectus, nor is it an offer to sell or a solicitation of an offer to buy securities where an offer or solicitation would be unlawful. You may not imply from the delivery of this prospectus, nor from any sale made under this prospectus, that our affairs are unchanged since the date of this prospectus or that the information contained in this prospectus is correct as of any time after the date of this prospectus. The information in this prospectus speaks only as of the date of this prospectus unless the information specifically indicates that another date applies.

SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should carefully read the entire prospectus, including "Risk Factors" beginning on page 2, before investing in our common stock. When we use the terms "Adaptec," "we," "us," or "our," we are referring to Adaptec, Inc. and its subsidiaries, unless the context requires otherwise or we expressly state otherwise in this prospectus.

Adaptec, Inc.

We design, manufacture and market an end-to-end set of direct-attached and networked storage solutions that help organizations reliably move, manage and protect critical data and digital content. Our software and hardware solutions range from ASIC and RAID components to complete external storage arrays, and span SCSI, Serial Attached SCSI, Serial ATA, fibre channel and iSCSI technologies. We are focused on delivering cost-effective storage that is easy to manage for organizations of all sizes. Our products are sold through OEMs and distribution channel customers to enterprises, Internet service providers, small and midsize businesses, government agencies, VARs and retail consumers across geographically diverse markets.

We were incorporated in California in 1981 and reincorporated in Delaware in 1988. Our principal executive offices are located at 691 South Milpitas Blvd., Milpitas, California 95035. Our telephone number is (408) 945-8600.

The Offering

This prospectus relates to the sale of up to 500,000 shares of our common stock that are issuable upon the exercise of two outstanding warrants that we issued on June 29, 2004 and August 10, 2004 to International Business Machines Corporation, or IBM. We issued a warrant on June 29, 2004 in connection with the license and acquisition of IBM's i/p Series RAID component business to expand and enhance our RAID product offerings. We issued an additional warrant on August 10, 2004 in connection with a supply agreement that we entered into with IBM with respect to our external storage products. The prices at which IBM may sell the shares underlying the warrants will be determined by the prevailing market for the shares or in negotiated transactions. See "Selling Stockholder."

IBM will receive all of the proceeds from the sale of the common stock pursuant to this prospectus. We will not receive any of the proceeds from sales by IBM of the offered shares of common stock. We may receive proceeds from the exercise of the outstanding warrants by IBM, and any proceeds we receive from the exercise of these warrants will be used for our general corporate purposes.

RISK FACTORS

Before you invest in any of our securities, you should be aware of various risks to which we may be subject, including those described below. The following lists the material risks and uncertainties, which may adversely affect our business, financial condition or results of operations. You should carefully consider these risks and uncertainties, together with all of the other information included or incorporated by reference in this prospectus, before you decide whether to purchase our securities. The risks and uncertainties set out below are not the only risks and uncertainties we face. If any of the material risks or uncertainties we face were to occur, the trading price of our securities could decline, and you may lose part or all of your investment.

Our operating results have fluctuated in the past, and are likely to continue to fluctuate, and if our future results are below the expectations of investors or securities analysts, the market price of our common stock would likely decline significantly.

Our quarterly operating results have fluctuated in the past, and are likely to vary significantly in the future, based on a number of factors related to our industry and the markets for our products. Factors that are likely to cause our operating results to fluctuate include those discussed in the risk factors below. In addition, in the first half of fiscal 2005, our operating results were materially affected by unusual charges, including the write-off of acquired in-process technology from the acquisition of the i/p Series RAID business from IBM and Snap Appliance.

Our operating expenses are largely based on anticipated revenues, and a large portion of our expenses, including those related to rent and salaries, are fixed in the short term. As a result, lower than anticipated revenues for any reason could cause significant variations in our operating results from quarter to quarter.

Due to the factors summarized above, and the other risks described in this section, we believe that you should not rely on period-to-period comparisons of our financial results as an indication of our future performance. In the event that our operating results fall below the expectations of market analysts or investors, the market price of our common stock could decline substantially.

Our operating results may be adversely affected by the uncertain geopolitical environment and unfavorable economic and market conditions.

Adverse economic conditions in some markets have contributed to the slowdown in the information technology industry and may continue to impact our business, resulting in:

- Reduced demand for our products as a result of a decrease in capital spending by our customers;
- Increased price competition for our products;
- Increased risk of excess and obsolete inventories;
- Excess facilities and manufacturing capacity; and
- Higher overhead costs as a percentage of revenues.

Political turmoil in many parts of the world, including terrorist and military actions, may continue to put pressure on global economic conditions. If the conditions do not improve in affected markets, or if conditions deteriorate further, our business, operating results and financial condition may be adversely affected. We do not expect the trend of lower capital spending among our customers to reverse itself in the near term.

Demand for our products would likely be negatively affected if demand in the server and network storage markets declines. Our business or operating results would be adversely affected by a decline in demand for our products. For example, demand in the server market declined slightly in fiscal 2002 and fiscal 2003, which contributed to a decline in our net revenues. It is difficult to predict future server sales growth, if any. In addition, other technologies may replace the technologies used in our existing products and the acceptance of our products using new technologies in the market may not be widespread, which could adversely affect our revenues.

Because our sales are made by means of standard purchase orders rather than long-term contracts, if demand for our customers' products declines or if our customers do not control their inventories effectively, they may cancel or reschedule shipments previously ordered from us or reduce their levels of purchases from us.

The volume and timing of orders received during a quarter are difficult to forecast. Our customers generally order based on their forecasts and they frequently encounter uncertain and changing demand for their products. If demand falls below such forecasts or if our customers do not control their inventories effectively, they may cancel or reschedule shipments previously ordered from us. Our customers have from time to time in the past canceled or rescheduled shipments previously ordered from us, and we cannot assure you that they will not do so in the future. In addition, because our sales are made by means of standard purchase orders rather than long-term contracts, we cannot assure you that these customers will continue to purchase quantities of our products at current levels, or at all. Historically, we have set our operating budget based on forecasts of future revenues because we do not have significant backlog. Because much of our operating budget is relatively fixed in the short-term, if revenues do not meet our expectations, then our financial results will be adversely affected.

We expect that the products we are developing for the network storage marketplace will be an important component of our future growth, and these products may not be accepted by the market or reach the market in a timely fashion.

We believe that developing products for the network storage marketplace will be an important component of our future growth, and we have attempted to accelerate such product development efforts through acquisitions. For example, in July 2004, we acquired Snap Appliance, Inc., a provider of network-attached storage solutions, in February 2004, we acquired Elipsan, a network storage software provider, and in April 2003, we acquired Eurologic, a provider of external and networked storage solutions. The marketplace for advanced storage products is highly competitive. While we are focusing on solutions employing iSCSI technology for this market, other companies are also focusing on network storage solutions based on identified technologies that include, but are not limited to, iSCSI. As a result, our technology may never be broadly adopted. Even if iSCSI technology achieves broad market acceptance, our early technological advantage in this field may not afford us the advantages we had anticipated if such acceptance continues to be delayed. In addition, there are substantial risks that known and unknown challenges to successful deployment of our products, and of products incorporating our products, will cause delays in their reaching the market. If iSCSI technology and our network storage products, and our customers' products using our technology, do not achieve a broad level of market acceptance, or if we encounter substantial delays in entering the market, our growth will likely be impaired.

If we do not provide adequate support during our customers' design and development stage, or if we are unable to provide such support in a timely manner, we may lose revenues to our competition.

Certain of our products are designed to meet our customers' specifications and, to the extent we are not able to meet these expectations in a timely manner or provide adequate support during our customers' design and development stage, our customers may choose to buy similar products from another company. If this were to occur we may lose revenues and market share to our competitors.

Our reliance on industry standards and technological changes in the marketplace may cause our net revenues to fluctuate or decline.

The computer industry is characterized by various, evolving standards and protocols. We design our products to conform to certain industry standards and protocols such as the following:

Technologies:

- ATA
- Serial ATA
- Fibre channel
- FireWire/1394
- IPsec
- iSCSI
- PCI
- PCI-X
- PCI-Express
- RAID
- SCSI
- Serial Attached SCSI
- SMI-S
- Ultra DMA
- USB

Operating Systems:

- Linux
- Macintosh

Netware

OS/2

UNIX

Windows

If consumer acceptance of these standards declines, or if new standards emerge, and if we do not anticipate these changes and develop new products, these changes could adversely affect our business and financial results.

If we lose the cooperation of other hardware and software producers whose products are integral to ours, our ability to sustain or grow our revenues could be adversely affected.

We must design our products to operate effectively with a variety of hardware and software products supplied by other manufacturers, including the following:

Microprocessors;

- Peripherals; and
- Operating system software.

We depend on significant cooperation from these manufacturers to achieve our design objectives and develop products that operate successfully with their products. These companies could, from time to time, elect to make it more difficult for us to design our products for successful operability with their products. For example, if one or more of these companies were to determine that as a result of competition or other factors our technology or products would not be broadly accepted by the markets we target, these companies may no longer work with us to plan for new products and new generations of our products, which would make it more difficult to introduce products on a timely basis or at all. Further, some of these companies might decide not to continue to offer products that are compatible with our technology and our markets could contract. If any of these events were to occur, our revenue could be adversely affected.

Our dependence on new products may cause our net revenues to fluctuate or decline.

Our future success significantly depends upon our completing and introducing enhanced and new products at competitive prices and performance levels in a timely manner. The success of new product introductions depends on several factors, including the following:

- Designing products to meet customer needs;
- Product costs;
- Timely completion and introduction of new product designs;
- Quality of new products;
- Differentiation of new products from those of our competitors; and
- Market acceptance of our products.

Our product life cycles in each of our segments may be as brief as 12 months. As a result, we believe that we will continue to incur significant expenditures for research and development in the future. We may fail to identify new product opportunities and may not develop and bring new products to market in a timely manner. In addition, products or technologies developed by others may render our products or technologies obsolete or noncompetitive, or our targeted customers may not select our products for design or integration into their products. The failure of any of our new product development efforts could have an adverse effect on our business and financial results.

We have introduced RAID-enabled products based on the next generation Serial ATA technology and delivered our products based on Serial Attached SCSI technology to certain major OEMs for testing and integration. We will not succeed in generating significant revenues from our new Serial ATA and Serial Attached SCSI technology products if the market does not adapt to these new technologies, which would, over time, adversely affect our net revenues and operating results.

If we are unable to compete effectively, our net revenues could be adversely affected.

The markets for all of our products are intensely competitive and are characterized by the following:

- Rapid technological advances;
- Frequent new product introductions;

Evolving industry standards; and

Price erosion.

Consequently, we must continue to enhance our products on a timely basis to keep pace with market demands. If we do not do so, or if our competition is more effective in developing products that meet the needs of our existing and potential customers, we may lose market share and not participate in the future growth of our target markets. For example, intense competition in the transition from products employing Ultra 160 technology to solutions employing Ultra 320 technology has adversely affected revenues from our SCSI products. Our future success will depend on the level of acceptance of our external storage products and products based on the next generation Serial ATA and Serial Attached SCSI technologies by new and existing customers. In addition, we expect that our future success will depend significantly on our ability to participate in the ongoing development of the network storage market in which we face intense competition from other companies that are also focusing on networked storage solutions.

We cannot assure you that we will have sufficient resources to accomplish all of the following:

- Satisfy any growth in demand for our products;
- Make timely introductions of new products;
- Compete successfully in the future against existing or potential competitors;
- Provide OEMs with design specifications in a timely manner; and
- Prevent price competition from eroding margins.

Costs associated with acquisitions or strategic alliances may adversely affect our results of operations, which could be exacerbated if we are unable to integrate the acquired companies, products or technologies.

In the first quarter of fiscal 2005, we acquired the i/p Series RAID business from IBM, and in the second quarter of fiscal 2005, we acquired Snap Appliance, a provider of NAS solutions. In fiscal 2004, we acquired Elipsan, a network storage software provider, ICP vortex, a provider of a broad range of hardware and software RAID data protection solutions, and Eurologic, a provider of external and networked storage solutions. In addition, we enter into strategic alliances from time to time with other companies. For example, we entered into a technology licensing agreement with IBM in fiscal 2002. As part of our overall strategy, we may continue to acquire or invest in complementary companies, products or technologies and enter into strategic alliances with other companies. In order to be successful in these activities, we must:

- Conduct acquisitions that are timely, relative to existing business opportunities;
- Successfully prevail over competing bidders for target acquisitions at an acceptable price;
- Invest in companies and technologies that contribute to the growth of our business;
- Incorporate acquired operations into our business and maintain uniform standards, controls and procedures;
- Retain the key employees of the acquired operation; and
- Develop the capabilities necessary to exploit newly acquired technologies.

The benefits of acquisitions or strategic alliances may prove to be less than anticipated and may not outweigh the costs reported in our financial statements. Completing any potential future acquisitions or strategic alliances could cause significant diversions of management time and resources. If we acquire new businesses, products or technologies in the future, we may be required to assume warranty claims or other contingent liabilities, including liabilities unknown at the time of acquisition, and amortize significant amounts of other intangible assets and, over time, recognize significant charges for impairment of goodwill, other intangible assets or other losses. If we consummate any potential

future acquisitions in which the consideration consists of stock or other securities, our existing stockholders' ownership may be significantly diluted. If we proceed with any potential future acquisitions in which the consideration is cash, we may be required to use a substantial portion of our available cash. In addition, we may be required to invest significant resources in order to perform under a strategic alliance or to complete an acquisition, which could adversely affect our results of operations, at least in the short-term, even if we believe the strategic alliance or acquisition will benefit us in the long-term. We may not be successful in overcoming these risks or any other problems encountered in connection with these or other business combinations, investments or strategic alliances. These transactions may adversely affect our business, financial position and operating results.

Product quality problems could lead to reduced revenues and gross margins.

We produce highly complex products that incorporate leading-edge technology, including both hardware and software. Software often contains "bugs" which can interfere with expected operations. We cannot assure you that our pre-shipment testing programs will be adequate to detect all defects which might interfere with customer satisfaction, reduce sales opportunities, or affect our gross margins if the cost of remedying the problems exceed reserves established for that purpose. An inability to cure a product defect could result in the failure of a product line, and withdrawal, at least temporarily, from a product or market segment, damage to our reputation, inventory costs, product reengineering expenses, and a material impact on revenues and margins.

If there is a shortage of components used in our customers' products, our sales may decline, which could adversely affect our results of operations and financial position.

If our customers are unable to purchase certain components which are embedded into their products, their demand for our products may decline. For example, beginning in the fourth quarter of fiscal 2000, we experienced the impact of other companies' chip supply shortages, which reduced the demand for certain of our products. This negatively affected our revenues in the first half of fiscal 2001. Similar shortages of components used in our customers' products could adversely affect our net revenues and financial results in future periods.

The manufacture and introduction of our products is highly complex.

We confront challenges in the manufacturing process that require us to:

- Maintain a competitive manufacturing cost structure;
- Implement the latest process technologies required to manufacture new products;
- Exercise stringent quality control measures to ensure high yields;
- Effectively manage inventory levels;
- Effectively manage the subcontractors engaged in the wafer fabrication, test and assembly of products; and
- Update equipment and facilities as required for leading edge production capabilities.

We cannot assure you that problems with our manufacturing process may not occur in the future. If any such problems with our manufacturing process were to occur, we might not be able to meet the demands of our customers, which could harm our reputation, result in the loss of customers and adversely affect our net revenues and financial results in future periods.

We currently purchase all of the finished production silicon wafers used in our products from wafer suppliers, and if they fail to meet our manufacturing needs, it would delay our production and our product shipments to customers and negatively affect our operations.

Independent foundries manufacture to our specifications all of the finished silicon wafers used for our products. We currently purchase finished production silicon wafers used in our products through our agreements with Taiwan Semiconductor Manufacturing Company, or TSMC, and IBM. The manufacture of semiconductor devices is sensitive to a wide variety of factors, including the following:

- The availability of raw materials;
- The availability of manufacturing capacity;
- Transition to smaller geometries of semiconductor devices;
- The level of contaminants in the manufacturing environment;
- Impurities in the materials used; and
- The performance of personnel and equipment.

We cannot assure you that manufacturing problems may not occur in the future. A shortage of raw materials or production capacity could lead our wafer suppliers to allocate available capacity to other customers. Any prolonged inability to obtain wafers with competitive performance and cost attributes, adequate yields or timely deliveries would delay our production and our product shipments, and could have an adverse effect on our business and financial results. We expect that our wafer suppliers will continually seek to convert their processes for manufacturing wafers to more advanced process technologies. Such conversions entail inherent technological risks that can affect yields and delivery times. If for any reason the wafer suppliers we use are unable or unwilling to satisfy our wafer needs, we will be required to identify and qualify additional suppliers. Additional wafer suppliers may be unavailable, may take significant amounts of time to qualify or may be unable to satisfy our requirements on a timely basis.

If our manufacturing demand for silicon wafers falls below our projections, we may not be able to fully utilize our prepayments to TSMC, which could adversely affect our results of operations and financial position.

From time to time, we have entered into "take or pay" contracts that have committed us to purchase specific wafer quantities over extended periods based on our projected needs. In addition, we have made advance payments to TSMC in order to secure guaranteed wafer capacity. If our demand for wafer units falls below our projections, we may not be able to fully utilize our advance payments. The unused portion of the advance payments may be impaired and written off as an asset impairment charge, which would adversely affect our financial results.

We depend on subcontractors, and if they fail to meet our manufacturing needs, it could delay shipments of our products and result in the loss of customers.

We rely on subcontractors for the assembly and packaging of the integrated circuits included in our products and for the assembly and manufacturing of a portion of our systems products. We have no long-term agreements with our assembly and packaging subcontractors. We have, from time to time, used board subcontractors to better balance production runs and capacity. For example, we employ Quanta Computer, Inc. and Sanmina-SCI Corporation to manufacture certain Snap Appliance related products. We also employ Celestica, Inc. and Jabil Circuit, Inc. to manufacture products related to the IBM i/p Series RAID business. We cannot assure you these subcontractors will continue to be able and willing to meet our requirements for these components or services. Any significant disruption in supplies from, or degradation in the quality of components or services supplied by, these subcontractors could delay shipments and result in the loss of customers or revenues, which could have an adverse effect on our financial results.

We depend on the efforts of our distributors, which if reduced, could result in a loss of sales of our products in favor of competitive offerings.

We derived approximately 40% of our gross revenues for the first half of fiscal 2005 from independent distributor and reseller channels. Our financial results could be adversely affected if our relationships with these distributors or resellers were to deteriorate or if the financial condition of these distributors or resellers were to decline. Given the current economic environment, the risk of distributors and resellers going out of business has increased significantly.

Our distributors generally offer a diverse array of products from several different manufacturers. Accordingly, we are at risk that these distributors may give higher priority to selling products from other suppliers. A reduction in sales efforts by our current distributors could adversely affect our business and financial results. Our distributors build inventories in anticipation of future sales, and if such sales do not occur as rapidly as they anticipate, our distributors will decrease the size of their product orders. If we decrease our price protection or distributor-incentive programs, our distributors may also decrease their orders from us. In addition, we have from time to time taken actions to reduce levels of products at distributors and may do so in the future. These actions may affect our net revenues and negatively affect our financial results.

We depend on a few key customers and the loss of any of them could significantly reduce our revenues.

Historically, a small number of our customers has accounted for a significant portion of our revenues. During the first half of fiscal 2005, sales to the ten customers from which we received the greatest revenues accounted for approximately 72% of our total gross revenues. In addition, IBM represented 20% of our total net revenues in the first half of fiscal 2005, and Dell represented 12% of our total net revenues in the first half of fiscal 2005. We expect IBM to represent an even larger percentage of our total net revenues in future periods as a result of our acquisition of the IBM i/p Series RAID business and our recently announced supply agreement with IBM. We believe that our major customers continually evaluate whether or not to purchase products from alternate or additional sources. Additionally, customers' economic and market conditions frequently change. Accordingly, we cannot assure you that a major customer will not reduce, delay or eliminate its purchases from us, which would likely cause our revenues to decline. In addition, we do not carry credit insurance on our accounts receivables and any difficulty in collecting outstanding amounts due from our customers, particularly customers that place larger orders or experience financial difficulties, could adversely affect our revenues and our net income. Because our sales are made by means of standard purchase orders rather than long-term contracts, we cannot assure you that these customers will continue to purchase quantities of our products at current levels, or at all.

We reorganized our business segments to be focused on customers and have planned significant system enhancements and improvements and these changes could adversely impact our business if not adequately managed and controlled.

In the second quarter of fiscal 2005 and in response to the Snap Appliance acquisition in July 2004, we refined our internal organizational structure to operate in three segments: OEM, Channel and DSG. Whereas historically our former SSG and SNG segments each offered distinct products across our entire customer base, the new OEM and Channel segments will offer an integrated set of products to customers that are specific to the segment. The reorganization has placed demands on our management, operational and financial infrastructure. In addition, management is in the process of enhancing certain systems and processes, such as in the supply chain area. These system enhancements and improvements require expenditures and allocation of management resources. If these improvements are not implemented successfully, our ability to manage our new organization could be impaired. In addition, we may be required to incur additional expenditures to address these issues, which could harm our financial position.

If we do not meet our restructuring objectives, we may have to implement additional plans in order to reduce our operating costs and may, as a result, incur additional material restructuring charges.

We have implemented several restructuring plans to reduce our operating costs, including in the first and second quarters of fiscal 2005, fiscal 2004 and fiscal 2003, and recorded related restructuring charges of $2.7 million, $4.3 million and $14.3 million in the first half of fiscal 2005, fiscal 2004 and fiscal 2003, respectively. The plans included primarily the reduction of our workforce and the consolidation of our manufacturing operations in Singapore. The goals of these plans were to support future growth opportunities, focus on investments that grow revenues and increase operating margins. If we do not meet our restructuring objectives, we may have to implement additional restructuring plans to reduce our operating costs, which could cause us to incur material restructuring charges. Further, these restructuring plans may not achieve the goals we had in implementing them due to such factors as significant costs or restrictions that may be imposed in some international locales on workforce reductions and a potential adverse effect on employee morale that could harm our efficiency and our ability to act quickly and effectively in the rapidly changing technology markets in which we sell our products.

Our operations depend on key personnel, the loss of whom could affect the growth and success of our business.

In order to be successful, we must retain and motivate our executives, the general managers of our business segments, our principal engineers and other key employees, including those in managerial, technical, marketing and information technology support positions. In particular, our product generation efforts depend on hiring and retaining qualified engineers. Competition for experienced management, technical, marketing and support personnel remains intense. For example, we transitioned certain research and development efforts to India, where we have experienced significant competition in our efforts to attract and retain qualified engineers. In addition, with the exception of a few employees with whom we entered into employment agreements in connection with acquisition transactions, we do not have employment contracts with our key employees, including any of our executive officers. The loss of any of these key employees could have a significant impact on our operations. We also must continue to motivate employees and keep them focused on our strategies and goals, which may be particularly difficult due to morale challenges posed by workforce reductions and general uncertainty.

Our international operations involve risks, and may be subject to political or other non-economic barriers to our being able to sell our products in certain countries, local economic conditions that reduce demand for our products among our target market, and potential disruption in the supply of necessary components.

Many of our subcontractors are primarily located in Asia and we have sales offices and customers located throughout Europe, Japan and other countries. Our international operations and sales are subject to political and economic risks, including political instability, currency controls, changes in import/export regulations, tariffs and freight rates. In addition, because our primary wafer supplier, TSMC, is located in Taiwan, we may be subject to certain risks resulting from political instability in Taiwan, including conflicts between Taiwan and the People's Republic of China. These and other international risks could result in the creation of political or other non-economic barriers to our being able to sell our products in certain countries, create local economic conditions that reduce demand for our products among our target market or expose us to potential disruption in the supply of necessary components or otherwise adversely affect our ability to generate revenue and operate effectively.

We depend on third parties to transport our products.

We rely on independent freight forwarders to move our products between manufacturing plants and our customers. Any transport or delivery problems because of their errors, or because of unforeseen interruptions in their activities due to factors such as strikes, political instability, terrorism, natural disasters and accidents, could adversely affect our business, financial condition and results of operations and ultimately impact our relationship with our customers.

If the carrying value of our long-lived assets is not recoverable, an impairment loss must be recognized which would adversely affect our financial results.

Certain events or changes in circumstances would require us to assess the recoverability of the carrying amount of our long-lived assets. In fiscal 2004, we recorded an impairment charge of $5.0 million related to certain properties classified as held-for sale and a charge of $1.0 million relating to the decline in value of a minority investment. In fiscal 2003, we recorded an impairment charge of $1.5 million relating to the decline in value of minority investments. In fiscal 2002, we recorded impairment charges of $77.6 million relating to technology acquired in a prior acquisition and the decline in value of minority investments. We will continue to evaluate the recoverability of the carrying amount of our long-lived assets, and we may incur substantial impairment charges which could adversely affect our financial results.

If actual results or events differ materially from those contemplated by us in making estimates and assumptions, our reported financial condition and results of operations for future periods could be materially affected.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Note 1 of the Notes to Consolidated Financial Statements in our Current Report on Form 8-K filed on September 24, 2004 describes the significant accounting policies essential to preparing our consolidated financial statements. The preparation of these financial statements requires estimates and assumptions that affect the reported amounts and disclosures. Although we believe that our judgments and estimates are appropriate and correct, actual future results may differ materially from our estimates.

If we are unable to protect and enforce our intellectual property rights, we may be unable to compete effectively.

Although we actively maintain and defend our intellectual property rights, we may be unable to adequately protect our proprietary rights. In addition, the laws of certain territories in which our products are or may be developed, manufactured or sold, including Asia and Europe, may not protect our products and intellectual property rights to the same extent as the laws of the United States. Because we conduct a substantial portion of our operations in Singapore and other locations outside of the United States and sell to a worldwide customer base, we are more dependent on our ability to protect our intellectual property in international environments than would be the case if a larger portion of our operations were domestic.

Despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property, which could harm our business and ability to compete effectively. We have from time to time discovered counterfeit copies of our products being manufactured or sold by others. Although we have programs to detect and deter the counterfeiting of our products, significant availability of counterfeit products could reduce our revenues and damage our reputation and goodwill with customers.

Third parties may assert infringement claims against us, which may be expensive to defend and could divert our resources.

From time to time, third parties assert exclusive patent, copyright and other intellectual property rights to our key technologies, and we expect to continue to receive such claims in the future. For example, we entered into a patent cross-license agreement with IBM in May 2000. Under this agreement, which was amended in March 2002, we received a release from infringement claims prior to January 1, 2000 and received the right to use certain of IBM's patents through June 30, 2007. In consideration, we are paying, in annual installments, an aggregate patent fee of $13.3 million, and we granted IBM a license to use all of our patents for the same period. The risks of our receiving additional claims from third parties may be enhanced in periods such as the one that we are currently entering where we are beginning to offer product lines employing new technologies relative to our existing products.

We cannot assure you that third parties will not assert other infringement claims against us, directly or indirectly, in the future, that assertions by third parties will not result in costly litigation or that we would prevail in such litigation or be able to license any valid and infringed intellectual property from third parties on commercially reasonable terms. These claims may be asserted in respect of intellectual property that we own or that we license from others. In addition to claims brought against us by third parties, we may also bring litigation against others to protect our rights. Intellectual property litigation, regardless of the outcome, could result in substantial costs to us and diversion of our resources, and could adversely affect our business and financial results.

We may be subject to a higher effective tax rate that could negatively affect our results of operations and financial position.

Our effective tax rate is benefited by a Singapore tax holiday relating to certain of our products. The tax holiday package, which is effective until fiscal 2010, provides that profits derived from certain products will be exempt from tax, subject to certain conditions. If we do not meet the conditions and requirements of the tax holiday in Singapore, our effective tax rate will increase, which would adversely affect our financial results. Additionally, we held $427.6 million of cash, cash equivalents and marketable securities at our subsidiary in Singapore at September 30, 2004. From time to time we may need to repatriate our cash from Singapore to the United States. If we do so, we could incur additional income taxes up to the combined United States Federal and state statutory rate of approximately 40% from the repatriation, which would negatively affect our results of operations and financial condition.

We may be required to pay additional federal income taxes which could negatively affect our results of operations and financial position.

On December 15, 2000, we received a statutory notice of deficiency from the IRS with respect to our Federal income tax return for fiscal 1997. We filed a Petition with the United States Tax Court on March 14, 2001 contesting the asserted deficiencies and settlement agreements have been filed with the United States Tax Court on all but one issue. In addition, the IRS is currently auditing our Federal income tax returns for fiscal 1998 through fiscal 2001. We have settled all issues for fiscal 1998 and 1999 other than the rollover impact of any potential resolution on the remaining fiscal 1997 issue and tax credits that were generated but not used in subsequent years that may be carried back to fiscal 1998 and 1999. The fiscal 2000 and 2001 audit is ongoing. While we believe we have meritorious defenses against the asserted deficiencies and any proposed adjustments, and that sufficient taxes have been provided, we cannot predict the final outcome of these matters, and the final resolution could adversely affect our results of operations and financial position.

We may be engaged in legal proceedings that could cause us to incur unforeseen expenses and could occupy a significant amount of our management's time and attention.

From time to time we are subject to litigation or claims that could negatively affect our business operations and financial position. Such disputes could cause us to incur unforeseen expenses, could occupy a significant amount of our management's time and attention, and could negatively affect our business operations and financial position.

We have entered into an expanded relationship with IBM and if we do not fulfill our responsibilities under this agreement, it could result in a loss of revenues.

In the first quarter of fiscal 2005, we entered into an expanded relationship with IBM to supply external storage products. We may encounter challenges in fulfilling our responsibilities under this expanded relationship such as, timely completion and introduction of product designs to meet the specifications of IBM, quality of new products introduced, sales forecasting, material planning and inventory management to meet its demand forecast. If we are not successful in managing this relationship, product shipments could be delayed, which could result in delayed or lost revenues and customer dissatisfaction.

We finance our capital expenditure needs from operating cash flows and capital market financing, and if we need to seek additional financing, it may not be available on favorable terms.

In order to finance strategic acquisitions, capital asset acquisitions and other general corporate needs, we rely, in part, on operating cash flows and capital markets. Historically, we have been able to access capital markets, but this does not necessarily guarantee that we will be able to access these markets in the future or at terms that are acceptable to us. The availability of capital in these markets is affected by several factors, including geopolitical risk, the interest rate environment and the condition of the economy as a whole. In addition, our own operating performance, capital structure and expected future performance impacts our ability to raise capital. We believe that our current cash, cash equivalents, short-term investments and future cash provided by operations will be sufficient to fund our needs for at least the next twelve months. However, if our operating performance falls below expectations, we may need additional funds, which may not be available on favorable terms, if at all.

We are exposed to fluctuations in foreign currency exchange rates.

Because a significant portion of our business is conducted outside the United States, we face exposure to adverse movements in non-United States currency exchange rates. These exposures may change over time as business practices evolve and could have an adverse impact on our financial results and cash flows. Historically, our exposures have related to non-dollar-denominated operating expenses in Europe and Asia. We began Euro-denominated sales to our distribution customers in the European Union in the fourth quarter of fiscal 2003. Additionally, we purchase a substantial portion of our raw materials and manufacturing equipment from foreign suppliers, and incur labor and other operating costs in foreign currencies, particularly in our Singapore manufacturing facility. An increase in the value of the dollar could increase the real cost to our customers of our products in markets outside the United States where we sell in dollars, and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials to the extent we must purchase components in foreign currencies.

We hold minority interests in privately held venture funds, and if these venture funds face financial difficulties in their operations, our investments could be impaired.

We continue to hold minority interests in privately held venture funds. These investments are inherently risky because these venture funds invest in companies that may still be in the development stage or depend on third parties for financing to support their ongoing operations. In addition, the markets for the technologies or products of these companies are typically in the early stages and may never develop. If these companies do not have adequate cash funding to support their operations, or if they encounter difficulties developing their technologies or products, the venture funds' investment in these companies may be impaired, which in turn, could result in impairment of our investment in these venture funds.

Our spin-off of Roxio may have potential subsequent tax liabilities that could negatively affect our results of operations.

Pursuant to our distribution of the Roxio, Inc. common stock, we received an opinion from PricewaterhouseCoopers LLP, or PwC, regarding the tax-free nature of the transaction to us and to our stockholders under Section 355 of the Internal Revenue Code. The validity of the PwC opinion relating to the qualification of the distribution as a tax-free transaction is subject to factual representations and assumptions. We are not aware of any facts or circumstances that would cause such representations and assumptions to be untrue. In addition, the opinion of PwC is not binding on the IRS. If Roxio or we fail to conform to the requirements set forth in the IRS regulations, it could cause the distribution to be taxable to us and to our stockholders, and our financial results could be adversely affected.

We may have potential business conflicts of interest with Roxio with respect to our past and ongoing relationships, and we may not resolve these conflicts on terms favorable to us.

Conflicts of interest may arise between Roxio and us in areas relating to our past and ongoing relationship, including:

- Tax, indemnification and other matters arising from the separation; and
- Intellectual property matters.

These and other business conflicts could adversely affect the growth of our business in the future.

Recently enacted and proposed changes in securities laws and regulations are likely to increase our costs.

Recently enacted and proposed changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002, will increase our expenses as we evaluate the implications of new rules and devote resources to respond to the new requirements. The Sarbanes-Oxley Act mandates, among other things, that companies adopt new corporate governance measures and imposes comprehensive reporting and disclosure requirements, sets stricter independence and financial expertise standards for audit committee members and imposes increased civil and criminal penalties for companies, their chief executive officers and chief financial officers and directors for securities law violations. In particular, we expect to incur additional administrative expense as we implement Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our Independent Registered Public Accounting Firm to attest to, our internal control over financial reporting. We are in the process of completing the documentation of our controls and testing their effectiveness and expect that our management will be able to provide a favorable assessment and that our auditors will concur with this assessment. However, this evaluation and attestation process is new and neither our auditors nor we have significant experience with it, and we cannot be assured that our auditors and we will reach a favorable conclusion under Section 404. If our auditors or we fail to do so on a timely basis, investor confidence in us could be adversely affected and our results of operations could be adversely affected as we seek to address any shortcomings, and as a result our stock price could decline.

In addition, The Nasdaq National Market, on which our common stock is listed, has also adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices. We also expect these developments to make it more difficult and more expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, our board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficultly attracting and retaining qualified board members and executive officers, which would adversely affect our business.

We may encounter natural disasters, which could cause disruption to our employees or interrupt the manufacturing process for our products.

Our operations could be subject to natural disasters and other business disruptions, which could seriously harm our revenues and financial condition and increase our costs and expenses. Our corporate headquarters are located in California, near major earthquake faults. Additionally, our primary wafer supplier, TSMC, is located in Taiwan, which has experienced significant earthquakes in the past. A severe earthquake could cause disruption to our employees or interrupt the manufacturing process, which would affect TSMC's ability to supply wafers to us, which would negatively affect our business and financial results. The ultimate impact on us and our general infrastructure of being located near major earthquake faults is unknown, but our net revenues and financial condition and our costs and expenses could be significantly impacted in the event of a major earthquake.

Manmade problems such as computer viruses or terrorism may disrupt our operations and harm our operating results.

Despite our implementation of network security measures, our servers are vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems. Any such event could have an adverse effect on our business, operating results, and financial condition. In addition, the effects of war or acts of terrorism could have an adverse effect on our business, operating results, and financial condition. In addition, as a multi-national company with headquarters and significant operations located in the United States, we may be impacted by actions against the United States. We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war.

If we account for employee stock options using the fair value method, it could adversely impact our net income.

There has been ongoing public debate whether stock options granted to employees should be treated as a compensation expense and, if so, how to properly value such charges. On March 31, 2004 and as subsequently amended, the Financial Accounting Standard Board (FASB) issued an Exposure Draft, *Share-Based Payment: an amendment of FASB statements No. 123 and 95*, which would require a company to recognize, as an expense, the fair value of stock options and other stock-based compensation to employees for fiscal years beginning after June 15, 2005 and subsequent reporting periods. If we elect or are required to record an expense for our stock-based compensation plans using the fair value method as described in the Exposure Draft, we could have significant and ongoing accounting charges. See Note 3 of Notes to Unaudited Condensed Consolidated Financial Statements in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 for a more detailed presentation of accounting for stock-based compensation plans.

We may experience significant fluctuations in our stock price, which may, in turn, significantly affect the trading price of our convertible notes.

Our stock has experienced substantial price volatility, particularly as a result of quarterly variations in our operating results, the published expectations of analysts, and as a result of announcements by our competitors and us. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many technology companies, in particular, and that have often been unrelated to the operating performance of such companies. In addition, the price of our securities may also be affected by general global, economic and market conditions, and the cost of operations in one or more of our product markets. While we cannot predict the individual effect that these factors may have on the price or our securities, these factors, either individually or in the aggregate, could result in significant variations in the price of our common stock during any given period of time. These fluctuations in our stock price also impact the price of our outstanding convertible securities and the likelihood of the convertible securities being converted into our common stock.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control. All statements other than statements of historical facts included or incorporated by reference in this prospectus regarding our strategy, future operations, financial position, estimated revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. When used in this prospectus or the documents incorporated by reference in this prospectus, the words "will," "believe," "anticipate," "plan," intend," "estimate," "expect," "project," and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Although we believe that our plans, intentions and expectations reflected in or suggested by these forward-looking are reasonable, we cannot assure you that these plans, intentions or expectations will be achieved. Actual results may differ materially from those stated in these forward-looking statements due to a variety of factors, including those described under "Risk Factors." All forward-looking statements speak only as of the date on the front cover of the applicable document. Neither we nor the selling stockholder undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

USE OF PROCEEDS

We will not receive any proceeds from the sale of shares by IBM. The aggregate exercise price for the warrants is approximately $3.8 million. If IBM exercises the warrants by paying cash, any proceeds we receive will be used for general corporate purposes. The warrants also contain a "net exercise" provision, pursuant to which IBM may elect to exercise either warrant without paying any cash. Pursuant to that provision, IBM will receive the number of shares of our common stock determined by multiplying the number of shares to which it would otherwise be entitled by a fraction. The numerator of the fraction will be the difference between (i) the current market price per share of our common stock on the date of exercise and (ii) the exercise price. The denominator of the fraction will be the current market price per share of our common stock.

SELLING STOCKHOLDER

The following table sets forth the name of the selling stockholder, the number of shares being registered for sale by the selling stockholder as of the date of this prospectus and the number of shares of common stock known by us to be beneficially owned by the selling stockholder. The selling stockholder may sell an aggregate of 500,000 shares pursuant to this prospectus. All of these shares are issuable upon exercise of currently outstanding warrants to purchase common stock held by the selling stockholder. We issued the warrants to the selling stockholder in private transactions on June 29, 2004 and August 10, 2004. We issued a warrant on June 29, 2004 in connection with the acquisition of IBM's i/p Series RAID component business to expand and enhance our RAID product offerings. We issued an additional warrant on August 10, 2004 in connection with a supply agreement that we entered into with IBM with respect to our external storage products. The shares subject to the warrants were "restricted securities" under the Securities Act prior to this registration.

We have assumed, for purposes of the table, that the selling stockholder acquires and then sells the maximum number of shares subject to the warrants. Each warrant contains a "net exercise" provision, pursuant to which the selling stockholder may elect to exercise the warrant without paying any cash. If either warrant is exercised pursuant to these provisions, the selling stockholder will acquire fewer shares than those indicated below.

Based on 111,169,293 shares of our common stock outstanding as of November 5, 2004, the selling stockholder will beneficially own less than 1% of our outstanding common stock both prior to and after completion of the offering. The selling stockholder has not, or within the past three years has not had, any position, office or other material relationship with us or any of our predecessors or affiliates. The information in this section of the prospectus regarding share-ownership by the selling stockholder and material relationships of the selling stockholder is based on our records and on information provided to us as of November 5, 2004 by our transfer agent.

The selling stockholder may from time to time offer and sell any or all of its shares that are registered under this prospectus. Because the selling stockholder is not obligated to sell its shares, and because the selling stockholder may also acquire publicly traded shares of our common stock, we cannot estimate how many shares the selling stockholder will own after this offering. We may update, amend or supplement this prospectus from time to time to update the disclosure in this section.

Name	Shares of Common Stock Beneficially Owned Before the Offering	Total Shares That May be Offered by Selling Stockholder
International Business Machines Corporation	500,000	500,000

PLAN OF DISTRIBUTION

The selling stockholder will be offering and selling all shares offered and sold with this prospectus. We will not receive any of the proceeds of the sale of these shares. Offers and sales of shares made with this prospectus must comply with the terms of the warrants issued to the selling stockholder. However, the selling stockholder may resell all or a portion of its shares without this prospectus in open market transactions in reliance upon available exemptions under the Securities Act, if any, provided they meet the criteria and confirm to the requirements of one of these exemptions.

Who may sell and applicable restrictions

The selling stockholder may offer and sell shares with this prospectus directly to purchasers. The selling stockholder may donate or otherwise transfer its shares to any person so long as the transfer complies with applicable securities laws.

The selling stockholder may from time to time offer shares through brokers, dealers or agents. Brokers, dealers, agents or underwriters participating in transactions may receive compensation in the form of discounts, concessions or commissions from the selling stockholder (and, if they act as agent for the purchaser of the shares, from that purchaser). The discounts, concessions or commissions might be in excess of those customary in the type of transaction involved. Any brokerage commissions and similar selling expenses attributable to the sale of shares covered by this prospectus will be borne by the selling stockholder. In order to comply with some state securities laws, the shares may be sold in those jurisdictions only through registered or licensed brokers or dealers.

The selling stockholder and any brokers, dealers or agents who participate in the distribution of the shares may be deemed to be underwriters, and any profits on the sale of shares by it and any discounts, commissions or concessions received by any broker, dealer or agent may be deemed underwriting discounts and commissions under the Securities Act. The selling stockholder has advised us that, as of the date of this prospectus, it has not entered into any plan, arrangement or understanding with a broker, dealer or underwriter regarding sales of share with this prospectus.

Prospectus delivery

A prospectus supplement or a post-effective amendment may be filed with the Securities and Exchange Commission to disclose additional information with respect to the distribution of the shares. In particular, if we receive notice from the selling stockholder that a donee, pledgee, transferee or other successor intends to sell more than 500 shares of our common stock, or that the selling stockholder has entered into a material arrangement with an underwriter or broker-dealer for the sale of shares covered by this prospectus, then, to the extent required, we will file a supplement to this prospectus.

Manner of sales

The selling stockholder will act independently of Adaptec in making decisions with respect to the timing, manner and size of each sale. Sales may be made over the Nasdaq National Market, the over-the-counter market, or any other national securities exchange or quotation service on which the securities may be listed or quoted at the time of sale. The shares may be sold and then prevailing market prices, at prices related to prevailing market prices, at fixed prices or at other negotiated prices.

The shares may be sold according to one or more of the following methods:

- A block trade in which the broker or dealer so engaged will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;

Purchases by a broker or dealer as principal and resale by the broker or dealer for its account as allowed under this prospectus;

Ordinary brokerage transactions and transactions in which the broker solicits purchasers;

Pledges of shares to a broker-dealer or other person, who may, in the event of default, purchase or sell the pledged shares;

An exchange distribution under the rules of the exchange;

Face-to-face transactions between sellers and purchasers without a broker-dealer; and

By writing options.

Hedging Transactions

In addition, the selling stockholder may generally enter into option, derivative or hedging transactions with respect to the shares, and any related offers or sales of shares may be made under this prospectus. The selling stockholder may, for example:

Enter into transactions involving short sales of the shares by broker-dealers in the course of hedging the positions they assume with the selling stockholder;

Sell shares short itself and deliver the shares registered hereby to settle such short sales or to close out stock loans incurred in connection with its short positions;

Write call options, put options or other derivative instruments (including exchange-traded options or privately negotiated options) with respect to the shares, or which it settles through delivery of the shares;

Enter into option transactions or other types of transactions that require the selling stockholder to deliver shares to a broker, dealer or other financial institution, who may then resell or transfer the shares under this prospectus; or

Loan the shares to a broker, dealer or other financial institution, who may sell the loaned shares.

These options, derivative and hedging transactions may require the delivery to a broker, dealer or other financial institution of shares offered under this prospectus.

Indemnification and contribution

The selling stockholder and we have agreed to indemnify or provide contribution to each other and specified other persons against some liabilities in connection with the offering of the shares, including liabilities arising under the Securities Act. The selling stockholder may also agree on its own to indemnify any broker-dealer or agent that participates in transactions involving sales of the shares against some liabilities, including liabilities arising under the Securities Act.

Suspension of this offering

We may suspend the use of this prospectus on a limited basis if we learn of any event that causes this prospectus to include an untrue statement of material fact or omit to state a material fact required to be stated in the prospectus or necessary to make the statements in the prospectus not misleading in light of the circumstances then existing. If this type of event occurs, a prospectus supplement or post-effective amendment, if required, will be distributed to the selling stockholder.

This prospectus relates to the sale of up to 500,000 shares of our common stock that are issuable upon the exercise of two outstanding warrants. The prices at which the selling stockholder may sell the shares will be determined by the prevailing market for the shares or in negotiated transactions. See "Selling Stockholder."

The selling stockholder will receive all of the proceeds from the sale of the common stock pursuant to this prospectus. We may receive proceeds from the exercise of the outstanding warrants by the selling stockholder and those proceeds will be used for our general corporate purposes.

LEGAL MATTERS

The validity of the securities offered under this prospectus will be passed upon for us by Fenwick & West LLP, Mountain View, California.

EXPERTS

The consolidated financial statements incorporated in this prospectus by reference to the Current Report on Form 8-K filed on December 7, 2004 have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

INCORPORATION OF DOCUMENTS BY REFERENCE

This prospectus incorporates by reference some of the reports, proxy and information statements and other information that we have filed with the SEC under the Exchange Act. This means that we are disclosing important business and financial information to you by referring you to those documents. The information that we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below and any future filings made with the SEC under sections 13(a), 13(c), 14 or 15(d) of the Exchange Act until all of the securities offered by this prospectus are sold.

Annual Report on Form 10-K for the year ended March 31, 2004, except for Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Item 8,"Financial Statements and Supplementary Data" that are incorporated by reference from our Current Report on Form 8-K filed December 7, 2004 referenced below;

Quarterly Report on Form 10-Q for the quarter ended June 30, 2004;

Quarterly Report on Form 10-Q for the quarter ended September 30, 2004;

Current Report on Form 8-K filed on December 7, 2004, which includes amended and restated Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Item 8, "Financial Statements and Supplementary Data";

Current Report on Form 8-K filed on December 6, 2004;

Current Report on Form 8-K filed on September 24, 2004;

Current Report on Form 8-K filed on July 14, 2004;

Current Report on Form 8-K filed on July 2, 2004; and

Items 1 and 2 of our registration statement on Form 8-A filed July 20, 1992 pursuant to the Exchange Act and Exhibit 4.1 to Amendment No. 5 of our registration statement on Form 8-A filed March 20, 2001 amending our Form 8-A filed May 11, 1989.

Any statement made in a document incorporated by reference in this prospectus is deemed to be modified or superseded for purposes of this prospectus to the extent that a statement in this prospectus or in any other subsequently filed document, which is also incorporated by reference, modifies or supersedes the statement. Any statement made in this prospectus is deemed to be modified or superseded to the extent a statement in any subsequently filed document, which is incorporated by reference in this prospectus, modifies or supersedes such statement. Any statement so modified or superseded will not be deemed, except as so modified or superseded, to constitute a part of this prospectus.

In addition, for so long as any of the shares of common stock subject to this prospectus remain outstanding and during any period in which we are not subject to Section 13 or Section 15(d) of the

Exchange Act, we will make available to any prospective purchaser or beneficial owner of the securities in connection with the sale thereof that information required by Rule 144A(d)(4) under the Securities Act. The information relating to us contained in this prospectus should be read together with the information in the documents incorporated by reference. In addition, certain information, including financial information, contained in this prospectus or incorporated by reference in this prospectus should be read in conjunction with documents we have filed with the SEC.

Requests for documents should be directed to Investor Relations, Adaptec, Inc., 691 S. Milpitas Blvd., Milpitas, California 95035, telephone number (408) 945-8600. Exhibits to these filings will not be sent unless those exhibits have been specifically incorporated by reference in this document.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We are subject to the information requirements of the Exchange Act and file reports, proxy statements and other information with the SEC. We are required to file electronic versions of these documents with the SEC. Our reports, proxy statements and other information can be inspected and copied at prescribed rates at the public reference facilities maintained by the SEC at Judiciary Plaza, 450 Fifth Street, N.W., Washington D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. The SEC also maintains a website that contains reports, proxy and information statements and other information, including electronic versions of our filings. The website address is http://www.sec.gov.

500,000 Shares of Common Stock

PROSPECTUS

, 2004

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 14. Other Expenses of Issuance and Distribution.

The following table sets forth the various expenses payable by us in connection with the sale and distribution of the securities being registered hereby. We are paying all of the selling stockholder's expenses related to this offering, except that the selling stockholder will pay any applicable broker's commissions and expenses. All amounts are estimated except the Securities and Exchange Commission registration fee.

Securities and Exchange Commission registration fee	$	485
Legal fees and expenses		25,000
Accounting fees and expenses		15,000
Printing and engraving fees and expenses		10,000
Miscellaneous		515
Total	$	51,000

ITEM 15. Indemnification of Directors and Officers.

Section 145 of the Delaware General Corporation Law authorizes a court to award, or a corporation's board of directors to grant, indemnity to directors and officers in terms sufficiently broad to permit such indemnification under certain circumstances for liabilities (including reimbursement for expenses incurred) arising under the Securities Act of 1933.

As permitted by Section 145 of the Delaware General Corporation Law, our certificate of incorporation includes a provision that eliminates the personal liability of our directors for monetary damages for breach of fiduciary duty as a director, except for liability:

- for any breach of the director's duty of loyalty to us or our stockholders;
- for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of the law;
- under Section 174 of the Delaware General Corporation Law regarding unlawful dividends and stock purchases; and
- for any transaction from which the director derived an improper personal benefit.

As permitted by the Delaware General Corporation Law, our bylaws provide that:

- we are required to indemnify our directors and officers to the fullest extent permitted by the Delaware General Corporation Law, subject to limited exceptions;
- we may indemnify our other employees and agents to the extent that we indemnify our officers and directors, unless otherwise required by law, our certificate of incorporation, our bylaws or agreements to which we are a party;
- we are required to advance expenses, as incurred, to our directors and officers in connection with a legal proceeding to the fullest extent permitted by the Delaware General Corporation Law, subject to limited exceptions; and
- the rights conferred in the bylaws are not exclusive.

We have entered into Indemnity Agreements with each of our current directors and officers to give such directors and officers additional contractual assurances regarding the scope of the indemnification set forth in our certificate of incorporation and to provide additional procedural protections. At present, there is no pending litigation or proceeding involving one of our directors, officers or employees regarding which indemnification is sought, nor are we aware of any threatened litigation that may result in claims for indemnification.

We maintain directors' and officers' liability insurance.

ITEM 16. Exhibits.

The following exhibits are filed herewith or incorporated by reference herein:

Exhibit Number	Exhibit Title
4.01	Certificate of Incorporation of the Registrant filed with Delaware Secretary of State on November 19, 1997(1)
4.02	Bylaws of the Registrant(2)
4.03	Stock Purchase Warrant, dated June 29, 2004, issued to International Business Machines Corporation*

2,224		(181)
Increase (decrease) in accrued interest payable	5	(44)
Increase in other liabilities	1,251	2,603
Origination of mortgage loans for sale	(40,008)	(25,576)
Proceeds from the sale of mortgage loans	40,090	25,568
Gain on sale of mortgage loans, net	(1,103)	(778)
Other, net	(194)	(377)
Net cash provided by operating activities	11,566	9,851
Cash flows from investing activities:		
Net increase in loans	(21,892)	(24,155)
Purchase of available-for-sale debt securities	(81,595)	(41,321)
Proceeds from maturities of available-for-sale	24,188	18,015

Exhibit Number	Exhibit Title		
debt securities			
Proceeds from calls of available-for-sale debt securities		11,440	24,605
Proceeds from sales of available-for-sale debt securities		720	0
Proceeds from sales of FHLB stock		400	39
Purchases of FHLB stock		(4,915)	(440)
Purchases of premises and equipment		(709)	(1,181)
Proceeds from sales of premises and equipment		11	45
Proceeds from sales of other real estate and foreclosed assets		1,443	3,945
Net cash used in investing activities		(70,909)	(20,448)
Cash flows from financing activities:			
Net increase in demand deposits		2,014	12,898
Net increase in interest-bearing transaction accounts		10,819	14,748
Net decrease in time deposits		(10,179)	(19,412)
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase		9,792	(11,541)
Repayment of FHLB advances		(55,000)	(10,000)
FHLB advances		92,000	21,000

Exhibit Number	Exhibit Title			
Cash dividends paid - common stock		(785)		(755)
Net cash provided by financing activities		48,661		6,938
Net (decrease) increase in cash and cash equivalents		(10,682)		(3,659)
Cash and cash equivalents, beginning of period		42,809		28,439
Cash and cash equivalents, end of period	$	32,127	$	24,780

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

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HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (continued) *(unaudited)*

(In thousands)	Nine Months Ended September 30, 2015		2014	
Supplemental disclosures of cash flow information:				
Cash paid during the year for:				
Interest	$	3,717	$	3,872
Income taxes	$	1,559	$	1,650
Noncash investing activities:				
Other real estate and repossessed assets acquired in settlement of loans	$	4,549	$	1,817

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

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(Unaudited)

(1) Summary of Significant Accounting Policies

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

The accompanying unaudited consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q, and Rule 10-01 of Regulation S-X. Accordingly, the unaudited consolidated financial statements do not include all of the information and disclosures required by U.S. GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. Certain amounts in the 2014 condensed consolidated financial statements have been reclassified to conform to the 2014 condensed consolidated presentation. Such reclassifications have no effect on previously reported net income or stockholders' equity.

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.

Stock Dividend On July 1, 2015, the Company paid a special stock dividend of four percent to shareholders of record at the close of business on June 15, 2015. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect this change.

The following represents significant new accounting principles adopted in 2015:

Investments - Equity Method and Joint Ventures

The FASB issued ASU No. 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects*, in January 2014. These amendments allow investors in low income housing tax credit entities to account for the investments using a proportional amortization method, provided that certain conditions are met, and recognize amortization of the investment as a component of income tax expense. In addition, disclosures are required that will enable users to understand the nature of the investments, and the effect of the measurement of the investments and the related tax credits on the investor's financial statements. This ASU was effective January 1, 2015, and the adoption of this pronouncement did not have a significant effect on the Company's consolidated financial statements.

Troubled Debt Restructurings by Creditors

The FASB issued ASU No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, in January 2014. These amendments require companies to disclose the amount of foreclosed residential real estate property held and the recorded investment in consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction. The ASU also defines when a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. This ASU was effective January 1, 2015, and the adoption of this pronouncement did not have a significant effect on the Company's consolidated financial statements.

The FASB issued ASU No. 2014-14, *Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure* in August 2014. The objective of this update is to reduce diversity in practice by addressing the classification of foreclosed mortgage loans that are fully or partially guaranteed under government programs, including those guaranteed by the FHA and the VA. Some creditors reclassify those loans to real estate consistent with other foreclosed loans that do not have guarantees; others

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reclassify the loans to other receivables. The amendments in this ASU require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) The loan has a government guarantee that is not separable from the loan before foreclosure; (2) At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and (3) At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. This ASU was effective January 1, 2015, and the adoption of this pronouncement 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 September 30, 2015 and December 31, 2014 is as follows:

(in thousands)	September 30, 2015	December 31, 2014
Commercial, financial, and agricultural	$ 173,485	$ 154,834
Real estate construction - residential	13,531	18,103
Real estate construction - commercial	32,560	48,822
Real estate mortgage - residential	249,512	247,117
Real estate mortgage - commercial	388,220	372,321
Installment and other consumer	22,166	20,016

Total loans	$ 879,474	$ 861,213

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 Lee’s Summit, Missouri. As such, the Bank is susceptible to changes in the economic environment in these communities. The Bank does not have a concentration of credit in any one economic sector. Installment and other consumer loans consist primarily of the financing of automotive vehicles. At September 30, 2015, loans with a carrying value of $396.4 million, or $330.5 million fair value, were pledged to the Federal Home Loan Bank as collateral for borrowings and letters of credit.

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Hawthorn Bancshares, Inc.

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Notes to the Consolidated Financial Statements

(Unaudited)

Allowance for Loan Losses

The following is a summary of the allowance for loan losses during the periods indicated.

	Three Months Ended September 30, 2015							
	Commercial,	Real Estate	Real Estate	Real Estate	Real Estate	Installment		
	Financial, &	Construction -	Construction -	Mortgage -	Mortgage -	Loans to	Un-	
(in thousands)	Agricultural	Residential	Commercial	Residential	Commercial	Individuals	allocated	Total
Balance at beginning of period	$3,124	$ 17	$ 414	$ 2,332	$ 3,870	$ 185	$ 44	$9,986
Additions:								
Provision for loan losses	439	(27)	137	(233)	(503)	66	121	0
Deductions:								
Loans charged off	591	0	0	87	126	80	0	884
Less recoveries on loans	(28)	(28)	0	(45)	(5)	(38)	0	(144)
Net loans charged off	563	(28)	0	42	121	42	0	740
Balance at end of period	$3,000	$ 18	$ 551	$ 2,057	$ 3,246	$ 209	$ 165	$9,246

	Nine Months Ended September 30, 2015							
	Commercial,	Real Estate	Real Estate	Real Estate	Real Estate	Installment		
	Financial, &	Construction -	Construction -	Mortgage -	Mortgage -	Loans to	Un-	
(in thousands)	Agricultural	Residential	Commercial	Residential	Commercial	Individuals	allocated	Total
Balance at beginning of period	$1,779	$ 171	$ 466	$ 2,527	$ 3,846	$ 270	$ 40	$9,099

Additions:								
Provision for loan losses	1,319	(475)	90	(277)	(598)	66	125	250
Deductions:								
Loans charged off	741	0	5	298	159	241	0	1,444
Less recoveries on loans	(643)	(322)	0	(105)	(157)	(114)	0	(1,341)
Net loans (recovered) charged off	98	(322)	5	193	2	127	0	103
Balance at end of period	$3,000	$ 18	$ 551	$ 2,057	$ 3,246	$ 209	$ 165	$9,246

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	Three Months Ended September 30, 2014							
	Commercial,	Real Estate	Real Estate	Real Estate	Real Estate	Installment		
	Financial, &	Construction -	Construction -	Mortgage -	Mortgage -	Loans to	Un-	
(in thousands)	Agricultural	Residential	Commercial	Residential	Commercial	Individuals	allocated	Total
Balance at beginning of period	$1,943	$ 473	$ 618	$ 2,405	$ 6,428	$ 274	$ 9	$12,150
Additions:								
Provision for loan losses	(188)	(94)	(96)	313	7	38	20	0
Deductions:								
Loans charged off	105	0	0	41	80	71	0	297
Less recoveries on loans	(55)	0	0	(26)	(67)	(32)	0	(180)
Net loans charged off	50	0	0	15	13	39	0	117
Balance at end of period	$1,705	$ 379	$ 522	$ 2,703	$ 6,422	$ 273	$ 29	$12,033

	Nine Months Ended September 30, 2014							
	Commercial,	Real Estate	Real Estate	Real Estate	Real Estate	Installment		
	Financial, &	Construction -	Construction -	Mortgage -	Mortgage -	Loans to	Un-	
(in thousands)	Agricultural	Residential	Commercial	Residential	Commercial	Individuals	allocated	Total
Balance at beginning of period	$2,374	$ 931	$ 631	$ 2,959	$ 6,523	$ 294	$ 7	$13,719
Additions:								
Provision for loan losses	(660)	(553)	382	(171)	891	89	22	0
Deductions:								
Loans charged off	291	59	491	236	1,152	270	0	2,499
Less recoveries on loans	(282)	(60)	0	(151)	(160)	(160)	0	(813)
Net loans charged off	9	(1)	491	85	992	110	0	1,686
Balance at end of period	$1,705	$ 379	$ 522	$ 2,703	$ 6,422	$ 273	$ 29	$12,033

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.

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(Unaudited)

The following table provides the balance in the allowance for loan losses at September 30, 2015 and December 31, 2014, 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
September 30, 2015								
Allowance for loan losses:								
Individually evaluated for impairment	$ 305	$ 0	$ 8	$ 1,178	$ 459	$ 20	$ 0	$ 1,970
Collectively evaluated for impairment	2,695	18	543	879	2,787	189	165	7,276
Total	$ 3,000	$ 18	$ 551	$ 2,057	$ 3,246	$ 209	$ 165	$ 9,246
Loans outstanding:								
Individually evaluated for impairment	$ 3,643	$ 0	$ 54	$ 6,891	$ 3,481	$ 141	$ 0	$ 14,210
Collectively evaluated for impairment	169,842	13,531	32,506	242,621	384,739	22,025	0	865,264
Total	$ 173,485	$ 13,531	$ 32,560	$ 249,512	$ 388,220	$ 22,166	$ 0	$ 879,474
December 31, 2014								
Allowance for loan losses:								
Individually evaluated for impairment	$ 134	$ 0	$ 0	$ 1,343	$ 246	$ 26	$ 0	$ 1,749
Collectively evaluated for impairment	1,645	171	466	1,184	3,600	244	40	7,350
Total	$ 1,779	$ 171	$ 466	$ 2,527	$ 3,846	$ 270	$ 40	$ 9,099

Loans outstanding:								
Individually evaluated for impairment	$ 7,541	$ 1,750	$ 2,096	$ 7,878	$ 16,464	$ 234	$ 0	$ 35,963
Collectively evaluated for impairment	147,293	16,353	46,726	239,239	355,857	19,782	0	825,250
Total	$ 154,834	$ 18,103	$ 48,822	$ 247,117	$ 372,321	$ 20,016	$ 0	$ 861,213

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 $14.2 million and $36.0 million at September 30, 2015 and December 31, 2014, 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 September 30, 2015 and December 31, 2014, $11.9 million and $15.6 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 September 30, 2015, $2.0 million of the Company’s allowance for loan losses was allocated to impaired loans totaling $14.2 million compared to $1.7 million of the Company's allowance for loan losses allocated to impaired loans totaling approximately $36.0 million at December 31, 2014. Management determined that $7.4 million, or 52%, of total impaired loans required no reserve allocation at September 30, 2015 compared to $28.5 million, or 79%, at December 31, 2014 primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

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The categories of impaired loans at September 30, 2015 and December 31, 2014 are as follows:

(in thousands)	September 30, 2015	December 31, 2014
Non-accrual loans	$ 8,957	$ 18,243
Troubled debt restructurings continuing to accrue interest	5,253	17,720
Total impaired loans	$ 14,210	$ 35,963

The following tables provide additional information about impaired loans at September 30, 2015 and December 31, 2014, 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
September 30, 2015			
With no related allowance recorded:			
Commercial, financial and agricultural	$ 2,877	$ 3,403	$ 0
Real estate - construction residential	0	0	0
Real estate - construction commercial	0	0	0
Real estate - residential	2,095	2,532	0
Real estate - commercial	2,450	2,579	0
Total	$ 7,422	$ 8,514	$ 0
With an allowance recorded:			
Commercial, financial and agricultural	$ 766	$ 778	$ 305
Real estate - construction commercial	54	56	8
Real estate - residential	4,796	4,928	1,178
Real estate - commercial	1,031	1,315	459

Consumer	141	176	20
Total	$ 6,788	$ 7,253	$ 1,970
Total impaired loans	$ 14,210	$ 15,767	$ 1,970

(in thousands)	Recorded Investment	Unpaid Principal Balance	Specific Reserves
December 31, 2014			
With no related allowance recorded:			
Commercial, financial and agricultural	$ 6,021	$ 6,232	$ 0
Real estate - construction residential	1,750	2,259	0
Real estate - construction commercial	2,096	2,319	0
Real estate - residential	3,213	3,270	0
Real estate - commercial	15,409	18,950	0
Consumer	36	36	0
Total	$ 28,525	$ 33,066	$ 0
With an allowance recorded:			
Commercial, financial and agricultural	$ 1,520	$ 1,528	$ 134
Real estate - construction residential	0	0	0
Real estate - construction commercial	0	0	0
Real estate - residential	4,665	3,546	1,343
Real estate - commercial	1,055	1,171	246
Consumer	198	237	26
Total	$ 7,438	$ 6,482	$ 1,749
Total impaired loans	$ 35,963	$ 39,548	$ 1,749

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(Unaudited)

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2015		2014		2015		2014	
(in thousands)	Average Recorded Investment	Interest Recognized For the Period Ended	Average Recorded Investment	Interest Recognized For the Period Ended	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	$ 3,416	$ 6	$ 2,618	$ 22	$ 4,033	$ 33	$ 2,592	$ 69
Real estate - construction residential	0	0	16	2	1,101	0	65	2
Real estate - construction commercial	0	0	6,524	0	2,002	0	6,737	0
Real estate - residential	2,326	5	3,941	26	2,924	26	3,374	40
Real estate - commercial	2,958	17	12,578	84	8,978	103	12,334	255
Consumer	0	0	0	0	10	1	11	0
Total	$ 8,700	$ 28	$ 25,677	$ 134	$ 19,048	$ 163	$ 25,113	$ 366
With an allowance recorded:								
Commercial, financial and agricultural	$ 787	$ 5	$ 1,940	$ 4	$ 1,389	$ 18	$ 2,128	$ 19
Real estate - construction residential	0	0	2,260	0	0	0	2,263	0
Real estate - construction commercial	55	0	0	0	28	0	56	93
Real estate - residential	4,850	30	5,458	0	4,713	80	5,384	11

Real estate - commercial	1,228	0	4,587	28	1,216	0	4,695	0
Consumer	162	0	310	11	209	0	324	0
Total	$ 7,082	$ 35	$ 14,555	$ 43	$ 7,555	$ 98	$ 14,850	$ 123
Total impaired loans	$ 15,782	$ 63	$ 40,232	$ 177	$ 26,603	$ 261	$ 39,963	$ 489

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 $63,000 and $261,000, for the three months and nine months ended September 30, 2015, respectively, compared to $177,000 and $489,000 for the three and nine months ended September 30, 2014, respectively. The average recorded investment in impaired loans is calculated on a monthly basis during the periods reported.

Delinquent and Non-Accrual Loans

The delinquency status of loans is determined based on the contractual terms of the notes. Borrowers are generally classified as delinquent once payments become 30 days or more past due. The Company’s policy is to discontinue the accrual of interest income on any loan when, in the opinion of management, the ultimate collectibility 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 collectibility 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.

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(Unaudited)

The following table provides aging information for the Company's past due and non-accrual loans at September 30, 2015 and December 31, 2014.

(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
September 30, 2015					
Commercial, Financial, and Agricultural	$170,230	$424	$ 0	$ 2,831	$173,485
Real Estate Construction - Residential	13,459	72	0	0	13,531
Real Estate Construction - Commercial	32,447	59	0	54	32,560
Real Estate Mortgage - Residential	244,144	1,431	348	3,589	249,512
Real Estate Mortgage - Commercial	385,253	625	0	2,342	388,220
Installment and Other Consumer	21,794	230	1	141	22,166
Total	$867,327	$2,841	$ 349	$ 8,957	$879,474
December 31, 2014					
Commercial, Financial, and Agricultural	$149,366	$189	$ 0	$ 5,279	$154,834
Real Estate Construction - Residential	16,352	0	0	1,751	18,103
Real Estate Construction - Commercial	46,670	0	56	2,096	48,822
Real Estate Mortgage - Residential	239,469	3,229	0	4,419	247,117
Real Estate Mortgage - Commercial	366,653	1,203	0	4,465	372,321
Installment and Other Consumer	19,551	230	2	233	20,016
Total	$838,061	$4,851	$ 58	$ 18,243	$861,213

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.

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(Unaudited)

The following table presents the risk categories by class at September 30, 2015 and December 31, 2014.

(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 September 30, 2015							
Watch	$ 12,500	1,249	$ 1,146	$ 27,451	$ 28,987	$ 193	$71,526
Substandard	332	0	98	2,841	2,577	38	5,886
Performing TDRs	812	0	0	3,302	1,139	0	5,253
Non-accrual	2,831	0	54	3,589	2,342	141	8,957
Total	$ 16,475	$ 1,249	$ 1,298	$ 37,183	$ 35,045	$ 372	$91,622
At December 31, 2014							
Watch	$ 13,651	$ 1,103	$ 4,757	$ 27,172	$ 18,191	$ 199	$65,073
Substandard	926	90	1,211	3,124	4,102	139	9,592
Performing TDRs	2,262	0	0	3,459	11,999	0	17,720
Non-accrual	5,279	1,751	2,096	4,419	4,465	233	18,243
Total	$ 22,118	$ 2,944	$ 8,064	$ 38,174	$ 38,757	$ 571	$110,628

Troubled Debt Restructurings

At September 30, 2015, loans classified as TDRs totaled $6.7 million, of which $1.4 million were classified as nonperforming TDRs and included in non-accrual loans and $5.3 million were classified as performing TDRs. At December 31, 2014, TDRs totaled $19.3 million, of which $1.6 million were classified as nonperforming TDRs included in non-accrual loans and $17.7 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 $1.2 million and $1.0 million related to TDRs were allocated to the allowance for loan losses at September 30, 2015 and December 31, 2014, respectively.

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

	Nine Months Ended September 30,					
	2015			2014		
	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	3	$ 250	$ 240	3	$ 244	$ 225
Real estate mortgage - residential	3	510	352	1	1,256	1,171
Real estate mortgage - commercial	4	1,273	1,263	0	0	0
Total	10	$ 2,033	$ 1,855	4	$ 1,500	$ 1,396

(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. There were no modified loans that met the TDR criteria during the three months ended September 30, 2015 and 2014. During the nine months ended September 30, 2015, ten loans meeting the TDR criteria were modified compared to four loans during the nine months ended September 30, 2014.

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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 no TDRs that defaulted within twelve months of its modification date during the three and nine months ended September 30, 2015 and 2014, respectively.

(3) Other Real Estate and Repossessed Assets

(in thousands)	September 30, 2015	December 31, 2014
Commercial, financial and agricultural	$ 585	$ 0
Real estate construction - residential	0	23
Real estate construction - commercial	12,380	9,831
Real estate mortgage - residential	483	417
Real estate mortgage - commercial	4,923	4,831
Repossessed assets	10	38
Total	$ 18,381	$ 15,140
Less valuation allowance for other real estate owned	(3,233)	(3,255)
Total other real estate and repossessed assets	$ 15,148	$ 11,885

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014

Balance at beginning of period	$ 15,749	$ 15,231	$ 15,140	$ 19,542
Additions	3,032	1,512	4,549	1,817
Proceeds from sales	(407)	(821)	(1,443)	(3,945)
Charge-offs against the valuation allowance for other real estate owned	0	(199)	(16)	(1,843)
Repossessed assets impairment write-downs	0	0	0	0
Net gain (loss) on sales	7	(3)	151	149
Total other real estate and repossessed assets	$ 18,381	$ 15,720	$ 18,381	$ 15,720
Less valuation allowance for other real estate owned	(3,233)	(3,282)	(3,233)	(3,282)
Balance at end of period	$ 15,148	$ 12,438	$ 15,148	$ 12,438

Net charge-offs against the allowance for loan losses at the time of foreclosure were approximately $180,000 and $323,000 during the three and nine months ended September 30, 2015, respectively, compared to $51,000 and $280,000 during the three and nine months ended September 30, 2014, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Balance, beginning of period	$ 3,233	$ 3,205	$ 3,255	$ 4,675
Provision for other real estate owned	0	276	(6)	450
Charge-offs	0	(199)	(16)	(1,843)
Balance, end of period	$ 3,233	$ 3,282	$ 3,233	$ 3,282

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(4) Investment Securities

The amortized cost and fair value of debt securities classified as available-for-sale at September 30, 2015 and December 31, 2014 were as follows:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
September 30, 2015				
Government sponsored enterprises	$ 87,618	$ 444	$ 12	88,050
Asset-backed securities	122,348	1,046	668	122,726
Obligations of states and political subdivisions	32,935	555	16	33,474
Total available-for-sale securities	$ 242,901	$ 2,045	$ 696	$ 244,250
December 31, 2014				
Government sponsored enterprises	$ 57,002	$ 240	$ 143	57,099
Asset-backed securities	106,726	855	1,119	106,462
Obligations of states and political subdivisions	34,925	583	71	35,437
Total available-for-sale securities	$ 198,653	$ 1,678	$ 1,333	$ 198,998

All of the Company’s investment securities are classified as available for sale. Agency bonds and notes, 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 securities, and the Company's interest in statutory trusts. These securities are reported at cost in the amount of $9.2 million and $4.7 million as of September 30, 2015 and December 31, 2014, respectively.

Debt securities with carrying values aggregating approximately $208.9 million and $145.5 million at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities classified as available-for-sale at September 30, 2015, 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	$ 29,157	$ 29,204
Due after one year through five years	77,519	78,157
Due after five years through ten years	13,043	13,332
Due after ten years	834	831
Total	120,553	121,524
Asset-backed securities	122,348	122,726
Total available-for-sale securities	$ 242,901	$ 244,250

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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 September 30, 2015 and December 31, 2014 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 September 30, 2015						
Government sponsored enterprises	$ 17,015	$ (12)	$ 0	$ 0	$ 17,015	$ (12)
Asset-backed securities	25,801	(136)	35,885	(532)	61,686	(668)
Obligations of states and political subdivisions	2,125	(14)	501	(2)	2,626	(16)
Total	$ 44,941	$ (162)	$ 36,386	$ (534)	$ 81,327	$ (696)
(in thousands)						
At December 31, 2014						
Government sponsored enterprises	$ 2,983	$ (4)	$ 17,862	$ (139)	$ 20,845	$ (143)
Asset-backed securities	10,314	(50)	45,445	(1,069)	55,759	(1,119)
Obligations of states and political subdivisions	3,667	(15)	1,942	(56)	5,609	(71)
Total	$ 16,964	$ (69)	$ 65,249	$ (1,264)	$ 82,213	$ (1,333)

The total available for sale portfolio consisted of approximately 317 securities at September 30, 2015. The portfolio included 62 securities having an aggregate fair value of $81.3 million that were in a loss position at September 30, 2015. Securities identified as temporarily impaired which had been in a loss position for 12 months or longer totaled $36.4 million at fair value. The $696,000 aggregate unrealized loss included in accumulated other comprehensive income at September 30, 2015 was caused by interest rate fluctuations.

The total available for sale portfolio consisted of approximately 300 securities at December 31, 2014. The portfolio included 74 securities having an aggregate fair value of $82.2 million that were in a loss position at December 31, 2014. Securities identified as temporarily impaired which had been in a loss position for 12 months or longer totaled $65.2 million at fair value. The $1.3 million aggregate unrealized loss included in accumulated other comprehensive income at December 31, 2014 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 September 30, 2015 and December 31, 2014, respectively. 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 it will be required to sell such investment securities. There have been no investment securities gains and losses which have been recognized in earnings for the three months ended September 30, 2015 and 2014.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Gains realized on sales	$ 0	$ 0	$ 8	$ 0
Losses realized on sales	0	0	0	0
Other-than-temporary impairment recognized	0	0	0	0
Investment securities gains	$ 0	$ 0	$ 8	$ 0

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(5) Intangible Assets

Mortgage Servicing Rights

At September 30, 2015, the Company was servicing approximately $311.8 million of loans sold to the secondary market compared to $313.9 million at December 31, 2014, and $315.3 million at September 30, 2014. Mortgage loan servicing fees, reported as non-interest income, earned on loans sold were $206,000 and $648,000 for the three and nine months ended September 30, 2015, respectively, compared to $226,000 and $672,000 for the three and nine months ended September 30, 2014, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Balance at beginning of period	$ 2,727	$ 2,911	$ 2,762	$ 3,036
Originated mortgage servicing rights	76	95	303	217
Changes in fair value:				
Due to change in model inputs and assumptions (1)	136	27	223	97
Other changes in fair value (2)	(165)	(166)	(514)	(483)
Balance at end of period	$ 2,774	$ 2,867	$ 2,774	$ 2,867

(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 MSRs as of the nine months ended September 30, 2015 and 2014:

	Nine Months Ended September 30,			
	2015		2014	
Weighted average constant prepayment rate	10.06	%	10.05	%
Weighted average note rate	3.92	%	4.00	%
Weighted average discount rate	9.35	%	9.18	%
Weighted average expected life (in years)	5.80		5.90	

(6) Income Taxes

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 35.2% for the three months ended September 30, 2015 compared to 33.8% for the three months ended September 30, 2014. Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 34.6% for the nine months ended September 30, 2015 compared to 34.4% for the nine months ended September 30, 2014

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, taxable income available in carryback years, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these temporary differences at September 30, 2015 and, therefore, did not establish a valuation reserve.

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(7) Stockholders' Equity

Accumulated Other Comprehensive Income (Loss)

The following details the change in the components of the Company's accumulated other comprehensive (loss) income for the nine months ended September 30, 2015 and 2014:

	Nine months ended September 30, 2015		
(in thousands)	Unrealized Gain (Loss) on Securities (1)	Unrecognized Net Pension and Postretirement Costs (2)	Accumulated Other Comprehensive (Loss) Income
Balance at beginning of period	$ 214	$ (1,442)	$ (1,228)
Other comprehensive income before reclassifications	996	0	996
Amounts reclassified from accumulated other comprehensive income	8	108	116
Current period other comprehensive income, before tax	1,004	108	1,112
Income tax expense	(382)	(40)	(422)
Current period other comprehensive income, net of tax	622	68	690
Balance at end of period	$ 836	$ (1,374)	$ (538)

Nine months ended September 30, 2014
Accumulated
Other

(in thousands)	Unrealized Gain (Loss) on Securities (1)	Unrecognized Net Pension and Postretirement Costs (2)	Comprehensive (Loss) Income
Balance at beginning of period	$ (1,491)	$ 722	$ (769)
Other comprehensive income before reclassifications	1,939	0	1,939
Amounts reclassified from accumulated other comprehensive income	0	59	59
Current period other comprehensive income, before tax	1,939	59	1,998
Income tax expense	(737)	(23)	(760)
Current period other comprehensive income, net of tax	1,202	36	1,238
Balance at end of period	$ (289)	$ 758	$ 469

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

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

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(8) Employee Benefit Plans

Employee Benefits

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Payroll taxes	$ 261	$ 272	$ 860	$ 840
Medical plans	491	510	1,462	1,512
401k match and profit sharing	225	159	720	488
Pension plan	348	236	1,044	708
Other	56	42	99	81
Total employee benefits	$ 1,381	$ 1,219	$ 4,185	$ 3,629

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

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 pension contribution for the 2015 plan year of $716,000 is equal to the minimum annual required contribution and was paid April 15, 2015, which was determined under the pension relief provision of Moving Ahead for Progress in the 21st Century Act (MAP 21) and Highway and Transportation Funding Act of 2014 (HATFA). Without the pension relief provisions, the minimum required contribution for the 2015 plan year would have been approximately $1,034,000.

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

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

(in thousands)	Estimated 2015	Actual 2014
Service cost - benefits earned during the year	$ 1,325	$ 981
Interest costs on projected benefit obligations	838	732
Expected return on plan assets	(957)	(872)
Expected administrative expenses	40	40
Amortization of prior service cost	79	79
Amortization of unrecognized net loss	66	0
Net periodic pension expense	$ 1,391	$ 960
Pension expense - three months ended September 30, (actual)	$ 348	$ 236
Pension expense - nine months ended September 30, (actual)	$ 1,044	$ 708

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(9) Stock Compensation

The Company's stock option plan provides for the grant of options to purchase up to 592,168 shares of the Company's common stock to officers and other key employees of the Company and its subsidiaries. All options have been granted at exercise prices equal to fair value and vest over periods ranging from four to five years.

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

	Number of Shares	Weighted average Exercise Price	Weighted Average Contractual Term (in years)	Aggregate Intrinsic Value ($000)
Outstanding, beginning of period	100,361	$ 21.56		
Granted	0	0.00		
Exercised	0	0.00		
Forfeited or expired	(33,929)	21.66		
Outstanding, September 30, 2015	66,432	$ 21.51	1.70	$ 0.00
Exercisable, September 30, 2015	58,949	$ 22.21	1.50	$ 0.00

Options have been adjusted to reflect a 4% stock dividend paid on July 1, 2015.

Total stock-based compensation expense was $1,000 and $5,000 for the three and nine months ended September 30, 2015, respectively, compared to $5,000 and $15,000 for the three and nine months ended September 30, 2014, respectively. As of September 30, 2015, the total unrecognized compensation expense related to non-vested stock awards was $25,000 and the related weighted average period over which it is expected to be recognized is approximately 1.0 years.

(10) Earnings per Share

Basic earnings per share is computed by dividing income available to shareholders by the weighted average number of shares outstanding during the year. Diluted earnings per share gives effect to all dilutive potential shares that were outstanding during the year. The calculations of basic and diluted earnings per share are as follows for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands, except per share data)	2015	2014	2015	2014
Basic earnings per share:				
Net income available to shareholders	$ 2,539	$ 1,568	$ 6,605	$ 5,653
Basic earnings per share	$ 0.47	$ 0.29	$ 1.21	$ 1.04
Diluted earnings per share:				
Net income available to shareholders	$ 2,539	$ 1,568	$ 6,605	$ 4,085
Average shares outstanding	5,443,344	5,443,344	5,443,344	5,443,344
Effect of dilutive stock options	0	0	0	0
Average shares outstanding including dilutive stock options	5,443,344	5,443,344	5,443,344	5,443,344
Diluted earnings per share	$ 0.47	0.29	$ 1.21	1.04

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

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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.

Options to purchase 66,432 shares during the three and nine months ended September 30, 2015, compared to 101,330 shares during the three and nine months ended September 30, 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.

(11) Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain financial and nonfinancial assets and liabilities. The FASB ASC Topic 820, *Fair Value Measurements and Disclosures,* defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The standard applies whenever other standards require (permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, FASB clarified the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. As of September 30, 2015 and December 31, 2014, respectively, there were no transfers into or out of Levels 1-3.

The fair value hierarchy is as follows:

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

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.

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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)
September 30, 2015				
Assets:				
Government sponsored enterprises	$ 88,050	$ 0	$ 88,050	$ 0
Asset-backed securities	122,726	0	122,726	0
Obligations of states and political subdivisions	33,474	0	33,474	0
Mortgage servicing rights	2,774	0	0	2,774
Total	$ 247,024	$ 0	$ 244,250	$ 2,774
December 31, 2014				

Assets:				
Government sponsored enterprises	$ 57,099	$ 0	57,099	0
Asset-backed securities	106,462	0	106,462	0
Obligations of states and political subdivisions	35,437	0	35,437	0
Mortgage servicing rights	2,762	0	0	2,762
Total	$ 201,760	$ 0	$ 198,998	$ 2,762

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

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Mortgage Servicing Rights			
	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Balance at beginning of period	$ 2,727	$ 2,911	$ 2,762	$ 3,036
Total gains or losses (realized/unrealized):				
Included in earnings	(29)	(139)	(291)	(386)
Included in other comprehensive income	0	0	0	0
Purchases	0	0	0	0
Sales	0	0	0	0
Issues	76	95	303	217
Settlements	0	0	0	0
Balance at end of period	$ 2,774	$ 2,867	$ 2,774	$ 2,867

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Total gains (losses) included in earnings attributable to the change in unrealized gains or losses related to assets still held were $136,000 and $223,000 for the three and nine months ended September 30, 2015, respectively, compared to $27,000 and $97,000 for the three and nine months ended September 30, 2014, respectively. MSR values have been falling steadily since 2014. The lower values are primarily related to faster prepay speed assumptions, consistent with lower long term interest rates. (See table below) The cost of compliance with new government regulations also has had an impact.

	Quantitative Information about Level 3 Fair Value Measurements					
	Valuation Technique	Unobservable Inputs	Input Value Nine Months Ended September 30, 2015		2014	
Mortgage servicing rights	Discounted cash flows	Weighted average constant prepayment rate	10.06	%	10.05	%
		Weighted average discount rate	9.35	%	9.18	%
		Weighted average expected life (in years)	5.80		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 September 30, 2015, the Company identified $6.8 million in impaired loans that had specific allowances for losses aggregating $2.0 million. Related to these loans, there was $695,000 and $1.0 million in charge-offs recorded during the three and nine months ended September 30, 2015, respectively. As of September 30, 2014, the Company identified $14.7 million in impaired loans that had specific allowances for losses aggregating $4.7 million. Related to these loans, there was $204,000 and $2.1 million in charge-offs recorded during the three and nine months ended September 30, 2014, respectively.

Other Real Estate and Repossessed Assets

Other real estate and repossessed assets consisted of loan collateral that has been repossessed through foreclosure. This collateral is comprised of commercial and residential real estate and other non-real estate property, including autos, manufactured homes, and construction equipment. Other real estate 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.

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	Fair Value Measurements Using					
(in thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Three Months Ended September 30, Total Gains (Losses)*	Nine Months Ended September 30, Total Gains (Losses)*
September 30, 2015						
Assets:						
Impaired loans:						
Commercial, financial, & agricultural	$462	$ 0	$ 0	$ 462	$ (540)	$ (561)
Real estate construction - residential	0	0	0	0	0	0
Real estate construction - commercial	45	0	0	45	0	0
Real estate mortgage - residential	3,618	0	0	3,618	(61)	(267)
Real estate mortgage - commercial	572	0	0	572	(89)	(118)
Consumer	121	0	0	121	(5)	(54)
Total	$4,818	$ 0	$ 0	$ 4,818	$ (695)	$ (1,000)
Other real estate and foreclosed assets	$15,148	$ 0	$ 0	$ 15,148	$ (80)	$ 112
September 30, 2014						
Assets:						
Impaired loans:						
Commercial, financial, & agricultural	$1,364	$ 0	$ 0	$ 1,364	$ (28)	$ (150)
Real estate construction - residential	1,767	0	0	1,767	0	(60)
Real estate construction - commercial	0	0	0	0	0	(491)
Real estate mortgage - residential	3,795	0	0	3,795	(41)	(179)

Real estate mortgage - commercial	2,887	0	0	2,887	(131)	(1,200)
Consumer	213	0	0	213	(4)	(74)
Total	$10,026	$ 0	$ 0	$ 10,026	$ (204)	$ (2,154)
Other real estate and repossessed assets	$12,438	$ 0	$ 0	$ 12,438	$ (203)	$ (1,733)

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

(12) 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.

Hawthorn Bancshares, Inc.
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Notes to the Consolidated Financial Statements

(Unaudited)

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 cashflows. The discount rate is estimated using the rates currently offered for other borrowed money of similar remaining maturities.

Hawthorn Bancshares, Inc.
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Notes to the Consolidated Financial Statements

(Unaudited)

A summary of the carrying amounts and fair values of the Company's financial instruments at September 30, 2015 and December 31, 2014 is as follows:

			September 30, 2015 Fair Value Measurements		
(in thousands)	September 30, 2015 Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Net Significant Unobservable Inputs (Level 3)
Assets:					
Cash and due from banks	$17,664	$17,664	$17,664	$ 0	$ 0
Federal funds sold and overnight interest-bearing deposits	14,463	14,463	14,463	0	0
Investment in available-for-sale securities	244,250	244,250	0	244,250	0
Loans, net	870,228	868,077	0	0	868,077
Investment in FHLB stock	4,590	4,590	0	4,590	0
Mortgage servicing rights	2,774	2,774	0	0	2,774
Cash surrender value - life insurance	2,329	2,329	0	2,329	0
Accrued interest receivable	4,909	4,909	4,909	0	0
	$1,161,207	$1,159,056	$37,036	$ 251,169	$ 870,851
Liabilities:					
Deposits:					
Non-interest bearing demand	$209,714	$209,714	$209,714	$ 0	$ 0
Savings, interest checking and money market	452,878	452,878	452,878	0	0
Time deposits	309,576	310,674	0	0	310,674
Federal funds purchased and securities sold under agreements to repurchase	27,762	27,762	27,762	0	0
Subordinated notes	49,486	35,056	0	35,056	0

Federal Home Loan Bank advances	80,000	82,572	0	82,572	0
Accrued interest payable	378	378	378	0	0
	$1,129,794	$1,119,034	$690,732	$ 117,628	$ 310,674

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Hawthorn Bancshares, Inc.
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Notes to the Consolidated Financial Statements

(Unaudited)

			December 31, 2014 Fair Value Measurements		
	December 31, 2014		Quoted Prices in Active Markets for Identical Assets	Other Observable Inputs	Net Significant Unobservable Inputs
(in thousands)	Carrying amount	Fair value	(Level 1)	(Level 2)	(Level 3)
Assets:					
Cash and due from banks	$22,364	$22,364	$22,364	$ 0	$ 0
Federal funds sold and overnight interest-bearing deposits	20,445	20,445	20,445	0	0
Investment in available-for-sale securities	198,998	198,998	0	198,998	0
Loans, net	852,114	854,062	0	0	854,062
Investment in FHLB stock	3,075	3,075	0	3,075	0
Mortgage servicing rights	2,762	2,762	0	0	2,762
Cash surrender value - life insurance	2,284	2,284	0	2,284	0
Accrued interest receivable	4,816	4,816	4,816	0	0
	$1,106,858	$1,108,806	$47,625	$ 204,357	$ 856,824
Liabilities:					
Deposits:					
Non-interest bearing demand	$207,700	$207,700	$207,700	$ 0	$ 0
Savings, interest checking and money market	442,059	442,059	442,059	0	0
Time deposits	319,755	321,041	0	0	321,041
Federal funds purchased and securities sold under agreements to repurchase	17,970	17,970	17,970	0	0
Subordinated notes	49,486	33,371	0	33,371	0
Federal Home Loan Bank advances	43,000	44,396	0	44,396	0
Accrued interest payable	373	373	373	0	0
	$1,080,343	$1,066,910	$668,102	$ 77,767	$ 321,041

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.

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Notes to the Consolidated Financial Statements

(Unaudited)

(13) Repurchase Reserve Liability

The Company’s repurchase reserve liability for estimated losses incurred on sold loans was $160,000 at September 30, 2015 and December 31, 2014, respectively. 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 September 30, 2015, the Company was servicing 3,024 loans sold to the secondary market with a balance of approximately $311.8 million compared to 3,057 loans sold with a balance of approximately $313.9 million at December 31, 2014.

(14) Commitments and Contingencies

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

The Company’s extent of involvement and maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for financial instruments included on its consolidated balance sheets. At September 30, 2015, no amounts have been accrued for any estimated losses for these financial instruments.

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

(in thousands)	**September 30, 2015**	**December 31, 2014**
Commitments to extend credit	$ 147,341	$ 135,137
Commitments to originate residential first and second mortgage loans	5,097	1,640
Standby letters of credit	1,432	1,621
Total	153,870	138,398

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 September 30, 2015.

Pending Litigation

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

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

And Results of Operations

Forward-Looking Statements

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

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

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

- competitive pressures among financial services companies may increase significantly,
- changes in the interest rate environment may reduce interest margins,
- general economic conditions, either nationally or in Missouri, may be less favorable than expected and may adversely affect the quality of our loans and other assets,
- increases in non-performing assets in the Company's loan portfolios and adverse economic conditions may necessitate increases to our provisions for loan losses,
- costs or difficulties related to the integration of the business of the Company and its acquisition targets may be greater than expected,
- legislative 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, 2014, and in other reports filed with the SEC from time to time, additional factors that could cause actual results to be materially different from those described in the forward-looking statements. Other factors that have not been identified in this report could also have this effect. You are cautioned not to put undue reliance on any forward-looking statement, which speak only as of the date they were made.

Overview

Crucial to the Company’s community banking strategy is growth in its commercial banking services, retail mortgage lending and retail banking services. Through the branch network of its subsidiary bank, the Company, with $1.2 billion in assets at September 30, 2015, 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 Lee's Summit, Missouri.

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'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.

CRITICAL ACCOUNTING POLICIES

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

Allowance for Loan Losses

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

Other Real Estate and Repossessed Assets

Other real estate 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 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.

SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents selected consolidated financial information for the Company as of and for each of the three and nine months ended September 30, 2015 and 2014, respectively. The selected consolidated financial data should be read in conjunction with the unaudited consolidated financial statements of the Company, including the related notes, presented elsewhere herein.

Selected Financial Data

(In thousands, except per share data)	**Three Months Ended September 30, 2015**	**2014**	**Nine Months Ended September 30, 2015**	**2014**
Per Share Data				
Basic earnings per share	$0.47	$0.29	$1.21	$1.04
Diluted earnings per share	0.47	0.29	1.21	1.04
Dividends paid on common stock	262	252	785	755
Book value per share			16.00	14.79
Market price per share			13.97	13.22
Selected Ratios				
(Based on average balance sheets)				
Return on total assets	0.84 %	0.54 %	0.74 %	0.65 %
Return on stockholders' equity	11.82%	7.71 %	10.55%	9.69 %
Stockholders' equity to total assets	7.09 %	6.97 %	7.00 %	6.74 %
Efficiency ratio (1)	69.62%	80.68%	72.25%	76.08%
(Based on end-of-period data)				
Stockholders' equity to assets			7.09 %	6.96 %
Total Capital Ratio (to risk weighted assets)			14.91%	15.68%
Tier 1 Capital Ratio (to risk weighted assets)			12.01%	12.02%
Tier 1 Capital Ratio (to average assets) (2)			9.70 %	9.18 %
Common Equity Tier 1 Capital (to risk weighted assets) (3)			9.02 %	NA %

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

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

(3) Calculated under Basel III rules, which became effective January 1, 2015.

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RESULTS OF OPERATIONS ANALYSIS

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

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
(In thousands)	**2015**	**2014**	**$ Change**	**% Change**	**2015**	**2014**	**$ Change**	**% Change**
Net interest income	$ 10,558	$ 9,956	$ 602	6.0 %	$ 30,520	$ 29,457	$ 1,063	3.6 %
Provision for loan losses	-	-	-	-	250	-	250	-
Noninterest income	2,336	2,313	23	1.0	6,785	6,582	203	3.1
Noninterest expense	8,977	9,899	(922)	(9.3)	26,953	27,417	(464)	(1.7)
Income before income taxes	3,917	2,370	1,547	65.3	10,102	8,622	1,480	17.2
Income tax expense	1,378	802	576	71.8	3,497	2,969	528	17.8
Net income	$ 2,539	$ 1,568	$ 971	61.9 %	$ 6,605	$ 5,653	$ 952	16.8 %

Business Events For the seventh consecutive year, on July 1, 2015, the Company distributed a four percent stock dividend to shareholders of record at the close of business on June 15, 2015. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect the stock dividend.

Consolidated net income increased $971,000 to $2.5 million, or $0.47 per diluted share, for the three months ended September 30, 2015 compared to $1.6 million, or $0.29 per diluted share, for the three months ended September 30, 2014. For the three months ended September 30, 2015, the return on average assets was 0.84%, the return on average stockholders' equity was 11.82%, and the efficiency ratio was 69.62%.

Consolidated net income increased $952,000 to $6.6 million, or $1.21 per diluted share, for the nine months ended September 30, 2015 compared to $5.7 million, or $1.04 per diluted share, for the nine months ended September 30, 2014. For the nine months ended September 30, 2015, the return on average assets was 0.74%, the return on average stockholders' equity was 10.55%, and the efficiency ratio was 72.25%.

Net interest income was $10.6 million and $30.5 million for the three and nine months ended September 30, 2015, respectively, compared to $10.0 million and $29.4 million for the three and nine months ended September 30, 2014, respectively. The net interest margin (expressed on a fully taxable equivalent basis) increased to 3.78% for the three months ended September 30, 2015 compared to 3.71% for the three months ended September 30, 2014, respectively, and remained consistent at 3.71% for both the nine months ended September 30, 2015 and 2014, respectively. These changes are discussed in greater detail under the *Average Balance Sheets and Rate and Volume Analysis* section below.

No ***provision for loan losses*** was recorded for the third quarter of 2015 and $250,000 was recorded for the nine months ended September 30, 2015 compared to no provision for the three and nine months ended September 30, 2014. The increase over 2014 was primarily due to an increase in specific reserves primarily related to two loan relationships.

The Company's net charge-offs were $740,000, or 0.08% of average loans, for the three months ended September 30, 2015 compared to $117,000, or 0.01% of average loans, for the three months ended September 30, 2014. The Company's net charge-offs were $103,000 for the nine months ended September 30, 2015, or 0.01% of average loans, compared to net charge-offs of $1.7 million, or 0.20% of average loans, for the nine months ended September 30, 2014. Non-performing loans totaled $14.6 million, or 1.66% of total loans, at September 30, 2015 compared to $36.0 million, or 4.18% of total loans, at December 31, 2014, and $35.7 million, or 4.15% of total loans, at September 30, 2014. These changes are discussed in greater detail under the *Lending and Credit Management* section below.

Non-interest income increased $23,000, or 1.0%, for the three months ended September 30, 2015, and increased $203,000, or 3.1%, for the nine months ended September 30, 2015 compared to the three and nine months ended September 30, 2014, respectively. These changes are discussed in greater detail below under Non-interest Income.

Non-interest expense decreased $922,000, or 9.3%, for the three months ended September 30, 2015, and decreased $464,000, or 1.7%, for the nine months ended September 30, 2015 compared to the three and nine months ended September 30, 2014, respectively. 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 periods ended September 30, 2015 and 2014, respectively.

(In thousands)	Three Months Ended September 30, 2015			2014		
	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)
ASSETS						
Loans: (2) (4)						
Commercial	$165,978	$ 1,938	4.63 %	$146,143	$ 1,749	4.75 %
Real estate construction - residential	14,102	385	10.83	21,603	260	4.77
Real estate construction - commercial	41,977	709	6.70	63,071	657	4.13
Real estate mortgage - residential	245,660	2,849	4.60	235,124	2,790	4.71
Real estate mortgage - commercial	382,707	4,616	4.79	373,138	4,470	4.75
Consumer	21,036	268	5.05	18,683	259	5.50
Total loans	$871,460	$ 10,765	4.90 %	$857,762	$ 10,185	4.71 %
Investment securities: (3)						
Government sponsored enterprises	$75,326	$ 261	1.37 %	$63,211	$ 229	1.44 %
Asset backed securities	125,188	598	1.90	112,350	601	2.12
State and municipal	33,984	265	3.09	34,195	284	3.30
Total investment securities	$234,498	$ 1,124	1.90 %	$209,756	$ 1,114	2.11 %
Other investments and securities, at cost	8,485	72	3.37	4,123	20	1.92
Federal funds sold and interest bearing deposits in other financial institutions	8,347	3	0.14	7,056	5	0.28
Total interest earning assets	$1,122,790	$ 11,964	4.23 %	$1,078,697	$ 11,324	4.16 %
All other assets	90,248			92,234		
Allowance for loan losses	(9,971)			(12,180)		
Total assets	$1,203,067			$1,158,751		
LIABILITIES AND STOCKHOLDERS' EQUITY						
NOW accounts	$191,026	$ 114	0.24 %	$195,162	$ 115	0.23 %
Savings	90,851	12	0.05	83,837	12	0.06
Money market	176,380	115	0.26	164,001	102	0.25
Time deposits of $100,000 and over	137,542	222	0.64	142,806	237	0.66
Other time deposits	172,945	269	0.62	194,144	331	0.68
Total time deposits	$768,744	$ 732	0.38 %	$779,950	$ 797	0.41 %
Federal funds purchased and securities sold under agreements to repurchase	26,296	11	0.17	21,029	5	0.09
Subordinated notes	49,486	326	2.61	49,486	318	2.55
Federal Home Loan Bank Advances	61,207	202	1.31	28,043	120	1.70
Total borrowings	$136,989	$ 539	1.56 %	$98,558	$ 443	1.78 %
Total interest bearing liabilities	$905,733	$ 1,271	0.56 %	$878,508	$ 1,240	0.56 %
Demand deposits	202,138			193,230		
Other liabilities	9,937			6,297		
Total liabilities	1,117,808			1,078,035		
Stockholders' equity	85,259			80,716		
Total liabilities and stockholders' equity	$1,203,067			$1,158,751		

Net interest income (FTE)	10,693		10,084	
Net interest spread	3.67	%	3.60	%
Net interest margin	3.78	%	3.71	%

(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 $135,000 and $128,000 for the three months ended September 30, 2015 and 2014, respectively.

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

(3) Average balances based on amortized cost.

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

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(In thousands)	Nine Months Ended September 30, 2015			2014		
	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)
ASSETS						
Loans: (2) (4)						
Commercial	$157,077	$ 5,594	4.76 %	$142,802	$ 5,060	4.74 %
Real estate construction - residential	15,077	789	7.00	22,894	755	4.41
Real estate construction - commercial	46,055	1,776	5.16	59,851	1,902	4.25
Real estate mortgage - residential	246,399	8,633	4.68	231,493	8,312	4.80
Real estate mortgage - commercial	378,344	13,455	4.75	373,427	13,351	4.78
Consumer	20,304	798	5.25	18,972	789	5.56
Total loans	$863,256	$ 31,045	4.81 %	$849,439	$ 30,169	4.75 %
Investment securities: (3)						
U.S. Treasury	$0	$ 0	0.00 %	$382	$ 3	1.05 %
Government sponsored enterprises	73,680	772	1.40	66,627	697	1.40
Asset backed securities	126,256	1,848	1.96	111,498	1,859	2.23
State and municipal	34,834	828	3.18	33,319	854	3.43
Total investment securities	$234,770	$ 3,448	1.96 %	$211,826	$ 3,413	2.15 %
Other investments and securities, at cost	6,252	138	2.95	4,044	59	1.95
Federal funds sold and interest bearing deposits in other financial institutions	11,716	24	0.27	10,428	23	0.29
Total interest earning assets	$1,115,994	$ 34,655	4.15 %	$1,075,737	$ 33,664	4.18 %
All other assets	89,568			94,310		
Allowance for loan losses	(9,757)			(12,895)		
Total assets	$1,195,805			$1,157,152		
LIABILITIES AND STOCKHOLDERS' EQUITY						
NOW accounts	$205,448	$ 375	0.24 %	$204,141	$ 406	0.27 %
Savings	88,651	36	0.05	82,157	45	0.07
Money market	173,014	328	0.25	162,753	299	0.25
Time deposits of $100,000 and over	138,598	653	0.63	143,934	723	0.67
Other time deposits	177,617	830	0.62	198,778	1,068	0.72
Total time deposits	$783,328	$ 2,222	0.38 %	$791,763	$ 2,541	0.43 %
Federal funds purchased and securities sold under agreements to repurchase	22,589	28	0.17	20,085	13	0.09
Subordinated notes	49,486	958	2.59	49,486	945	2.55
Federal Home Loan Bank Advances	47,960	513	1.43	25,747	328	1.70
Total borrowings	$120,035	$ 1,499	1.67 %	$95,318	$ 1,286	1.80 %
Total interest bearing liabilities	$903,363	$ 3,721	0.55 %	$887,081	$ 3,827	0.58 %
Demand deposits	198,690			185,843		
Other liabilities	10,085			6,231		
Total liabilities	1,112,138			1,079,155		
Stockholders' equity	83,667			77,997		
Total liabilities and stockholders' equity	$1,195,805			$1,157,152		
Net interest income (FTE)		30,934			29,837	

Net interest spread	3.60 %	3.60 %
Net interest margin	3.71 %	3.71 %

(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 $414,000 and $380,000 for the nine months ended September 30, 2015 and 2014, respectively.

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

(3) Average balances based on amortized cost.

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

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Rate and Volume Analysis

The following table summarizes the changes in net interest income on a fully taxable equivalent basis, by major category of interest earning assets and interest bearing liabilities, identifying changes related to volumes and rates for the three and nine months ended September 30, 2015 compared to the three and nine months ended September 30, 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.

	Three Months Ended September 30, 2015 vs. 2014			**Nine Months Ended September 30, 2015 vs. 2014**		
		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) (4)						
Commercial	$ 189	$ 232	$ (43)	$ 534	$ 508	$ 26
Real estate construction - residential	125	(115)	240	34	(314)	348
Real estate construction - commercial	52	(268)	320	(126)	(487)	361
Real estate mortgage - residential	59	123	(64)	321	526	(205)
Real estate mortgage - commercial	146	116	30	104	175	(71)
Consumer	9	31	(22)	9	53	(44)
Investment securities: (3)						
U.S. Treasury	0	0	0	(3)	(1)	(2)
Government sponsored entities	32	42	(10)	75	74	1
Asset backed securities	(3)	65	(68)	(11)	230	(241)
State and municipal	(19)	(2)	(17)	(26)	38	(64)
Other investments and securities, at cost	52	30	22	79	41	38
Federal funds sold and interest bearing deposits in other financial institutions	(2)	1	(3)	1	3	(2)
Total interest income	640	255	385	991	846	145
Interest expense:						
NOW accounts	(1)	(2)	1	(31)	3	(34)
Savings	0	1	(1)	(9)	4	(13)
Money market	13	8	5	29	19	10
Time deposits of $100,000 and over	(15)	(9)	(6)	(70)	(26)	(44)
Other time deposits	(62)	(34)	(28)	(238)	(107)	(131)
Federal funds purchased and securities sold under agreements to repurchase	6	1	5	15	2	13
Subordinated notes	8	0	8	13	0	13
Federal Home Loan Bank advances	82	115	(33)	185	245	(60)
Total interest expense	31	80	(49)	(106)	140	(246)

Net interest income on a fully taxable equivalent basis	$ 609	$ 175	$ 434	$ 1,097	$ 706	$ 391

(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 $135,000 and $414,000 for the three and nine months September 30, 2015, respectively, compared to $128,000 and $380,000 for the three and nine months ended September 30, 2014, respectively.

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

(3) Average balances based on amortized cost.

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

Financial results for the three months ended September 30, 2015 compared to the three months ended September 30, 2014, reflected an increase in net interest income, on a tax equivalent basis, of $609,000, or 6.04%, respectively, and financial results for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014 reflected an increase of $1.1 million, or 3.68%, respectively.

Measured as a percentage of average earning assets, the net interest margin (expressed on a fully taxable equivalent basis) increased to 3.78% for the three months ended September 30, 2015 compared to 3.71% for the three months ended September 30, 2014, respectively, and remained consistent at 3.71% for both the nine months ended September 30, 2015 and 2014, respectively.

The increase in net interest income for the three and nine months ended September 30, 2015 over the three and nine months ended September 30, 2014 was primarily due to an increase in average earning assets. The increase in the net interest margin quarter over quarter was primarily due to interest recognized on two construction loans.

Average interest-earning assets increased $44.1 million, or 4.09%, to $1.12 billion for the three months ended September 30, 2015 compared to $1.08 billion for the three months ended September 30, 2014, and average interest bearing liabilities increased $27.2 million, or 3.10%, to $905.7 million for the three months ended September 30, 2015 compared to $878.5 million for the three months ended September 30, 2014.

Average interest-earning assets increased $40.3 million, or 3.74%, to $1.16 billion for the nine months ended September 30, 2015 compared to $1.08 billion for the nine months ended September 30, 2014, and average interest bearing liabilities increased $16.3 million, or 1.84%, to $903.4 million for the nine months ended September 30, 2015 compared to $887.1 million for the nine months ended September 30, 2014.

Total interest income (expressed on a fully taxable equivalent basis) increased to $12.0 million and $34.7 million for the three and nine months ended September 30, 2015, respectively, compared to $11.3 million and $33.7 million for the three and nine months ended September 30, 2014, respectively. The Company’s rates earned on interest earning assets were 4.23% and 4.15% for the three and nine months ended September 30, 2015, respectively, compared to 4.16% and 4.18% for the three and nine months ended September 30, 2014, respectively.

Interest income on loans was $10.8 million and $31.0 million for the three and nine months ended September 30, 2015, respectively, compared to $10.2 million and $30.2 million for the three and nine months ended September 30, 2014, respectively.

Average loans outstanding increased $13.7 million, or 1.6%, to $871.5 million for the three months ended September 30, 2015 compared to $857.8 million for the three months ended September 30, 2014. The average yield on loans receivable increased to 4.90% for the three months ended September 30, 2015 compared to 4.71% for the three months ended September 30, 2014.

For the nine months ended September 30, 2015, average loans outstanding increased $13.8 million, or 1.6%, to $863.3 million compared to $849.4 million for the nine months ended September 30, 2014. The average yield on loans receivable increased to 4.81% for the nine months ended September 30, 2015 compared to 4.75% for the nine months ended September 30, 2014. See the *Lending and Credit Management* section for further discussion of changes in the composition of the lending portfolio.

Total interest expense was $1.3 million and $3.7 million for the three and nine months ended September 30, 2015, respectively, compared to $1.2 million and $3.8 million for the three and nine months ended September 30, 2014, respectively. The Company's rates paid on interest bearing liabilities were 0.56% and 0.55% for the three and nine months ended September 30, 2015 compared to 0.56% and 0.58% for the three and nine months ended September 30, 2014, respectively. See the *Liquidity Management* section for further discussion.

Interest expense on deposits decreased to $732,000 and $2.2 million for the three and nine months ended September 30, 2015, respectively, compared to $797,000 and $2.5 million for the three and nine months ended September 30, 2014, respectively.

Average time deposits decreased $11.2 million, or 1.44%, to $768.7 million for the three months ended September 30, 2015 compared to $779.9 million for the three months ended September 30, 2014. The average cost of deposits decreased to 0.38% for the three months ended September 30, 2015 compared to 0.41% for the three months ended September 30, 2014 primarily as a result of lower market interest rates.

For the nine months ended September 30, 2015, average time deposits decreased $8.4 million, or 1.07%, to $783.3 million for the nine months ended September 30, 2015 compared to $791.7 million for the nine months ended September 30, 2014. The average cost of deposits decreased to 0.38% for the nine months ended September 30, 2015 compared to 0.43% for the nine months ended September 30, 2014 primarily as a result of lower market interest rates.

Interest expense on borrowings increased to $539,000 and $1.5 million for the three and nine months ended September 30, 2015, respectively, compared to $443,000 and $1.3 million for the three and nine months ended September 30, 2014, respectively. Average borrowings increased to $137.0 million and $120.0 million for the three and nine months ended September 30, 2015, respectively, compared to $98.6 million and $95.3 million for the three and nine months ended September 30, 2014, respectively. See the *Liquidity Management* section for further discussion.

Non-interest Income and Expense

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
(In thousands)	2015	2014	$ Change	% Change	2015	2014	$ Change	% Change
Non-interest Income								
Service charges and other fees	$903	$979	$(76)	(7.8)%	$2,597	$2,808	$(211)	(7.5)%
Bank card income and fees	632	621	11	1.8	1,849	1,780	69	3.9
Trust department income	235	211	24	11.4	714	641	73	11.4
Real estate servicing fees, net	177	86	91	105.8	357	285	72	25.3
Gain on sales of mortgage loans, net	322	330	(8)	(2.4)	1,103	778	325	41.8
Other	67	86	(19)	(22.1)	165	290	(125)	(43.1)
Total non-interest income	$2,336	$2,313	$23	1.0 %	$6,785	$6,582	$203	3.1 %
Non-interest income as a % of total revenue *	18.1 %	18.9 %			18.2 %	18.3 %		
Total revenue per full time equivalent employee	$37.9	$35.7			$109.7	$104.8		

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

Total non-interest income was consistent at $2.3 million for both quarters ended September 30, 2015 and 2014, and increased $203,000, or 3.1%, to $6.8 million for the nine months ended September 30, 2015 compared to $6.6 million for the nine months ended September 30, 2014.

Real estate servicing fees, net of the change in the valuation of mortgage servicing rights increased $91,000 to $177,000 for the quarter ended September 30, 2015 compared to $86,000 for the quarter ended September 30, 2014, and increased $72,000 to $357,000 for the nine months ended September 30, 2015 compared to $285,000 for the nine months ended September 30, 2014.

Mortgage loan servicing fees earned on loans sold were $206,000 and $648,000 for the three and nine months ended September 30, 2015, respectively, compared to $226,000 and $672,000 for the three and nine months ended

September 30, 2014.

The change in valuation of mortgage servicing rights arising from inputs and assumptions increased $136,000 for the quarter ended September 30, 2015 compared to a $27,000 increase for the quarter ended September 30, 2014, and increased $223,000 for the nine months ended September 30, 2015 compared to a $97,000 increase for the nine months ended September 30, 2014. Total realized losses included in earnings attributable to the change in unrealized gains or losses related to assets still held were $(165,000) for the quarter ended September 30, 2015 compared to $(166,000) for the quarter ended September 30, 2014, and $(514,000) for the nine months ended September 30, 2015 compared to $(483,000) for the nine months ended September 30, 2014. The Company was servicing $311.8 million of mortgage loans at September 30, 2015 compared to $313.9 million and $315.3 million at December 31, 2014 and September 30, 2014, respectively.

Gain on sales of mortgage loans decreased $8,000, or 2.4%, to $322,000 for the quarter ended September 30, 2015 compared to $330,000 for the quarter ended September 30, 2014, and increased $325,000, or 41.8%, to $1.1 million for the nine months ended September 30, 2015 compared to $778,000. The Company sold loans of $11.2 million and $40.1 million for the three and nine months ended September 30, 2015, respectively, compared to $11.0 million and $25.6 million for the three and nine months ended September 30, 2014, respectively. Refinancing activity during the first nine months of 2015 impacting both the volume of loans sold and gains recognized contributed to this increase.

Other income decreased $19,000, or 22.1%, to $67,000 for the quarter ended September 30, 2015 compared to $86,000 for the quarter ended September 30, 2014, and decreased $125,000, or 43.1%, to $165,000 for the nine months ended September 30, 2015 compared to $290,000. The decrease in other income primarily related to a decrease in rental income received on other real estate owned during 2014 and an increase in the servicing repurchase liability during the first quarter of 2015 for reimbursement of costs incurred by Freddie Mac related to a foreclosure.

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
(In thousands)	2015	2014	$ Change	% Change	2015	2014	$ Change	% Change
Non-interest Expense								
Salaries	$3,939	$4,363	$ (424)	(9.7)%	$11,613	$11,944	$ (331)	(2.8)%
Employee benefits	1,381	1,219	162	13.3	4,185	3,629	556	15.3
Occupancy expense, net	685	705	(20)	(2.8)	2,064	1,997	67	3.4
Furniture and equipment expense	464	438	26	5.9	1,379	1,334	45	3.4
Processing, network, and bank card expense	806	780	26	3.3	2,402	2,359	43	1.8
Legal, examination, and professional fees	332	341	(9)	(2.6)	943	849	94	11.1
FDIC insurance assessment	175	244	(69)	(28.3)	673	724	(51)	(7.0)
Advertising and promotion	273	305	(32)	(10.5)	780	852	(72)	(8.5)
Postage, printing, and supplies	250	268	(18)	(6.7)	794	813	(19)	(2.3)
Real estate foreclosure expense and (gains), net	(329)	361	(690)	(191.1)	(352)	657	(1,009)	(153.6)
Other	1,001	875	126	14.4	2,472	2,259	213	9.4
Total non-interest expense	$8,977	$9,899	$ (922)	(9.3)%	$26,953	$27,417	$ (464)	(1.7)%
Efficiency ratio *	69.6 %	80.7 %			72.3 %	76.1 %		
Salaries and benefits as a % of total non-interest expense	59.3 %	56.4 %			58.6 %	56.8 %		
Number of full-time equivalent employees	340	344			340	344		

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

Total non-interest expense decreased $922,000, or 9.3%, to $9.0 million for the quarter ended September 30, 2015 compared to $9.9 million for the quarter ended September 30, 2014, and decreased $464,000, or 1.7%, to $26.9 million for the nine months ended September 30, 2015 compared to $27.4 million for the nine months ended September 30, 2014.

Salary expense decreased $424,000, or 9.7%, to $3.9 million for the quarter ended September 30, 2015 compared to $4.4 million for the quarter ended September 30, 2014, and decreased $331,000, or 2.8%, to 11.6 million for the nine months ended September 30, 2015 compared to $11.9 million for the nine months ended September 30, 2014. The decrease for both the three and nine months ended September 30, 2015 was primarily due to the accrual of a new incentive program approved by the Board of Directors in the third quarter of 2014.

Employee benefits increased $162,000, or 13.3%, to $1.4 million for the quarter ended September 30, 2015 compared to $1.2 million for the quarter ended September 30, 2014, and increased $556,000, or 15.3%, to 2.8 million for the nine months ended September 30, 2015 compared to $3.6 million for the nine months ended September 30, 2014. The increase was primarily due to a $178,000 and $568,000 increase in the 401(k) profit-sharing and pension expenses for the three and nine months ended September 30, 2015, respectively.

FDIC insurance assessment decreased $69,000, or 28.3%, to 175,000 for the quarter ended September 30, 2015 compared to $244,000 for the quarter ended September 30, 2014, and decreased $51,000, or 07.0%, to $673,000 for the nine months ended September 30, 2015 compared to $724,000 for the nine months ended September 30, 2014. The decrease for the quarter and nine months ended September 30, 2015 over the prior periods primarily consisted of a decrease in the assessment base.

Real estate foreclosure expense and (gains), net decreased $690,000, or 191.1%, to $(329,000) for the quarter ended September 30, 2015 compared to $361,000 for the quarter ended September 30, 2014, and decreased $1.0 million, or 153.6%, to $(352,000) for the nine months ended September 30, 2015 compared to $657,000 for the nine months ended September 30, 2014.

Net gains recognized on other real estate owned were $435,000 and $690,000 for the three and nine months ended September 30, 2015 compared to net losses of $21,000 and $295,000 for the three and nine months ended September 30, 2014. Expenses to maintain these foreclosed properties were $107,000 and $338,000 for the three and nine months ended September 30, 2015 compared to $87,000 and $362,000 for the three and nine months ended September 30, 2014. Gains were recognized on two properties sold during the first quarter of 2015 and one new foreclosure in the third quarter resulting in a net gain for both the three and nine months ended September 30, 2015.

Other non-interest expense increased $126,000, or 14.4%, to $1.0 million for the quarter ended September 30, 2015 compared to $875,000 for the quarter ended September 30, 2014, and increased $213,000, or 9.4%, to $2.5 million for the nine months ended September 30, 2015 compared to $2.3 million for the nine months ended September 30, 2014. The increase was primarily due to a $176,000 impairment write-down on a building held for sale partially offset by the $136,000 loss recorded due to employee fraud that management discovered during the third quarter of 2014.

Income taxes

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 35.2% for the quarter ended September 30, 2015 compared to 33.8% for the quarter ended September 30, 2014, and 34.6% for the nine months ended September 30, 2015 compared to 34.4% for the nine months ended September 30, 2014.

Lending and Credit Management

Interest earned on the loan portfolio is a primary source of interest income for the Company. Net loans represented 70.9% of total assets as of September 30, 2015 compared to 72.9% as of December 31, 2014.

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)	September 30, 2015		December 31, 2014	
Commercial, financial, and agricultural	$ 173,485		$ 154,834	
Real estate construction - residential	13,531		18,103	
Real estate construction - commercial	32,560		48,822	
Real estate mortgage - residential	249,512		247,117	
Real estate mortgage - commercial	388,220		372,321	
Installment loans to individuals	22,166		20,016	
Total loans	$ 879,474		$ 861,213	
Percent of categories to total loans:				
Commercial, financial, and agricultural	19.7	%	18.0	%
Real estate construction - residential	1.5		2.1	
Real estate construction - commercial	3.7		5.7	
Real estate mortgage - residential	28.4		28.7	
Real estate mortgage - commercial	44.1		43.2	
Installment loans to individuals	2.6		2.3	

Total	100.0	%	100.0	%

The Company experienced positive trends in commercial, financial, and agricultural loans, and real estate mortgage loans at September 30, 2015 compared to December 31, 2014, and real estate construction loans saw a slight decrease. At both September 30, 2015 and December 31, 2014, the Company benefited from commercial borrowers being more willing to expand operations, and new calling programs resulted in new customers and expanded loan relationships with existing customers. 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 Company generally does not retain long-term fixed rate residential mortgage loans in its portfolio. Fixed rate loans conforming to standards required by the secondary market are offered to qualified borrowers, but are not funded until the Company has a non-recourse purchase commitment from the secondary market at a predetermined price. During the three months ended September 30, 2015, the Company saw an increase in refinancing activity due to low interest rates and uncertainty of rate increases by the Federal Reserve. The Company sold loans of $11.2 million and $40.1 million for the three and nine months ended September 30, 2015, respectively, compared to $11.0 million and $25.6 million for the three and nine months ended September 30, 2014, respectively. Refinancing activity during the first nine months of 2015 impacting both the volume of loans sold and gains recognized contributed to this increase. At September 30, 2015, the Company was servicing approximately $311.8 million of loans sold to the secondary market compared to $313.9 million at December 31, 2014, and $315.3 million at September 30, 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, *Accounting by Creditors for Impairment of a Loan,* in identifying and measuring loan impairment. If management determines that it is probable that all amounts due on a loan will not be collected under the original terms of the loan agreement, the loan is considered to be impaired. These loans are evaluated individually for impairment, and in conjunction with current economic conditions and loss experience, specific reserves are estimated as further discussed below. Loans not 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 adequate 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)	September 30, 2015		December 31, 2014	
Nonaccrual loans:				
Commercial, financial, and agricultural	$ 2,831		$ 5,279	
Real estate construction - residential	0		1,751	
Real estate construction - commercial	54		2,096	
Real estate mortgage - residential	3,589		4,419	
Real estate mortgage - commercial	2,342		4,465	
Installment loans to individuals	141		233	
Total	$ 8,957		$ 18,243	
Loans contractually past - due 90 days or more and still accruing:				
Real estate construction - commercial	$ 0		$ 56	
Real estate mortgage - residential	348		0	
Installment loans to individuals	1		2	
Total	$ 349		$ 58	
Performing Troubled debt restructurings	5,253		17,720	
Total nonperforming loans	14,559		36,021	
Other real estate owned and repossessed assets	15,148		11,885	
Total nonperforming assets	$ 29,707		$ 47,906	
Loans	$ 879,474		$ 861,213	
Allowance for loan losses to loans	1.05	%	1.06	%
Nonperforming loans to loans	1.66	%	4.18	%

Allowance for loan losses to nonperforming loans	63.51	%	25.26	%
Allowance for loan losses to nonperforming loans, excluding performing TDR's	99.36	%	49.72	%
Nonperforming assets to loans, other real estate owned and repossessed assets	3.32	%	5.49	%

Total nonperforming assets totaled $29.7 million at September 30, 2015 compared to $47.9 million at December 31, 2014. Nonperforming loans, defined as loans on nonaccrual status, loans 90 days or more past due and still accruing, and TDRs totaled $14.6 million, or 1.66%, of total loans at September 30, 2015 compared to $36.0 million, or 4.18%, of total loans at December 31, 2014. Non-accrual loans included $1.4 million and $1.6 million of loans classified as TDRs at September 30, 2015 and December 31, 2014, respectively.

As of September 30, 2015 and December 31, 2014, approximately $5.9 million and $9.6 million, respectively, 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. Even though borrowers are experiencing moderate cash flow problems as well as some deterioration in collateral value, management believes the general allowance was sufficient to cover the risks and probable losses related to such loans at September 30, 2015 and December 31, 2014, respectively.

Total non-accrual loans decreased $9.3 million to $9.0 million at September 30, 2015 from December 31, 2014. This decrease primarily consisted of a $2.4 million decrease in commercial, financial and agricultural loans, $1.8 million decrease in real estate construction – residential loans, $2.0 million decrease in real estate construction – commercial loans, and a $2.1 million decrease in real estate mortgage – commercial loans. The decrease in non-accrual loans primarily resulted from the sale of a piece 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 September 30, 2015 were $349,000 compared to $58,000 at December 31, 2014. Other real estate and repossessed assets at September 30, 2015 were $15.1 million compared to $11.9 million at December 31, 2014. During the nine months ended September 30, 2015, $4.5 million of nonaccrual loans, net of charge-offs taken, moved to other real estate owned and repossessed assets compared to $1.8 million during the nine months ended September 30, 2014.

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

	September 30, 2015			December 31, 2014		
(In thousands)	**Number of Contracts**	**Recorded Investment**	**Specific Reserves**	**Number of Contracts**	**Recorded Investment**	Specific Reserves
Performing TDRs						
Commercial, financial and agricultural	9	$ 812	$ 70	10	$ 2,262	$ 6
Real estate mortgage - residential	6	3,302	832	6	3,459	752
Real estate mortgage - commercial	2	1,139	-	8	11,999	-
Total performing TDRs	17	$ 5,253	$ 902	24	$ 17,720	$ 758
Nonperforming TDRs						
Commercial, financial and agricultural	1	$ 56	$ -	2	$ 71	$ -
Real estate mortgage - residential	2	467	44	2	347	140
Real estate mortgage - commercial	5	886	223	3	1,167	10
Total nonperforming TDRs	8	$ 1,409	$ 267	7	$ 1,585	$ 150
Total TDRs	25	$ 6,662	$ 1,169	31	$ 19,305	$ 908

At September 30, 2015, loans classified as TDRs totaled $6.7 million, of which $1.4 million were classified as nonperforming TDRs and included in non-accrual loans and $5.3 million were classified as performing TDRs. At December 31, 2014, TDRs totaled $19.3 million, of which $1.6 million were classified as nonperforming TDRs included in non-accrual loans and $17.7 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 $1.2 million and $1.0 million related to TDRs were allocated to the allowance for loan losses at September 30, 2015 and December 31, 2014, respectively. The net decrease in total TDRs from December 31, 2014 to September 30, 2015 was primarily due to $2.0 million additions to TDRs that were offset by $273,000 charged off, $100,000 moved to ORE, approximately $2.0 million of payments received, and $12.3 million from five loan relationships moved to performing loans due to subsequent restructuring at market rates and terms followed by satisfactory payment performance.

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)	September 30, 2015	December 31, 2014
Allocation of allowance for loan losses at end of period:		
Commercial, financial, and agricultural	$ 3,000	$ 1,779
Real estate construction - residential	18	171
Real estate construction - commercial	551	466
Real estate mortgage - residential	2,057	2,527
Real estate mortgage - commercial	3,246	3,846
Installment loans to individuals	209	270
Unallocated	165	40
Total	$ 9,246	$ 9,099

The allowance for loan losses was $9.2 million, or 1.05%, of loans outstanding at September 30, 2015 compared to $9.1 million, or 1.06%, of loans outstanding at December 31, 2014, and $12.0 million, or 1.40%, of loans outstanding at September 30, 2014. The ratio of the allowance for loan losses to nonperforming loans, excluding TDR’s – accruing, was 99.36% at September 30, 2015, compared to 49.72% at December 31, 2014, and 49.14% at September 30, 2014.

Provision

No provision for loan losses was recorded for the third quarter of 2015 and $250,000 was recorded for the nine months ended September 30, 2015 compared to no provision for the three and nine months ended September 30, 2014. The increase over 2014 was primarily due to an increase in specific reserves primarily related to two loan relationships.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2015	2014	2015	2014
Analysis of allowance for loan losses:				
Balance beginning of period	$ 9,986	$ 12,150	$ 9,099	$ 13,719
Charge-offs:				
Commercial, financial, and agricultural	591	105	741	291
Real estate construction - residential	-	-	-	59
Real estate construction - commercial	-	-	5	491
Real estate mortgage - residential	87	41	298	236
Real estate mortgage - commercial	126	80	159	1,152
Installment loans to individuals	80	71	241	270
Total charge-offs	884	297	1,444	2,499
Recoveries:				
Commercial, financial, and agricultural	$ 28	$ 55	$ 643	$ 282
Real estate construction - residential	28	-	322	60
Real estate mortgage - residential	45	26	105	151
Real estate mortgage - commercial	5	67	157	160
Installment loans to individuals	38	32	114	160
Total recoveries	144	180	1,341	813
Net charge-offs	740	117	103	1,686
Provision for loan losses	-	-	250	-
Balance end of period	$ 9,246	$ 12,033	$ 9,246	$ 12,033

Net Loan Charge-offs (Recoveries)

The Company’s net charge-offs were $740,000, 0.08% of average loans, for the quarter ended September 30, 2015 compared to $117,000, or 0.01%, of average loans, for the quarter ended September 30, 2014. Detailed in the table above, the increase in net charge-offs quarter over quarter was primarily due to a $513,000 increase in commercial, financial, and agricultural charge-offs related to one loan relationship.

The Company’s net charge-offs were $103,000 for the nine months ended September 30, 2015, or 0.01% of average loans, compared to net charge-offs of $1.7 million, or 0.20% of average loans, for the nine months ended September 30, 2014. Detailed in the table above, the Company’s recoveries increased for the nine months ended September 30, 2015 over the prior year primarily due to one loan relationship in commercial loans, and one loan relationship in real estate construction loans. In addition to the increase in recoveries recorded during the nine months ended September 30, 2015, the Company also noted a decrease in charge-offs of $1.0 million compared to the nine months ended September 30, 2014.

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

(In thousands)	September 30, 2015	December 31, 2014
Allocation of allowance for loan losses:		
Individually evaluated for impairment - specific reserves	$ 1,970	$ 1,749
Collectively evaluated for impairment - general reserves	7,276	7,350
Total	$ 9,246	$ 9,099

Specific reserves increased to $2.0 million at September 30, 2015 compared to $1.7 million at December 31, 2014. The increase in reserves from December 31, 2014 primarily occurred in commercial, financial, and agricultural loans, and real estate mortgage commercial loans. The increase in commercial, financial, and agricultural reserves primarily related to one loan relationship due to increased exposure resulting from liquidation of collateral during the current quarter. The increase in real estate mortgage reserves was primarily due to additional reserves required for one loan relationship resulting from the reevaluation of collateral values.

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 September 30, 2015, $2.0 million of the Company's allowance for loan losses was allocated to impaired loans totaling approximately $14.2 million compared to $1.7 million of the Company's allowance for loan losses (ALL) allocated to impaired loans totaling approximately $36.0 million at December 31, 2014. Management determined that $7.4 million, or 52%, of total impaired loans required no reserve allocation at September 30, 2015 compared to $28.5 million, or 79%, at December 31, 2014 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 percentages 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, delinquencies, current economic conditions, loan risk ratings, and industry concentration adjusted for certain qualitative factors to reflect current risk characteristics of the portfolio. In addition, the combined historical loan loss rates and qualitative factors 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. Management determined that the previous twelve quarters were reflective of the loss characteristics of the Company's loan portfolio during the recent economic environment. These historical loss rates for each risk group are used as the starting point to determine allowance provisions. The Company's methodology includes qualitative factors that allow management to adjust its estimates of losses based on the most recent information available. These factors reflect actual changes and anticipated changes such as changes in specific allowances on loans and real estate acquired through foreclosure, any gains and losses on final disposition of real estate acquired through foreclosure, changes in national and local economic conditions and developments, including general economic and business conditions affecting the Company's key lending areas, credit quality trends, specific industry conditions within portfolio segments, bank regulatory examination results, and findings of the internal loan review department. These risk factors are generally reviewed and updated quarterly, as appropriate.

Loss Emergence Periods While the historical loss rates and qualitative factors (discussed above) provide a good foundation as to the incurred losses in the current portfolio, the portfolio is comprised of very unique loan categories that inherently may need more time to produce a loss than other loan categories (given these unique segments and workout periods). As such, a review of the Company's LEP is necessary to ensure the ALL estimate is appropriately stated as of the balance sheet date, rather than relying on a singular annualized loss rate based upon the historical charge-off activity. Determination of the LEP allows for loans with effective useful lives other than twelve months, often loans with extended workout periods, to be incorporated into the reserve estimate, given the incurred loss event had occurred prior to the balance sheet date. This approach is consistent with the Interagency ALL Guidance noted above.

The specific and general reserve allocations represent management's best estimate of probable losses contained 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.

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.

(In thousands)	September 30, 2015	December 31, 2014
Federal funds sold and other overnight interest-bearing deposits	$ 14,463	$ 20,445
Available-for-sale investment securities	244,250	198,998
Total	$ 258,713	$ 219,443

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 $258.7 million at September 30, 2015 and included an unrealized net gain of $1.3 million. The portfolio includes projected maturities and mortgage backed securities pay-downs of

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approximately $31.0 million over the next twelve months, which offer resources to meet either new loan demand or reductions in the Company's deposit base.

The Company pledges portions of its investment securities portfolio to secure public fund deposits, federal funds purchase lines, securities sold under agreements to repurchase, borrowing capacity at the Federal Reserve Bank, and for other purposes required by law. At September 30, 2015 and December 31, 2014, the Company's unpledged securities in the available for sale portfolio totaled approximately $35.3 million and $53.4 million, respectively.

Total investment securities pledged for these purposes were as follows:

(In thousands)	September 30, 2015	December 31, 2014
Investment securities pledged for the purpose of securing:		
Federal Reserve Bank borrowings	$ 3,502	$ 3,504
Federal funds purchased and securities sold under agreements to repurchase	73,576	26,770
Other deposits	131,851	115,272
Total pledged, at fair value	$ 208,929	$ 145,546

Liquidity is available from the Company's base of core customer deposits, defined as demand, interest checking, savings, and money market deposit accounts. At September 30, 2015, such deposits totaled $662.6 million and represented 68.2% 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 $309.6 million at September 30, 2015. These accounts are normally considered more volatile and higher costing representing 31.8% of total deposits at September 30, 2015.

Core deposits at September 30, 2015 and December 31, 2014 were as follows:

(In thousands)	September 30, 2015	December 31, 2014
Core deposit base:		
Non-interest bearing demand	$ 209,714	$ 207,700
Interest checking	183,538	191,902
Savings and money market	269,340	250,157
Total	$ 662,592	$ 649,759

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 September 30, 2015, under agreements with these unaffiliated banks, the Bank may borrow up to $40.0 million in federal funds on an unsecured basis and $8.6 million on a secured basis. There were no federal funds purchased outstanding at September 30, 2015. Securities sold under agreements to repurchase are generally borrowed overnight and are secured by a portion of the Company’s investment portfolio. At September 30, 2015, there was $27.8 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 September 30, 2015.

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 September 30, 2015, the Bank had $80.0 million in outstanding borrowings with the FHLB. In addition, the Company has $49.5 million in outstanding subordinated notes issued to wholly-owned grantor trusts, funded by preferred securities issued by the trusts.

Borrowings outstanding at September 30, 2015 and December 31, 2014 were as follows:

(In thousands)	September 30, 2015	December 31, 2014
Borrowings:		
Securities sold under agreements to repurchase	$ 27,762	$ 17,970
Federal Home Loan Bank advances	80,000	43,000
Subordinated notes	49,486	49,486
Total	$ 157,248	$ 110,456

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 as follows:

	September 30, 2015				December 31, 2014			
(In thousands)	FHLB	**Federal Reserve Bank**	**Federal Funds Purchased Lines**	Total	FHLB	**Federal Reserve Bank**	**Federal Funds Purchased Lines**	Total
Advance equivalent	$243,414	$ 3,432	$ 45,200	$292,046	$273,613	$ 3,433	$ 44,340	$321,386
Advances outstanding	(80,000)	0	0	(80,000)	(43,000)	0	0	(43,000)
Total available	$163,414	$ 3,432	$ 45,200	$212,046	$230,613	$ 3,433	$ 44,340	$278,386

At September 30, 2015, loans with a market value of $330.5 million were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit. At September 30, 2015, investments with a market value of $9.5 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 $32.1 million at September 30, 2015 compared to $42.8 million at December 31, 2014. The $10.7 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 nine months ended September 30, 2015. Cash flow provided from operating activities consists mainly of net income adjusted for certain non-cash items. Operating activities provided cash flow of $11.6 million for the nine months ended September 30, 2015.

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 $70.9 million. The cash outflow primarily consisted of $81.6 million purchases of investment securities, and a $21.9 million increase in loans, partially offset by $35.6 million proceeds from maturities, calls, and pay-downs of investment securities.

Financing activities provided cash of $48.7 million, resulting primarily from a $37.0 million net increase in FHLB advances, a $10.8 million increase in interest bearing transaction accounts, and a $9.8 million increase in federal funds purchased and securities sold under agreements to repurchase, partially offset by a $10.2 million decrease in time deposits. Future short-term liquidity needs arising from daily operations are not expected to vary significantly during 2015.

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 $153.9 million in unused loan commitments and standby letters of credit as of September 30, 2015. Although the Company's current liquidity resources are adequate to fund this commitment level the nature of these commitments is such that the likelihood of such a funding demand is very low.

The Company is a legal entity, separate and distinct from the Bank, which must provide its own liquidity to meet its operating needs. The Company’s ongoing liquidity needs primarily include funding its operating expenses and paying cash dividends to its shareholders. The Company paid cash dividends to its shareholders totaling approximately $785,000 and $755,000 for the nine months ended September 30, 2015 and 2014, respectively. A large portion of the Company’s liquidity is obtained from the Bank in the form of dividends. The Bank declared and paid $1.0 million in dividends to the Company during the nine months ended September 30, 2015. At September 30, 2015 and December 31, 2014, the Company had cash and cash equivalents totaling $5.5 million and $1.0 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.

Quantitative measures established by regulations to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital to risk-weighted assets, and of Tier I capital to adjusted-average assets. The Company made a one-time election not to include accumulated other comprehensive income (AOCI) components in regulatory capital. Management believes, as of September 30, 2015 and December 31, 2014, the Company and the Bank each met all capital adequacy requirements.

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 community banking organizations began January 1, 2015, while larger institutions (generally those with assets of $250 billion or more) must begin compliance on January 1, 2014. The final rules call for the following capital requirements:

- A minimum ratio of common tier 1 capital to risk-weighted assets of 4.5%.
- A minimum ratio of tier 1 capital to risk-weighted assets of 6%.
- A minimum leverage ratio of 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. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations will begin on January 1, 2016.

The following table summarizes regulatory capital information as of September 30, 2015 and December 31, 2014 on a consolidated basis and for the Bank, as defined. Regulatory capital ratios for September 30, 2015 were calculated in accordance with the Basel III rules, whereas the December 31, 2014 regulatory ratios were calculated in accordance with Basel I rules.

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(in thousands)	**Actual** Amount	Ratio	**Required for Capital Adequacy Purposes** Amount	Ratio	**Well-Capitalized Under Prompt Corrective Action Provision** Amount	Ratio
September 30, 2015						
Total Capital (to risk-weighted assets):						
Company	$144,837	14.91 %	$ 77,721	8.00 %	$ N.A.	N.A. %
Bank	135,619	14.03	77,332	8.00	96,665	10.00
Tier I Capital (to risk-weighted assets):						
Company	$116,635	12.01 %	$ 58,291	6.00 %	$ N.A.	N.A. %
Bank	126,213	13.06	57,999	6.00	77,332	8.00
Common Equity Tier I Capital (to risk-weighted assets)						
Company	$87,611	9.02 %	$ 43,718	4.50 %	$ N.A.	N.A. %
Bank	126,213	13.06	43,499	4.50	62,832	6.50
Tier I Capital (to adjusted average assets):						
Company	$116,635	9.70 %	$ 48,084	4.00 %	$ N.A.	N.A. %
Bank	126,213	10.55	47,850	4.00	59,813	5.00
(in thousands)						
December 31, 2014						
Total Capital (to risk-weighted assets):						
Company	$138,619	15.78 %	$ 70,282	8.00 %	N.A.	N.A. %
Bank	128,311	14.78	69,430	8.00	$ 86,788	10.00
Tier I Capital (to risk-weighted assets):						
Company	$108,785	12.38 %	$ 35,141	4.00 %	N.A.	N.A. %
Bank	119,212	13.74	34,715	4.00	$ 52,073	6.00
Tier I capital (to adjusted average assets):						
Company	$108,785	9.42 %	$ 46,197	4.00 %	$ N.A.	N.A. %
Bank	119,212	10.42	45,784	4.00	57,230	5.00

Item 3. 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. For the three months ended September 30, 2015, our Company utilized a 400 basis point immediate and gradual move in interest rates (both upward and downward) applied to both a parallel and proportional yield curve. 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 September 30, 2015. 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	$36,986	$16,365	$29,971	$32,754	$24,071	$ 104,103	$244,250
Federal funds sold and other over-night interest-bearing deposits	14,463	-	-	-	-	-	14,463
Other restricted investments	6,237	-	-	-	3,000	-	9,237
Loans	305,071	151,320	138,926	103,964	117,147	63,046	879,474
Total	$362,757	$167,685	$168,897	$136,718	$144,218	$ 167,149	$1,147,424
LIABILITIES							
Savings, interest checking, and money market deposits	$261,988	$-	$190,890	$-	$-	$ -	$452,878
Time deposits	203,067	61,693	32,029	6,896	5,891	-	309,576
Federal funds purchased and securities sold under agreements to repurchase	27,762	-	-	-	-	-	27,762
Subordinated notes	49,486	-	-	-	-	-	49,486
Federal Home Loan Bank advances	38,000	5,000	22,000	4,000	11,000	-	80,000
Total	$580,303	$66,693	$244,919	$10,896	$16,891	$ -	$919,702
Interest-sensitivity GAP							
Periodic GAP	$(217,546)	$100,992	$(76,022)	$125,822	$127,327	$ 167,149	$227,722
Cumulative GAP	$(217,546)	$(116,554)	$(192,576)	$(66,754)	$60,573	$ 227,722	$227,722
Ratio of interest-earning assets to interest-bearing liabilities							
Periodic GAP	0.63	2.51	0.69	12.55	8.54	NM	1.25
Cumulative GAP	0.63	0.82	0.78	0.93	1.07	1.25	1.25

Effects of Inflation

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

Inflation does have an impact on the growth of total assets in the banking industry, often resulting in a need to increase capital at higher than normal rates to maintain an appropriate capital to asset ratio. In the opinion of management, inflation did not have a significant effect on the Company's operations for the three months ended September 30, 2015.

Item 4. Controls and Procedures

Our Company's management has evaluated, with the participation of our principal executive and principal financial officers, the effectiveness of our disclosure controls and procedures as defined in Rules 13a – 15(e) or 15d – 15(e) of the Securities Exchange Act of 1934 as of September 30, 2015. Based upon and as of the date of that evaluation, our principal executive and principal financial officers concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as and when required. It should be noted that any system of disclosure controls and procedures, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any system of disclosure controls and procedures is based in part upon assumptions about the likelihood of future events. Because of these and other inherent limitations of any such system, there can be no assurance that any design will always succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

There has been no change in our Company's internal control over financial reporting that occurred during the three months ended September 30, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Impact of New Accounting Standards

Revenue from Contracts with Customers The FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, 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, 2017 and must be applied retrospectively. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

Transfers and Servicing The FASB issued ASU 2014-11, *Repurchase-to-Maturity Transactions*, *Repurchase Financings, and Disclosures*, in September 2014. The amendments require that repurchase-to-maturity transactions and repurchase agreements that are part of financing arrangements be accounted for as secured borrowings. The amendments also require additional disclosures for certain transfers accounted for as sales. The accounting changes and the disclosures on sales are required to be presented in interim and annual periods beginning January 1, 2015. This ASU also requires disclosures about types of collateral, contractual tenor and potential risks for transactions accounted for as secured borrowings. These disclosures are required in interim and annual periods beginning April 1, 2015. The adoption is not expected to have a significant effect on the Company's consolidated financial statements.

Presentation of Financial Statements - Going Concern Uncertainties. The FASB has issued ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* in August 2014. ASU 2014-15 is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under Generally Accepted Accounting Principles (GAAP), financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. Financial reporting under this presumption is commonly referred to as the going concern basis of accounting. The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This ASU provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments are effective for interim and annual periods ending after December 15, 2016. The adoption is not expected to have a significant effect on the Company's consolidated financial statements.

Consolidation The FASB has issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*. 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 in this update are effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is currently evaluating the effect that ASU 2015-02 will have on its consolidated financial statements and related disclosures. The adoption is not expected to have a significant effect on the Company's consolidated financial statements.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A.	Risk Factors	None
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	None
Item 3.	Defaults Upon Senior Securities	None
Item 4.	Mine Safety Disclosures	None
Item 5.	Other Information	None
Item 6.	Exhibits	

Exhibit No.	**Description**
3.1	Restated Articles of Incorporation of our Company (filed as Exhibit 3.1 to our Company's current report on Form 8-K on August 9, 2007 and incorporated herein by reference).
3.2	Amended and Restated Bylaws of our Company (filed as Exhibit 3.1 to our Company's current report on Form 8-K on June 8, 2009 and incorporated herein by reference).
4.1	Specimen certificate representing shares of our Company's $1.00 par value common stock (filed as Exhibit 4.1 to our Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999 (Commission file number 0-23636) and incorporated herein by reference).
31.1	Certificate of the Chief Executive Officer of our Company pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2	Certificate of the Chief Financial Officer of our Company pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Changes in Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text and in detail (XBRL)

SIGNATURES

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

HAWTHORN BANCSHARES, INC.

Date	
	/s/ David T. Turner
November 16, 2015	David T. Turner, Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
	/s/ W. Bruce Phelps
November 16, 2015	W. Bruce Phelps, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

HAWTHORN BANCSHARES, INC.

INDEX TO EXHIBITS

September 30, 2015 Form 10-Q

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