Hawthorn Bancshares (HWBK)

Published June 21st, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	$20	**5 Year CAGR Estimate:**	7.1%	**Market Cap:**	$138 M
Fair Value Price:	$21	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	6/14/24
% Fair Value:	94%	**5 Year Valuation Multiple Estimate:**	1.4%	**Dividend Payment Date:**	7/1/24
Dividend Yield:	3.8%	**5 Year Price Target**	$24	**Years Of Dividend Growth:**	13
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Hawthorn Bancshares is a financial holding company that is the parent company of Hawthorn Bank, which was founded in 1865 and is headquartered in Jefferson City, Missouri. The bank, which has 18 branches, conducts a general banking and trust business, offering its customers checking and savings accounts, internet banking, debit cards, brokerage services and a wide range of loans, such as commercial and industrial loans, personal loans and residential real estate loans. Commercial real estate loans comprise 50% of total loans while residential real estate loans comprise 24% of total loans. Hawthorn Bancshares has a market capitalization of only $138 million.

In late April, Hawthorn Bancshares reported (4/24/24) financial results for the first quarter of fiscal 2024. Loans and deposits decreased -1.3% and -2.7%, respectively, on a sequential basis. Net interest margin contracted from 3.48% to 3.39% due to higher deposit costs amid intense competition among banks. Nevertheless, the bank switched from a loss per share of -$1.05 to earnings-per-share of $0.63, as the losses from sales of bonds in the previous quarter were not recurring. The excessive losses from bond sales incurred in the previous quarter raise a red flag about management. On the bright side, as interest rates are not likely to increase any further, the worse seems to be behind the bank. Hawthorn Bancshares has a healthy tier 1 capital ratio of 12.5% and thus it has earned the characterization of "well capitalized".

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.03	$1.15	$0.98	$0.46	$1.46	$2.20	$1.96	$3.15	$2.94	$0.14	***$2.30***	***$2.54***
DPS	$0.14	$0.15	$0.16	$0.21	$0.30	$0.39	$0.44	$0.54	$0.62	$0.67	***$0.76***	***$1.00***
Shares[1]	7.5	7.4	7.4	7.4	7.3	7.3	7.3	7.1	7.1	7.1	***7.0***	***6.8***

Hawthorn Bancshares has exhibited a decent but volatile performance record over the last decade. During the last four years, the bank has grown its loans and its deposits at an average annual rate of 7%. However, the bank incurred a -95% plunge in earnings-per-share last year due to excessive losses from sales of bonds. The losses were caused by the impact of high interest rates on the value of bonds. This is a stern reminder of the inherent risk of this small-cap bank. While the excessive losses do not bode well for the quality of management, Hawthorn Bancshares is likely to recover strongly this year, as the realized losses in 2023 are most likely non-recurring in nature. The bank is also likely to see its net interest margin improve in the upcoming years thanks to the interest rate reductions expected by the Fed. Overall, given the somewhat high comparison base formed by the expected earnings-per-share this year, we assume 2.0% average annual growth of earnings-per-share over the next five years. The bank may exceed our expectations but it is prudent to be on the safe side, given the vulnerable business model of this small-cap bank.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	9.6	8.8	11.2	34.1	12.2	9.2	8.8	6.5	8.0	141.4	***8.7***	***9.3***
Avg. Yld.	1.4%	1.5%	1.5%	1.3%	1.7%	1.9%	2.5%	2.6%	2.6%	3.4%	***3.8%***	***4.2%***

[1] In millions.

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Excluding the years 2017 and 2023, in which abnormally low earnings resulted in abnormally high price-to-earnings ratios, Hawthorn Bancshares has traded at an average price-to-earnings ratio of 9.3 over the last decade. We assume this valuation level as fair for this small-cap financial stock. The stock is currently trading at a price-to-earnings ratio of 8.7. If it trades at its fair valuation level in five years, it will enjoy a 1.4% annualized valuation gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	14%	13%	16%	46%	21%	18%	22%	17%	21%	479%	***33%***	***39%***

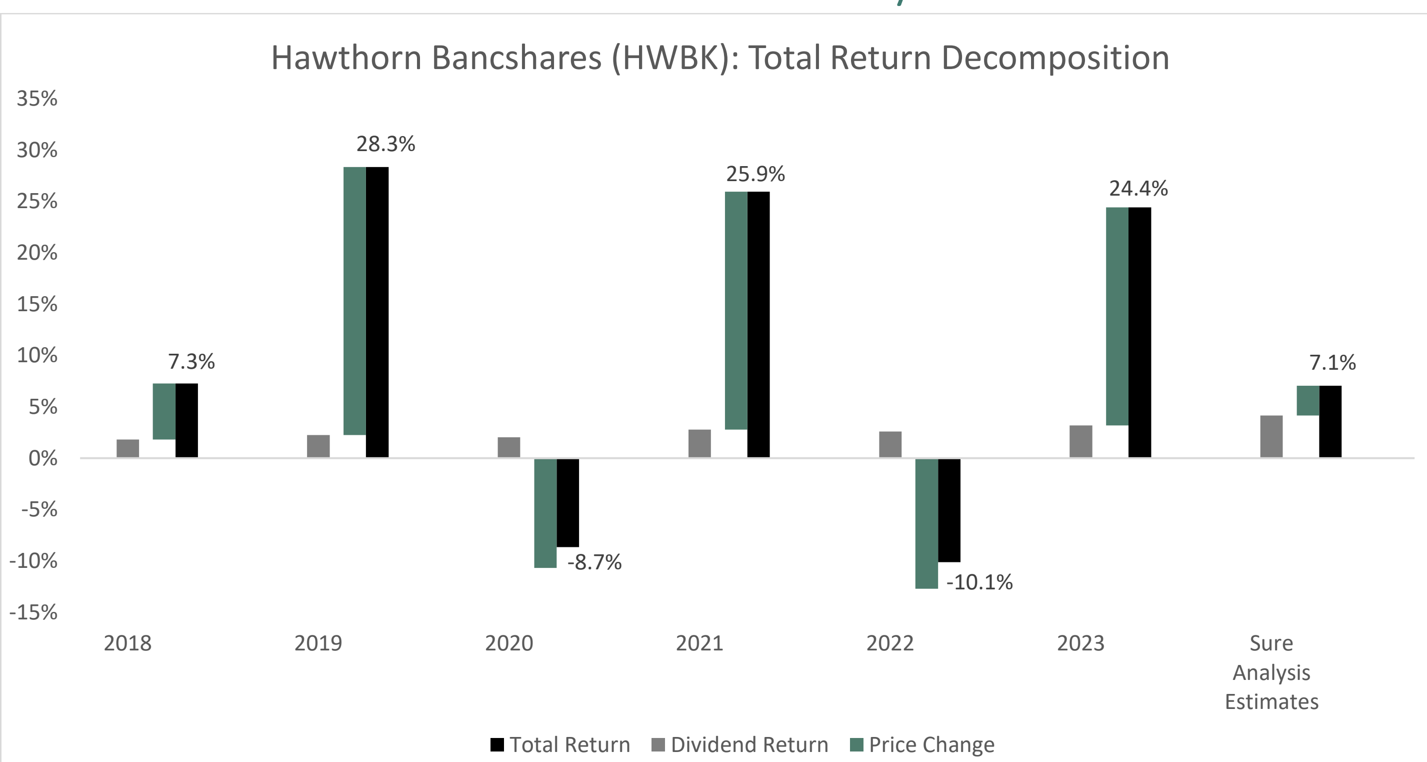
Hawthorn Bancshares has raised its dividend for 13 consecutive years. It is also offering a 3.8% dividend yield, with a solid payout ratio of only 33%. In addition, the bank has a healthy tier 1 capital ratio of 12.5% while its net loan charge-offs have remained below 0.04% in each of the last four years. Therefore, the bank is likely to continue raising its dividend for many more years.

Hawthorn Bancshares also proved resilient to the pandemic, as it reported just an -11% decrease in earnings-per-share in 2020 and posted record earnings-per-share in 2021. However, the bank proved highly vulnerable to the unexpected surge of inflation, which led the Fed to raise interest rates to 16-year highs within a short period. The excessive losses of the bank in the fourth quarter of 2023 and its vast underperformance vs. the S&P 500 over the last five years (-12% vs. +85%) are reminders of the inherent risk of this small-cap bank. Overall, Hawthorn Bancshares does not appear suitable for conservative, income-oriented investors.

Final Thoughts & Recommendation

Hawthorn Bancshares has begun to recover strongly from the downturn caused by the surge of interest rates to 16-year highs. The stock could offer a 7.1% average annual return over the next five years thanks to 2.0% growth of earnings-per-share, its 3.8% dividend and a 1.4% valuation tailwind. The stock receives a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	48	50	49	52	54	58	68	75	73	55
SG&A Exp.	23	23	22	23	24	23	27	29	29	30
D&A Exp.	2	2	2	2	2	2	2	2	2	2
Net Profit	8	9	7	3	11	16	14	23	21	1
Net Margin	15.9%	17.2%	14.8%	6.6%	19.8%	27.9%	20.9%	29.8%	28.5%	1.7%
Free Cash Flow	12	12	12	11	14	17	19	30	18	16
Income Tax	4	5	4	8	2	4	3	6	4	(1)

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,170	1,201	1,287	1,429	1,482	1,493	1,734	1,832	1,924	1,875
Cash & Equivalents	22	20	27	27	36	33	29	158	87	93
Total Liabilities	1,089	1,114	1,196	1,338	1,382	1,378	1,603	1,683	1,796	1,739
Acct. Payable	0	0	0	1	1	1	1	0	1	2
Long-Term Debt	92	99	143	171	145	146	156	127	147	156
Shareholder's Equity	81	87	91	91	99	115	131	149	127	136
LTD/E Ratio	1.15	1.14	1.57	1.87	1.45	1.27	1.20	0.85	1.16	1.15

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	0.7%	0.7%	0.6%	0.3%	0.7%	1.1%	0.9%	1.3%	1.1%	0.1%
Return on Equity	9.9%	10.2%	8.2%	3.7%	11.2%	15.0%	11.6%	16.1%	15.0%	0.7%
ROIC	4.8%	4.8%	3.5%	1.4%	4.2%	6.4%	5.2%	8.0%	7.5%	0.3%
Shares Out.	7.5	7.4	7.4	7.4	7.3	7.3	7.3	7.1	7.1	7.1
Revenue/Share	6.73	6.70	6.64	7.03	7.38	7.87	9.38	10.56	10.30	7.83
FCF/Share	1.70	1.67	1.65	1.52	1.90	2.35	2.63	4.14	2.51	2.20

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.