ULTRAPAR HOLDINGS INC
Form 425
November 15, 2007

Filer: Ultrapar Participações S.A.
Issuer: Ultrapar Participações S.A.
Subject of the offer: Refinaria de Petróleo Ipiranga S.A.,
Distribuidora de Produtos de Petróleo Ipiranga S.A. and
Companhia Brasileira de Petróleo Ipiranga S.A.
Commission File Number: 001-14950

DISTRIBUIDORA DE PRODUTOS DE PETRÓLEO IPIRANGA S.A.
NIRE 43.3.00004821 - CNPJ/MF 92.689.256/0001-76
Publicly Traded Company

Minutes of a meeting of the Board of Directors
Held on November 12, 2007

1. Date, Time and Location. Held on November 12, 2007 at 3 p.m. at Rua Antonio Carlos, Nº 434, in the City of São Paulo, in the State of São Paulo.

2. Convening and Presence. Duly convened and assembled, with the presence of (including participants by telephone) Mrs. Pedro Wongtschowski, André Covre, Eduardo de Toledo, José Roberto Opice, Roberto Kutschat Neto and José Afonso Alves Castanheira, members of the Board of Directors of Distribuidora de Produtos de Petróleo Ipiranga ("DPPI") in accordance with Articles 9 and 10 of the DPPI's bylaws. Present also, under the terms of Article 163, §3º of Law Nº 6.404/76, were members of the Fiscal Council of DPPI, Mrs. Ubaldo Evangelista Neto, Carlos Mello and Eliana Chimenti, the executive officers of DPPI, Srs. Leocadio de Almeida Antunes Filho and Sergio Roberto Weyne Ferreira da Costa, and representatives of KPMG Independent Auditors ("KPMG"), Banco de Investimentos Credit Suisse (Brasil) S.A. ("Credit Suisse") Apsis Consultoria Empresarial S/C Ltda. ("Apsis"), Mrs. Alexandre Heinerman, Marco Gonçalves and Luiz Paulo César Silveira, respectively.

3. Presiding at the Board. Pedro Wongtschowski - Chairman and André Covre - Secretary.

4. Deliberated Matters. The Presiding Chairman announced that the object of the meeting was to deliberate on the exchange of shares issued by DPPI by Ultrapar Participações S.A. ("ULTRAPAR") ("Share Exchange"). The members of the Board of Directors recognized that the Share Exchange is of the interest of DPPI, which will be strengthened together with the other companies of the Ipiranga Group, and their shareholders, in order to simplify the corporate structure of the Ipiranga Group, concentrating all the shareholders into one publicly-traded company, aligning the interests of all the shareholders, increasing market capitalization and share liquidity, and participating in a company recognized for its high corporate governance standards. After the presentation of the necessary clarifications by the Executive Officers, the members of the Board of Directors examined and discussed the documents sent by the Executive Officers, including the "Protocol and Justification for the Exchange of Shares issued by Distribuidora de Produtos de Petróleo Ipiranga S.A. by Ultrapar Participações S.A." and the documents referred to therein. In particular, considering the position of certain minority shareholders in relation to the intended Share Exchange, they carefully examined and discussed the results of the valuation reports prepared by Deutsche Bank Securities Inc. ("Deutsche Bank") and Credit Suisse according to which DPPI and ULTRAPAR were evaluated in order to establish the exchange ratio between the shares of DPPI and ULTRAPAR. Although the members of the Board had previously discussed with Credit Suisse, they requested additional clarification to Credit Suisse representatives related to the

final version of the document. Subsequently, the members of the Board inquired the representatives of Credit Suisse, Apsis and KPMG if they, as specialists on this subject, considered all the pertinent legal requirements on the elaboration of their respective valuation reports, in particular Brazilian Corporate Law, regulations of the CVM (Brazilian Securities and Exchange Commission) and generally accepted accounting practices, to which the representatives of the three companies each individually confirmed the complete conformity of their respective valuation reports to the legal precepts applicable, with the representatives of Credit Suisse in addition confirming, based on the valuation report that they prepared, that the exchange ratio offered for the Share Exchange, is adequate. Based on this examination and discussion and also considering the discussion at the meeting of the Board of Directors on November 6, 2007, during which the representatives of Credit Suisse answered to queries and clarified questions of the members present, in accordance with the minutes of such meeting, the members concluded, in their best judgement, that these valuation reports were prepared according to the concepts and assumptions which these banks used freely and independently in the exercising of their tasks. Thus, exercising their fiduciary duty in the fulfilment of their responsibilities, under the terms of articles 153, 154 and 155 of Law Nº 6.404/76, and having verified that the documents referred to below and the Share Exchange conform to legal and statutory requirements, decided to submit the proposal for the Share Exchange to the approval of the shareholders of DPPI, under the terms and conditions of the " Protocol and Justification for the Exchange of Shares issued by Distribuidora de Produtos de Petróleo Ipiranga S.A by Ultrapar Participações S.A.", and its annexes, signed by the executive officers of DPPI and ULTRAPAR on November 9, 2007. The Board of Directors authorised the Executive Officers to provide the publication of the relevant notice and Convening Notice for the convening of an Extraordinary Shareholders Meeting to deliberate on the Share Exchange, as well as practice all the necessary acts to implement these operation. Given the previous deliberations, the Board of Directors decided to convene the Special Shareholders Meeting to deliberate and approve the intended Share Exchange, for December 18, 2007.

5. Quorum for deliberations: All the deliberations above were voted on and approved unanimously.

6. Closing of the meeting. The Presiding Chairman, having offered the opportunity for any party to pronounce, none having done, declared the meeting closed, the minutes of which being duly transcript, read and approved by all those present undersigned.

São Paulo, November 12, 2007.

Compared with original
in registry book.

André Covre
Secretary

Forward-Looking Statements

This document may include "forward-looking statements" within the meaning of the "safe harbor" provisions of the United States Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of words such as "anticipate," "believe," "expect," "estimate," "plan," "outlook," "project" and other similar expressions th predict or indicate future events or trends or that are not statements of historical matters. Investors are cautioned that such forward-looking statements with respect to revenues, earnings, performance, strategies, prospects and other aspects of the businesses of Ultrapar Participações S.A. ("Ultrapar"), Refinaria de Petróleo Ipiranga S.A. ("RPI"),

Distribuidora de Produtos de Petróleo Ipiranga S.A. (“DPPI”), Companhia Brasileira de Petróleo Ipiranga (“CBPI” and together with RPI and DPPI, the “Target Companies”) and the combined group after completion of the proposed transaction are based on current expectations that are subject to risks and uncertainties. A number of factors could cause actual results or outcomes to differ materially from those indicated by such forward-looking statements. These factors include, but are not limited to, the following risks and uncertainties: those set forth in Ultrapar’s filings with the Securities and Exchange Commission (“SEC”), the failure to obtain and retain expected synergies from the proposed transaction, failure of Ultrapar stockholders to approve the related share exchange, delays in obtaining, or adverse conditions contained in, any required regulatory approvals, failure to consummate or delay in consummating the transaction for other reasons, changes in laws or regulations and other similar factors. Readers are referred to Ultrapar’s most recent reports filed with the SEC. Ultrapar and the Target Companies are under no obligation to (and expressly disclaim any such obligation to) update or alter their forward-looking statements whether as a result of new information, future events or otherwise.

Additional Information and Where to Find It

This document relates to a proposed transaction involving Ultrapar and the Target Companies. In connection with the proposed transaction, Ultrapar has filed with the SEC a registration statement on Form F-4 (File no. 333-146406) (the “Registration Statement”) to register Ultrapar preferred shares to be issued in the proposed transaction and that includes a prospectus of Ultrapar. Ultrapar has also filed, and intends to continue to file, additional relevant materials with the SEC. The Registration Statement and the related prospectus contain important information about Ultrapar, the Target Companies, the proposed transaction and related matters. Investors will be able to obtain copies of the offering document and other documents from the SEC's Public Reference Room at 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 Room. The documents may also be obtained from the website maintained by the SEC at http://www.sec.gov, which contains reports and other information regarding registrants that file electronically with the SEC. Ultrapar has also filed certain documents with the *Comissão de Valores Mobiliários*, the Brazilian securities commission, which are available on the CVM’s website at http://www.cvm.gov.br. In addition, documents (including any exhibits) filed with the SEC or CVM by Ultrapar will be available free of charge from the Investor Relations office of Ultrapar Participações S.A., located at Avenida Brigadeiro Luis Antonio, 1343, 9º Andar São Paulo, SP, Brazil 01317-910, tel: 011-55-11-3177-6695. **SHAREHOLDERS OF THE TARGET COMPANIES ARE URGED TO READ THE REGISTRATION STATEMENT AND ANY OTHER RELEVANT DOCUMENTS FILED WITH THE SEC, INCLUDING THE PROSPECTUS, BECAUSE THEY CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED TRANSACTION.**

" NOWRAP STYLE="font-weight: bold; text-align: center; border-bottom: Black 1pt solid">2015 Allocation of allowance for loan losses: Individually evaluated for impairment - specific reserves $1,348 $1,540 Collectively evaluated for impairment - general reserves 7,283 7,064 Total $8,631 $8,604

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 March 31, 2016, $1.3 million of the Company's ALL was allocated to impaired loans totaling approximately $8.9 million compared to $1.5 million of the Company's ALL allocated to impaired loans totaling approximately $10.3 million at December 31, 2015. Management determined that $3.8 million, or 42%, of total impaired loans required no reserve allocation at March 31, 2016 compared to $4.5 million, or 44%, at December 31, 2015 primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

The *incurred loss component* of the general reserve, or loans collectively evaluated for impairment, is determined by applying loss rates to pools of loans by asset type. Loans not individually evaluated are aggregated by risk characteristics and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type. Beginning in the first quarter of 2016, the Company began to lengthen its look-back period with the intent to increase such period from three to five years over the next two years. The Company believes that the five-year look-back period, which is consistent with the Company's practices prior to the start of the economic recession in 2008, provides a representative historical loss period in the current economic environment. These historical loss rates for each risk group are used as the starting point to determine loss rates for measurement purposes. The Company's methodology includes qualitative risk factors that allow management to adjust its estimates of losses based on the most recent information available and to address other limitations in the quantitative component that is based on historical loss rates. Such risk factors are generally reviewed and updated quarterly, as appropriate, and are adjusted to reflect changes in national and local economic conditions and developments, the nature, volume and terms of loans in the portfolio, including changes in volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans, loan concentrations, assessment of trends in collateral values, assessment of changes in the quality of the Company's internal loan review department, and changes in lending policies and procedures, including underwriting standards and collections, charge-off and recovery practices. The 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.

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

Provision

A $250,000 provision was required for the three months ended March 31, 2016 compared to no provision for the three months ended March 31, 2015. The increase was primarily due to using a thirteen quarter look-back period compared to twelve quarters, as discussed above, in addition to an increase in loans.

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

	Three Months Ended March 31,	
(In thousands)	2016	2015
Analysis of allowance for loan losses:		
Balance beginning of period	$ 8,604	$ 9,099
Charge-offs:		
Commercial, financial, and agricultural	103	28
Real estate construction - commercial	1	-
Real estate mortgage - residential	206	71
Real estate mortgage - commercial	82	24
Installment loans to individuals	56	48
Total charge-offs	448	171
Recoveries:		
Commercial, financial, and agricultural	$ 97	$ 575
Real estate construction - residential	-	177
Real estate construction - commercial	11	-
Real estate mortgage - residential	8	12
Real estate mortgage - commercial	61	34
Installment loans to individuals	48	35
Total recoveries	225	833
Net charge-offs (recoveries)	223	(662)
Provision for loan losses	250	-
Balance end of period	$ 8,631	$ 9,761

44

Net Loan Charge-offs (Recoveries)

The Company’s net loan charge-offs were $223,000, or 0.03%, of average loans for the three months ended March 31, 2016, compared to net loan recoveries of $662,000, or (0.08)%, of average loans for the three months ended March 31, 2015. The increase in charge-offs quarter over quarter primarily related to an increase in commercial, financial, and agricultural loans, and an increase in real estate mortgage residential loans. The decrease in recoveries quarter over quarter was primarily due to a recovery in one commercial loan relationship and one real estate construction loan relationship.

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)	March 31, 2016	December 31, 2015
Federal funds sold and other overnight interest-bearing deposits	$ 24,587	$ 7,893

Available-for-sale investment securities	245,773	235,054
Total	$ 270,360	$ 242,947

Federal funds sold and resale agreements normally have overnight maturities and are used for general daily liquidity purposes. The fair value of the available-for-sale investment portfolio was $245.8 million at March 31, 2016 and included an unrealized net gain of $581,000. The portfolio includes projected maturities and mortgage backed securities pay-downs of approximately $19.8 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 March 31, 2016 and December 31, 2015, the Company's unpledged securities in the available for sale portfolio totaled approximately $43.5 million and $52.4 million, respectively.

Total investment securities pledged for these purposes were as follows:

(In thousands)	March 31, 2016		December 31, 2015	
Investment securities pledged for the purpose of securing:				
Federal Reserve Bank borrowings	$	3,483	$	3,481
Federal funds purchased and securities sold under agreements to repurchase		48,671		66,911
Other deposits		150,154		112,282
Total pledged, at fair value	$	202,308	$	182,674

Liquidity is available from the Company's base of core customer deposits, defined as demand, interest checking, savings, and money market deposit accounts. At March 31, 2016, such deposits totaled $702.6 million and represented 70.8% 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 $289.9 million at March 31, 2016. These accounts are normally considered more volatile and higher costing representing 29.2% of total deposits at March 31, 2016.

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

(In thousands)	March 31, 2016	December 31, 2015
Core deposit base:		
Non-interest bearing demand	$ 216,886	$ 208,035
Interest checking	211,922	176,124
Savings and money market	273,837	264,956
Total	$ 702,645	$ 649,115

Other components of liquidity are the level of borrowings from third party sources and the availability of future credit. The Company's outside borrowings are comprised of securities sold under agreements to repurchase, Federal Home Loan Bank advances, and subordinated notes. Federal funds purchased are overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved credit lines. As of March 31, 2016, under agreements with these unaffiliated banks, the Bank may borrow up to $40.0 million in federal funds on an unsecured basis and $7.8 million on a secured basis. There were no federal funds purchased outstanding at March 31, 2016. Securities sold under agreements to repurchase are generally borrowed overnight and are secured by a portion of the Company's investment portfolio. At March 31, 2016, there was $41.5 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 March 31, 2016.

The Bank is a member of the Federal Home Loan Bank of Des Moines (FHLB). As a member of the FHLB, the Bank has access to credit products of the FHLB. As of March 31, 2016, the Bank had $50.0 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 March 31, 2016 and December 31, 2015 were as follows:

(In thousands)	March 31, 2016	December 31, 2015
Borrowings:		
Securities sold under agreements to repurchase	$ 41,523	$ 56,834
Federal Home Loan Bank advances	50,000	50,000
Subordinated notes	49,486	49,486
Total	$ 141,009	$ 156,320

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

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

	March 31, 2016				December 31, 2015			
(In thousands)	FHLB	Federal Reserve Bank	Federal Funds Purchased Lines	Total	FHLB	Federal Reserve Bank	Federal Funds Purchased Lines	Total
Advance equivalent	$266,411	$ 3,413	$ 44,370	$314,194	$257,513	$ 3,412	$ 45,175	$306,100
Advances outstanding	(50,000)	0	0	(50,000)	(50,000)	0	0	(50,000)
Total available	$216,411	$ 3,413	$ 44,370	$264,194	$207,513	$ 3,412	$ 45,175	$256,100

At March 31, 2016, loans with a market value of $362.4 million were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit. At March 31, 2016, investments with a market value of $8.9 million were pledged to secure federal funds purchase lines and borrowing capacity at the Federal Reserve Bank.

46

Sources and Uses of Funds

Cash and cash equivalents were $42.8 million at March 31, 2016 compared to $28.4 million at December 31, 2015. The $14.4 million increase resulted from changes in the various cash flows produced by operating, investing, and financing activities of the Company, as shown in the accompanying consolidated statement of cash flows for the three months ended March 31, 2016. Cash flow provided from operating activities consists mainly of net income adjusted for certain non-cash items. Operating activities provided cash flow of $3.6 million for the three months ended March 31, 2016.

Investing activities consisting mainly of purchases, sales and maturities of available-for-sale securities, and changes in the level of the loan portfolio used total cash of $18.8 million. The cash outflow primarily consisted of $66.5 million purchases of investment securities, partially offset by $44.1 million proceeds from sales of investment securities.

Financing activities provided cash of $29.7 million, resulting primarily from a $44.7 million increase in interest bearing transaction accounts partially offset by a $15.3 million decrease in federal funds purchased and securities sold under agreements to repurchase. Future short-term liquidity needs arising from daily operations are not expected to vary significantly during 2016.

In the normal course of business, the Company enters into certain forms of off-balance sheet transactions, including unfunded loan commitments and letters of credit. These transactions are managed through the Company's various risk management processes. Management considers both on-balance sheet and off-balance sheet transactions in its evaluation of the Company's liquidity. The Company had $239.8 million in unused loan commitments and standby letters of credit as of March 31, 2016. Although the Company's current liquidity resources are adequate to fund this commitment level the nature of these commitments is such that the likelihood of such a funding demand is very low.

The Company is a legal entity, separate and distinct from the Bank, which must provide its own liquidity to meet its operating needs. The Company’s ongoing liquidity needs primarily include funding its operating expenses and paying cash dividends to its shareholders. The Company paid cash dividends to its shareholders totaling approximately $271,000 and $262,000 for the three months ended March 31, 2016 and 2015, respectively. A large portion of the Company’s liquidity is obtained from the Bank in the form of dividends. The Bank did not declare or pay dividends to the Company during the three months ended March 31, 2016. At March 31, 2016 and December 31, 2015, the Company had cash and cash equivalents totaling $4.0 million and $5.0 million, respectively.

Capital Management

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

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

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

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

(in thousands)	Actual Amount	Ratio	Required for Capital Adequacy Purposes Amount	Ratio	Well-Capitalized Under Prompt Corrective Action Provision Amount	Ratio
March 31, 2016						
Total Capital (to risk-weighted assets):						
Company	$147,698	14.65%	$ 80,638	8.00 %	$ N.A.	N.A. %
Bank	140,127	13.96	80,322	8.00	100,402	10.00
Tier I Capital (to risk-weighted assets):						
Company	$121,209	12.03%	$ 60,479	6.00 %	$ N.A.	N.A. %
Bank	131,336	13.08	60,241	6.00	80,322	8.00
Common Equity Tier I Capital (to risk-weighted assets)						
Company	$90,907	9.02 %	$ 45,359	4.50 %	$ N.A.	N.A. %
Bank	131,336	13.08	45,181	4.50	65,261	6.50
Tier I Capital (to adjusted average assets):						
Company	$121,209	9.84 %	$ 48,976	4.00 %	$ N.A.	N.A. %
Bank	131,336	10.78	48,732	4.00	60,915	5.00

(in thousands)						
December 31, 2015						
Total Capital (to risk-weighted assets):						
Company	$146,068	14.78%	$ 79,066	8.00 %	N.A.	N.A. %
Bank	137,572	13.98	78,718	8.00	$ 98,398	10.00
Tier I Capital (to risk-weighted assets):						
Company	$118,875	12.03%	$ 59,299	6.00 %	N.A.	N.A. %
Bank	128,808	13.09	59,039	6.00	$ 78,718	8.00
Common Equity Tier I Capital (to risk-weighted assets)						
Company	$89,304	9.04 %	$ 44,475	4.50 %	$ N.A.	N.A. %
Bank	128,808	13.09	44,279	4.50	63,959	6.50
Tier I capital (to adjusted average assets):						
Company	$118,875	9.84 %	$ 48,314	4.00 %	$ N.A.	N.A. %
Bank	128,808	10.73	48,025	4.00	60,031	5.00

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

48

(In thousands)	Year 1	Year 2	Year 3	Year 4	Year 5	Over 5 Years or No stated Maturity	Total
ASSETS							
Investment securities	$36,160	$10,506	$24,518	$51,057	$75,042	$48,490	$245,773
Federal funds sold and other over-night interest-bearing deposits	24,587	-	-	-	-	-	24,587
Other restricted investments	5,080	-	-	-	3,000	-	8,080
Loans	246,746	106,529	140,663	143,082	129,588	108,704	875,312
Total	$312,573	$117,035	$165,181	$194,139	$207,630	$157,194	$1,153,752
LIABILITIES							
Savings, interest checking, and money market deposits	$251,623	$-	$234,136	$-	$-	$-	$485,759
Time deposits	197,680	53,082	26,823	6,759	5,571	-	289,915
Federal funds purchased and securities sold under agreements to repurchase	41,523	-	-	-	-	-	41,523
Subordinated notes	49,486	-	-	-	-	-	49,486
Federal Home Loan Bank advances	8,000	10,000	17,000	4,000	11,000	-	50,000
Total	$548,312	$63,082	$277,959	$10,759	$16,571	$-	$916,683
Interest-sensitivity GAP							
Periodic GAP	$(235,739)	$53,953	$(112,778)	$183,380	$191,059	$157,194	$237,069
Cumulative GAP	$(235,739)	$(181,786)	$(294,564)	$(111,184)	$79,875	$237,069	$237,069
Ratio of interest-earning assets to interest-bearing liabilities							
Periodic GAP	0.57	1.86	0.59	18.04	12.53	NM	1.26
Cumulative GAP	0.57	0.70	0.67	0.88	1.09	1.26	1.26

Effects of Inflation

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

Inflation does have an impact on the growth of total assets in the banking industry, often resulting in a need to increase capital at higher than normal rates to maintain an appropriate capital to asset ratio. In the opinion of management, inflation did not have a significant effect on the Company's operations for the three months ended March 31, 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 March 31, 2016. 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 March 31, 2016 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, 2018 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.

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

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

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

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

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

Stock Compensation The FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, in March 2016, in order to reduce complexity in this area and improve the usefulness of information provided to users. Amendments which will affect public companies include the recognition of excess tax benefits and deficiencies in income tax expense or benefit in the income statement, guidance as to the classification of excess tax benefits on the statement of cash

50

flows, an election to account for award forfeitures as they occur, and the ability to withhold taxes up to the maximum statutory rate in the applicable jurisdictions without triggering liability classification of the award. The amendments are effective January 1, 2017. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

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

The following table summarizes the purchases made by or on behalf of the Company or certain affiliated purchasers of shares of the Company's common stock during the three months ended March 31, 2016:

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs *
January 1-31, 2016	4,060	$ 15.16	4,060	$ 1,905,279
February 1-29, 2016	2,097	$ 15.01	2,097	$ 1,873,798
March 1-31, 2016	2,478	$ 14.53	2,478	$ 1,837,809
Total	8,635	$ 14.94	8,635	$ 1,837,809

* On August 6, 2015, the Company announced that its Board of Directors authorized the purchase, through open market transactions, of up to $2,000,000 market value of the Company's common stock. Management was given discretion to determine the number and pricing of the shares to be purchased, as well as, the timing of any such purchases.

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

52

	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
32.1	Certificate of the Chief Executive Officer of our Company pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certificate of the Chief Financial Officer of our Company pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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)

53

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
May 16, 2016	David T. Turner, Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
	/s/ W. Bruce Phelps
May 16, 2016	W. Bruce Phelps, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

54

HAWTHORN BANCSHARES, INC.

INDEX TO EXHIBITS

March 31, 2016 Form 10-Q

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
32.1	Certificate of the Chief Executive Officer of our Company pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certificate of the Chief Financial Officer of our Company pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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)

*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.

55