

LCNB CORP
Form 10-Q
November 08, 2013

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended September 30, 2013

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the transition period from _____ to _____

Commission File Number 000-26121

LCNB Corp.

(Exact name of registrant as specified in its charter)

Ohio

31-1626393

(State or other jurisdiction of incorporation or
organization)

(I.R.S. Employer Identification Number)

2 North Broadway, Lebanon, Ohio 45036

(Address of principal executive offices, including Zip Code)

(513) 932-1414

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

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The number of shares outstanding of the issuer's common stock, without par value, as of November 7, 2013 was 9,283,186 shares.

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LCNB CORP. AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

| | September 30, 2013 (Unaudited) | December 31, 2012 |
|---|--------------------------------------|----------------------|
| ASSETS: | | |
| Cash and due from banks | \$14,563 | 11,260 |
| Interest-bearing demand deposits | 124 | 2,215 |
| Total cash and cash equivalents | 14,687 | 13,475 |
| Investment securities: | | |
| Available-for-sale, at fair value | 271,304 | 258,506 |
| Held-to-maturity, at cost | 21,058 | 15,424 |
| Federal Reserve Bank stock, at cost | 1,603 | 949 |
| Federal Home Loan Bank stock, at cost | 2,854 | 2,091 |
| Loans, net | 562,686 | 450,346 |
| Premises and equipment, net | 20,058 | 16,564 |
| Goodwill | 13,971 | 5,915 |
| Bank owned life insurance | 21,115 | 16,915 |
| Other assets | 13,013 | 8,452 |
| TOTAL ASSETS | \$942,349 | 788,637 |
| LIABILITIES: | | |
| Deposits: | | |
| Noninterest-bearing | \$159,453 | 133,848 |
| Interest-bearing | 648,882 | 537,623 |
| Total deposits | 808,335 | 671,471 |
| Short-term borrowings | 22,811 | 13,756 |
| Long-term debt | 12,446 | 13,705 |
| Accrued interest and other liabilities | 6,542 | 7,699 |
| TOTAL LIABILITIES | 850,134 | 706,631 |
| SHAREHOLDERS' EQUITY: | | |
| Preferred shares – no par value, authorized 1,000,000 shares, none outstanding | — | — |
| Common shares – no par value, authorized 12,000,000 shares, issued 8,393,790 and 7,485,527 shares at September 30, 2013 and December 31, 2012, respectively | 39,774 | 27,107 |
| Retained earnings | 64,614 | 61,843 |
| Treasury shares at cost, 753,627 shares at September 30, 2013 and December 31, 2012 | (11,665 |) (11,665 |
| Accumulated other comprehensive income (loss), net of taxes | (508 |) 4,721 |
| TOTAL SHAREHOLDERS' EQUITY | 92,215 | 82,006 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$942,349 | 788,637 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------|-------------------|---------------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| INTEREST INCOME: | | | | |
| Interest and fees on loans | \$6,902 | 5,822 | 20,298 | 17,950 |
| Interest on investment securities – | | | | |
| Taxable | 862 | 941 | 2,556 | 2,810 |
| Non-taxable | 654 | 615 | 1,932 | 1,831 |
| Other short-term investments | 32 | 26 | 145 | 115 |
| TOTAL INTEREST INCOME | 8,450 | 7,404 | 24,931 | 22,706 |
| INTEREST EXPENSE: | | | | |
| Interest on deposits | 875 | 1,050 | 2,789 | 3,332 |
| Interest on short-term borrowings | 11 | 4 | 18 | 12 |
| Interest on long-term debt | 109 | 136 | 331 | 440 |
| TOTAL INTEREST EXPENSE | 995 | 1,190 | 3,138 | 3,784 |
| NET INTEREST INCOME | 7,455 | 6,214 | 21,793 | 18,922 |
| PROVISION FOR LOAN LOSSES | 178 | 436 | 369 | 742 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 7,277 | 5,778 | 21,424 | 18,180 |
| NON-INTEREST INCOME: | | | | |
| Trust income | 626 | 530 | 1,810 | 1,769 |
| Service charges and fees on deposit accounts | 1,062 | 911 | 3,114 | 2,698 |
| Net gain on sales of securities | 58 | 427 | 753 | 886 |
| Bank owned life insurance income | 168 | 145 | 512 | 432 |
| Gains from sales of mortgage loans | 57 | 151 | 305 | 360 |
| Other operating income | 76 | 41 | 238 | 151 |
| TOTAL NON-INTEREST INCOME | 2,047 | 2,205 | 6,732 | 6,296 |
| NON-INTEREST EXPENSE: | | | | |
| Salaries and employee benefits | 3,247 | 3,059 | 9,783 | 9,004 |
| Equipment expenses | 318 | 263 | 908 | 789 |
| Occupancy expense, net | 505 | 445 | 1,529 | 1,242 |
| State franchise tax | 208 | 193 | 635 | 595 |
| Marketing | 145 | 129 | 446 | 409 |
| FDIC insurance premiums | 128 | 83 | 375 | 298 |
| Other non-interest expense | 1,612 | 1,392 | 5,902 | 4,005 |
| TOTAL NON-INTEREST EXPENSE | 6,163 | 5,564 | 19,578 | 16,342 |
| INCOME BEFORE INCOME TAXES | 3,161 | 2,419 | 8,578 | 8,134 |
| PROVISION FOR INCOME TAXES | 804 | 572 | 2,145 | 2,023 |
| NET INCOME | \$2,357 | 1,847 | 6,433 | 6,111 |
| Dividends declared per common share | \$0.16 | 0.16 | 0.48 | 0.48 |
| Earnings per common share: | | | | |
| Basic | \$0.31 | 0.27 | 0.85 | 0.91 |
| Diluted | 0.30 | 0.27 | 0.83 | 0.90 |

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Weighted average common shares outstanding:

| | | | | |
|---------|-----------|-----------|-----------|-----------|
| Basic | 7,636,098 | 6,721,699 | 7,592,818 | 6,713,959 |
| Diluted | 7,787,098 | 6,797,675 | 7,722,686 | 6,787,000 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------|-------------------|--------------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Net income | \$2,357 | 1,847 | 6,433 | 6,111 |
| Other comprehensive income: | | | | |
| Net unrealized gain (loss) on available-for-sale securities (net of taxes of \$391 and \$556 for the three months ended September 30, 2013 and 2012, respectively, and \$2,452 and \$787 for the nine months ended September 30, 2013 and 2012, respectively) | 760 | 1,080 | (4,758 |) 1,529 |
| Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of taxes of \$20 and \$145 for the three months ended September 30, 2013 and 2012, respectively, and \$256 and \$300 for the nine months ended September 30, 2013 and 2012, respectively) | (38 |) (282 |) (497 |) (586 |
| Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of \$5 and \$4 for the three months ended September 30, 2013 and 2012, respectively, and \$14 and \$12 for the nine months ended September 30, 2013 and 2012, respectively) | 8 | 9 | 26 | 25 |
| TOTAL COMPREHENSIVE INCOME | \$3,087 | 2,654 | 1,204 | 7,079 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Dollars in thousands, except per share amounts)

(Unaudited)

| | Common Shares Outstanding | Common Stock | Retained Earnings | Treasury Shares | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|--|---------------------------------|-----------------|----------------------|--------------------|--|----------------------------------|
| Balance at December 31, 2011 | 6,704,723 | \$26,753 | 57,877 | (11,698) | 5,028 | 77,960 |
| Net income | | | 6,111 | | | 6,111 |
| Net unrealized gain on available-for-sale securities, net of taxes | | | | | 1,529 | 1,529 |
| Reclassification adjustment for net realized gain on sales of available-for-sale securities included in net income, net of taxes | | | | | (586) | (586) |
| Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost, net of taxes | | | | | 25 | 25 |
| Dividend Reinvestment and Stock Purchase Plan | 19,640 | 257 | | | | 257 |
| Exercise of stock options | 2,144 | | (5) | 33 | | 28 |
| Compensation expense relating to stock options | | 30 | | | | 30 |
| Common stock dividends, \$0.48 per share | | | (3,223) | | | (3,223) |
| Balance at September 30, 2012 | 6,726,507 | \$27,040 | 60,760 | (11,665) | 5,996 | 82,131 |
| Balance at December 31, 2012 | 6,731,900 | \$27,107 | 61,843 | (11,665) | 4,721 | 82,006 |
| Net income | | | 6,433 | | | 6,433 |
| Net unrealized gain (loss) on available-for-sale securities, net of taxes | | | | | (4,758) | (4,758) |
| Reclassification adjustment for net realized gain on sales of available-for-sale securities included in net income, net of taxes | | | | | (497) | (497) |
| Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost, net of taxes | | | | | 26 | 26 |
| Dividend Reinvestment and Stock Purchase Plan | 13,832 | 248 | | | | 248 |

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| | | | | | |
|--|-----------|----------|----------|------------------|----------|
| Exercise of stock options | 5,620 | 70 | | | 70 |
| Acquisition of First Capital Bancshares, Inc. | 888,811 | 12,321 | | | 12,321 |
| Compensation expense relating to stock options | | 28 | | | 28 |
| Common stock dividends, \$0.48 per share | | | (3,662) | | (3,662) |
| Balance at September 30, 2013 | 7,640,163 | \$39,774 | 64,614 | (11,665) (508) | 92,215 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-----------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$6,433 | 6,111 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation, amortization, and accretion | 1,886 | 2,339 |
| Provision for loan losses | 369 | 742 |
| Increase in cash surrender value of bank owned life insurance | (512) | (432) |
| Realized (gain) loss from sales of securities available-for-sale | (753) | (886) |
| Realized (gain) loss from sales of premises and equipment | (1) | (10) |
| Realized (gain) loss from sales and write-downs of other real estate owned and repossessed assets | (175) | 80 |
| Origination of mortgage loans for sale | (16,831) | (19,328) |
| Realized gains from sales of mortgage loans | (305) | (360) |
| Proceeds from sales of mortgage loans | 16,970 | 19,492 |
| Compensation expense related to stock options | 28 | 30 |
| Changes in: | | |
| Accrued income receivable | (802) | (650) |
| Other assets | 745 | 358 |
| Other liabilities | (239) | 314 |
| TOTAL ADJUSTMENTS | 380 | 1,689 |
| NET CASH FLOWS FROM OPERATING ACTIVITIES | 6,813 | 7,800 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sales of investment securities available-for-sale | 41,888 | 64,002 |
| Proceeds from maturities and calls of investment securities: | | |
| Available-for-sale | 15,724 | 22,759 |
| Held-to-maturity | 4,437 | 1,563 |
| Purchases of investment securities: | | |
| Available-for-sale | (57,106) | (97,344) |
| Held-to-maturity | (9,687) | (3,332) |
| Purchase of Federal Reserve Bank stock | (497) | (8) |
| Net (increase) decrease in loans | (13,446) | 2,248 |
| Purchase of bank owned life insurance | — | (1,500) |
| Proceeds from sale of other real estate owned and repossessed assets | 1,062 | 20 |
| Additions to other real estate owned | — | (16) |
| Purchases of premises and equipment | (614) | (403) |
| Proceeds from sale of premises and equipment | 1 | 13 |
| Net cash acquired from acquisition | 9,771 | — |
| NET CASH FLOWS FROM INVESTING ACTIVITIES | (8,467) | (11,998) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase (decrease) in deposits | 206 | 37,518 |
| Net increase (decrease) in short-term borrowings | 9,055 | (9,520) |

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| | | | |
|---|-----------|----------|---|
| Principal payments on long-term debt | (3,051 |) (7,324 |) |
| Proceeds from issuance of common stock | 32 | 41 | |
| Proceeds from exercise of stock options | 70 | 28 | |
| Cash dividends paid on common stock | (3,446 |) (3,006 |) |
| NET CASH FLOWS FROM FINANCING ACTIVITIES | 2,866 | 17,737 | |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 1,212 | 13,539 | |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 13,475 | 19,535 | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 14,687 | 33,074 | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | | |
| Interest paid | \$3,150 | 3,857 | |
| Income taxes paid | 2,715 | 1,735 | |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES: | | | |
| Transfer from loans to other real estate owned and repossessed assets | 133 | 755 | |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

Substantially all of the assets, liabilities and operations of LCNB Corp. ("LCNB" or the "Company") are attributable to its wholly-owned subsidiary, LCNB National Bank (the "Bank"). The accompanying unaudited consolidated financial statements include the accounts of LCNB and the Bank.

The unaudited interim consolidated financial statements, which have been reviewed by J.D. Cloud & Co. L.L.P., LCNB's independent registered public accounting firm, in accordance with standards established by the Public Company Accounting Oversight Board, as indicated by their report included herein and which does not express an opinion on those statements, have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC").

Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation of financial position, results of operations, and cash flows for the interim periods, as required by Regulation S-X, Rule 10-01.

Certain prior period data presented in the financial statements have been reclassified to conform with the current year presentation.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the full year ending December 31, 2013. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, accounting policies, and financial notes thereto included in LCNB's 2012 Annual Report on Form 10-K filed with the SEC.

Note 2 – Acquisition

On October 9, 2012, LCNB and First Capital Bancshares, Inc. ("First Capital") entered into an Agreement and Plan of Merger ("Merger Agreement") pursuant to which First Capital was merged into LCNB on January 11, 2013 in a stock and cash transaction valued at approximately \$20.2 million. Immediately following the merger of First Capital into LCNB, Citizens National Bank of Chillicothe ("Citizens"), a wholly-owned subsidiary of First Capital, was merged into LCNB National Bank. Citizens operated six full-service branches with a main office and two other facilities in Chillicothe, Ohio and one branch in each of Frankfort, Ohio, Clarksburg, Ohio, and Washington Court House, Ohio. These offices became branches of the Bank after the merger.

Under the terms of the Merger Agreement, each shareholder of First Capital common stock was entitled to elect to receive, for each share of First Capital Common Stock, (i) \$30.76 in cash, (ii) 2.329 common shares of LCNB (subject to an adjustment based upon the average closing price of LCNB common shares for the 25 trading days prior to the

effective date of the merger), or (iii) a combination of cash and LCNB common stock. A First Capital shareholder's election to receive cash or stock was subject to allocation procedures that ensured that no more than 50% and no less than 40% of the outstanding First Capital shares were exchanged for cash and that no more than 60% and no less than 50% of the outstanding First Capital shares were exchanged for LCNB common shares.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 – Acquisition (continued)

The merger with First Capital was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid were recorded at their estimated fair values as of the merger date, as summarized in the following table (in thousands):

| | |
|--|----------|
| Consideration Paid: | |
| Common shares issued (888,811) | \$12,354 |
| Cash paid to shareholders | 7,828 |
| Total value of consideration paid | 20,182 |
| Identifiable Assets Acquired: | |
| Cash and cash equivalents | 17,632 |
| Investment securities: | |
| Available-for-sale | 21,606 |
| Held-to-maturity | 384 |
| Federal Reserve Bank stock | 157 |
| Federal Home Loan Bank stock | 763 |
| Loans | 98,906 |
| Premises and equipment | 3,949 |
| Bank owned life insurance | 3,687 |
| Core deposit intangible | 2,574 |
| Other real estate owned | 127 |
| Deferred income taxes | 409 |
| Other assets | 1,369 |
| Total identifiable assets acquired | 151,563 |
| Liabilities Assumed: | |
| Deposits | 136,823 |
| Long-term debt | 1,792 |
| Other liabilities | 822 |
| Total liabilities assumed | 139,437 |
| Total Identifiable Net Assets Acquired | 12,126 |
| Goodwill resulting from merger | \$8,056 |

The amount of goodwill recorded reflects LCNB's entrance into a new market and related synergies that are expected to result from the acquisition and represents the excess purchase price over the estimated fair value of the net assets acquired. The goodwill will not be amortizable and is not deductible for tax purposes. The core deposit intangible will be amortized over nine years using the straight-line method.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 – Acquisition (continued)

The following table details the changes in fair value of net assets acquired and liabilities assumed from the amounts reported in the Form 10-Q for the period ending June 30, 2013 (in thousands):

| | |
|--------------------------------|---------|
| Goodwill at June 30, 2013 | \$8,258 |
| Effect of adjustments to: | |
| Deferred income taxes | 18 |
| Other assets | (220) |
| Goodwill at September 30, 2013 | \$8,056 |

Management believes that acquisition method adjustments are substantially complete at September 30, 2013.

Direct costs related to the acquisition were expensed as incurred and are recorded in other non-interest expense in the consolidated statements of income. During the first nine months of 2013, LCNB incurred \$1,326,000 in merger and acquisition integration expenses related to the transaction, including \$603,000 in merger related costs and \$723,000 for converting Citizens data processing system to LCNB's system.

The results of operations are included in the consolidated statement of income from the date of the merger. The estimated amount of Citizens revenue (net interest income plus non-interest income) and net income, excluding merger and data conversion costs, included in LCNB's consolidated statement of income for the three and nine months ended September 30, 2013 were as follows (in thousands):

| | Three Months | Nine Months |
|---------------|-----------------|----------------|
| Total revenue | \$1,676 | 4,561 |
| Net income | 750 | 1,898 |

The following table presents unaudited pro forma information as if the merger with First Capital had occurred on January 1, 2012 (in thousands). This pro forma information gives effect to certain adjustments, including purchase accounting fair value adjustments, amortization of the core deposit intangible, and related income tax effects. It does not include merger and data conversion costs. The pro forma information does not necessarily reflect the results of operations that would have occurred had the merger with First Capital occurred in 2012. In particular, expected operational cost savings are not reflected in the pro forma amounts.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2013 | 2012 | 2013 | 2012 |
| Total revenue | \$9,502 | 10,067 | 28,728 | 30,446 |
| Net income | 2,358 | 2,097 | 7,000 | 7,027 |
| Basic earnings per common share | 0.31 | 0.27 | 0.92 | 0.92 |
| Diluted earnings per common share | 0.30 | 0.27 | 0.90 | 0.91 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Investment Securities

The amortized cost and estimated fair value of available-for-sale investment securities at September 30, 2013 and December 31, 2012 are summarized as follows (in thousands):

| | September 30, 2013 | | | |
|--|--------------------|---------------------|----------------------|---------------|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| U.S. Treasury notes | \$8,904 | — | 197 | 8,707 |
| U.S. Agency notes | 113,475 | 340 | 3,036 | 110,779 |
| U.S. Agency mortgage-backed securities | 45,723 | 721 | 868 | 45,576 |
| Certificates of deposit with other banks | 1,492 | 9 | — | 1,501 |
| Municipal securities: | | | | |
| Non-taxable | 78,822 | 2,480 | 793 | 80,509 |
| Taxable | 19,157 | 668 | 140 | 19,685 |
| Mutual funds | 2,408 | — | 23 | 2,385 |
| Trust preferred securities | 149 | 3 | 5 | 147 |
| Equity securities | 1,751 | 317 | 53 | 2,015 |
| | \$271,881 | 4,538 | 5,115 | 271,304 |
| | | | | |
| | December 31, 2012 | | | |
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| U.S. Treasury notes | \$18,462 | 224 | — | 18,686 |
| U.S. Agency notes | 89,372 | 1,364 | 130 | 90,606 |
| U.S. Agency mortgage-backed securities | 51,121 | 1,444 | 24 | 52,541 |
| Corporate securities | 3,032 | 35 | — | 3,067 |
| Municipal securities: | | | | |
| Non-taxable | 70,504 | 3,497 | 119 | 73,882 |
| Taxable | 14,851 | 993 | 3 | 15,841 |
| Mutual funds | 2,138 | 30 | — | 2,168 |
| Trust preferred securities | 250 | 2 | 7 | 245 |
| Equity securities | 1,390 | 106 | 26 | 1,470 |
| | \$251,120 | 7,695 | 309 | 258,506 |

The fair value of held-to-maturity investment securities, consisting of taxable and non-taxable municipal securities, approximates amortized cost at September 30, 2013 and December 31, 2012.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Investment Securities (continued)

Information concerning available-for-sale investment securities with gross unrealized losses at September 30, 2013, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

| | Less than Twelve Months | | Twelve Months or Greater | |
|--|-------------------------|-------------------|--------------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury notes | \$8,707 | 197 | — | — |
| U.S. Agency notes | 91,919 | 3,036 | — | — |
| U.S. Agency mortgage-backed securities | 23,840 | 868 | — | — |
| Municipal securities: | | | | |
| Non-taxable | 23,864 | 793 | — | — |
| Taxable | 5,633 | 140 | — | — |
| Mutual funds | 1,385 | 23 | — | — |
| Trust preferred securities | 46 | 4 | 48 | 1 |
| Equity securities | 311 | 34 | 95 | 19 |
| | \$155,705 | 5,095 | 143 | 20 |

Management has determined that the unrealized losses at September 30, 2013 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because LCNB does not have the intent to sell the investments and it is more likely than not that LCNB will not be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, LCNB does not consider these investments to be other-than-temporarily impaired.

Note 4 - Loans

Major classifications of loans at September 30, 2013 and December 31, 2012 are as follows (in thousands):

| | September 30, 2013 | | | December 31, 2012 |
|---|--------------------------|---------|---------|-------------------|
| | Acquired Credit Impaired | Other | Total | |
| Commercial and industrial | \$341 | 30,939 | 31,280 | 26,236 |
| Commercial, secured by real estate | 4,252 | 298,059 | 302,311 | 238,357 |
| Residential real estate | 1,346 | 214,972 | 216,318 | 175,031 |
| Consumer | — | 12,928 | 12,928 | 10,554 |
| Agricultural | — | 3,245 | 3,245 | 1,668 |
| Other loans, including deposit overdrafts | — | 58 | 58 | 1,875 |
| | 5,939 | 560,201 | 566,140 | 453,721 |
| Deferred net origination costs (fees) | — | (31) | (31) | 62 |

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| | | | | |
|--------------------------------|---------|---------|---------|---------|
| | 5,939 | 560,170 | 566,109 | 453,783 |
| Less allowance for loan losses | — | 3,423 | 3,423 | 3,437 |
| Loans, net | \$5,939 | 556,747 | 562,686 | 450,346 |

Loans acquired from the merger with First Capital are recorded at fair value with no carryover of the acquired entity's previously established allowance for loan losses. The excess of expected cash flows over the estimated fair value of acquired loans is recognized as interest income over the remaining contractual lives of the loans using the level yield method.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows result in the recognition of additional interest income over the then-remaining contractual lives of the loans.

Impaired loans acquired are accounted for under FASB ASC 310-30. Factors considered in evaluating whether an acquired loan was impaired include delinquency status and history, updated borrower credit status, collateral information, and updated loan-to-value information. The difference between contractually required payments at the time of acquisition and the cash flows expected to be collected is referred to as the nonaccretable difference. The interest component of the cash flows expected to be collected is referred to as the accretable yield and is recognized as interest income over the remaining contractual life of the loan using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows will result in a reclassification from the nonaccretable difference to the accretable yield.

The following table provides certain information at the acquisition date on loans acquired from First Capital, not including loans considered to be impaired (in thousands):

| | | |
|---|----------|---|
| Contractually required principal at acquisition | \$91,614 | |
| Less fair value adjustment | (1,908 |) |
| Fair value of acquired loans | \$89,706 | |
| | | |
| Contractual cash flows not expected to be collected | \$2,149 | |

The following table provides details on acquired impaired loans that are accounted for in accordance with FASB ASC 310-30 (in thousands):

| | | |
|--|----------|---|
| Contractually required principal at acquisition | \$11,460 | |
| Contractual cash flows not expected to be collected (nonaccretable difference) | (1,260 |) |
| Expected cash flows at acquisition | 10,200 | |
| Interest component of expected cash flows (accretable discount) | (1,389 |) |
| Fair value of acquired impaired loans | \$8,811 | |

The following table provides the outstanding balance and related carrying amount for acquired impaired loans at the dates indicated (in thousands):

| | September 30, 2013 | January 11, 2013 |
|---------------------|-----------------------|---------------------|
| Outstanding balance | \$8,155 | 11,460 |
| Carrying amount | 5,939 | 8,811 |

Activity during 2013 for the accretable discount related to acquired impaired loans is as follows (in thousands):

| | | |
|--|---------|---|
| Accretable discount at January 11, 2013 | \$1,389 | |
| Reclass from nonaccretable discount to accretable discount | 157 | |
| Less transferred to other real estate owned | (23 |) |

| | | |
|---|---------|---|
| Less accretion | (394 |) |
| Accretable discount at September 30, 2013 | \$1,129 | |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

Non-accrual, past-due, and accruing restructured loans as of September 30, 2013 and December 31, 2012 are as follows (in thousands):

| | September 30, 2013 | | | December 31, 2012 |
|--|--------------------------------|--------|--------|-------------------|
| | Acquired Credit Impaired | Other | Total | |
| Non-accrual loans: | | | | |
| Commercial and industrial | \$— | 144 | 144 | 264 |
| Commercial, secured by real estate | 369 | 1,120 | 1,489 | 788 |
| Residential real estate | 143 | 1,052 | 1,195 | 1,231 |
| Total non-accrual loans | 512 | 2,316 | 2,828 | 2,283 |
| Past-due 90 days or more and still accruing | — | 29 | 29 | 128 |
| Total non-accrual and past-due 90 days or more and still accruing | 512 | 2,345 | 2,857 | 2,411 |
| Accruing restructured loans | — | 14,175 | 14,175 | 13,343 |
| Total | \$512 | 16,520 | 17,032 | 15,754 |
| Percentage of total non-accrual loans and loans past-due 90 days or more and still accruing to total loans | | | 0.50 | % 0.53 % |
| Percentage of total non-accrual loans, loans past-due 90 days or more and still accruing, and accruing restructured loans to total loans | | | 3.01 | % 3.47 % |

Loans sold to and serviced for the Federal Home Loan Mortgage Corporation and other investors are not included in the accompanying consolidated balance sheets. The unpaid principal balances of those loans at September 30, 2013 and December 31, 2012 are \$91,125,000 and \$71,568,000, respectively. Loans sold during the three months ended September 30, 2013 and 2012 totaled \$2,434,000 and \$7,934,000, respectively, and \$16,831,000 and \$19,328,000 during the nine months ended September 30, 2013 and 2012, respectively.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

The allowance for loan losses and recorded investment in loans for the nine months ended September 30 are as follows (in thousands):

| | Commercial & Industrial | Commercial, Secured by Real Estate | Residential Real Estate | Consumer | Agricultural | Other | Total |
|---------------------------------------|----------------------------|--|----------------------------|----------|--------------|-------|----------|
| 2013 | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Balance, beginning of year | \$ 320 | 2,296 | 712 | 108 | — | 1 | 3,437 |
| Provision charged to expenses | (41) | 107 | 268 | 14 | — | 21 | 369 |
| Losses charged off: | | | | | | | |
| Acquired credit impaired loans | — | — | (5) | — | — | — | (5) |
| Other loans | (120) | (34) | (203) | (148) | — | (56) | (561) |
| Recoveries | 4 | 26 | 21 | 98 | — | 34 | 183 |
| Balance, end of period | \$ 163 | 2,395 | 793 | 72 | — | — | 3,423 |
| Individually evaluated for impairment | \$ 1 | 766 | 190 | 1 | — | — | 958 |
| Collectively evaluated for impairment | 162 | 1,629 | 603 | 71 | — | — | 2,465 |
| Acquired credit impaired loans | — | — | — | — | — | — | — |
| Balance, end of period | \$ 163 | 2,395 | 793 | 72 | — | — | 3,423 |
| Loans: | | | | | | | |
| Individually evaluated for impairment | \$ 166 | 14,444 | 1,543 | 35 | — | — | 16,188 |
| Collectively evaluated for impairment | 30,739 | 283,288 | 213,669 | 12,983 | 3,245 | 58 | 543,982 |
| Acquired credit impaired loans | 341 | 4,252 | 1,346 | — | — | — | 5,939 |
| Balance, end of period | \$ 31,246 | 301,984 | 216,558 | 13,018 | 3,245 | 58 | 566,109 |
| 2012 | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Balance, beginning of year | \$ 162 | 1,941 | 656 | 166 | — | 6 | 2,931 |
| Change in classification | 18 | (18) | — | — | — | — | — |
| Provision charged to expenses | 163 | (16) | 624 | (49) | — | 20 | 742 |
| Losses charged off | (159) | (234) | (479) | (84) | — | (64) | (1,020) |
| Recoveries | — | 71 | 7 | 95 | — | 40 | 213 |
| Balance, end of period | \$ 184 | 1,744 | 808 | 128 | — | 2 | 2,866 |
| | \$ 21 | 49 | 219 | — | — | — | 289 |

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| | | | | | | | |
|---------------------------------------|-----------|---------|---------|--------|-------|-------|---------|
| Individually evaluated for impairment | | | | | | | |
| Collectively evaluated for impairment | 163 | 1,695 | 589 | 128 | — | 2 | 2,577 |
| Balance, end of period | \$ 184 | 1,744 | 808 | 128 | — | 2 | 2,866 |
| Loans: | | | | | | | |
| Individually evaluated for impairment | \$ 264 | 13,895 | 1,157 | 13 | — | — | 15,329 |
| Collectively evaluated for impairment | 25,462 | 223,898 | 176,114 | 11,550 | 2,061 | 2,993 | 442,078 |
| Balance, end of period | \$ 25,726 | 237,793 | 177,271 | 11,563 | 2,061 | 2,993 | 457,407 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

LCNB uses a risk-rating system to quantify loan quality. A loan is assigned to a risk category based on relevant information about the ability of the borrower to service the debt including, but not limited to, current financial information, historical payment experience, credit documentation, public information, and current economic trends.

The categories used are:

Pass – loans categorized in this category are higher quality loans that do not fit any of the other categories described below.

Other Assets Especially Mentioned (OAEM) - loans in this category are currently protected but are potentially weak.

•These loans constitute a risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an undue risk in light of the circumstances surrounding a specific asset.

Substandard – loans in this category are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that LCNB will sustain some loss if the deficiencies are not corrected.

Doubtful – loans classified in this category have all the weaknesses inherent in loans classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

A breakdown of the loan portfolio by credit quality indicators at September 30, 2013 and December 31, 2012 is as follows (in thousands):

| | Pass | OAEM | Substandard | Doubtful | Total |
|------------------------------------|------------|-------|-------------|----------|---------|
| September 30, 2013 | | | | | |
| Acquired credit impaired: | | | | | |
| Commercial & industrial | \$ 12 | — | 329 | — | 341 |
| Commercial, secured by real estate | — | 766 | 3,486 | — | 4,252 |
| Residential real estate | — | — | 1,346 | — | 1,346 |
| Total | \$ 12 | 766 | 5,161 | — | 5,939 |
| Other: | | | | | |
| Commercial & industrial | \$ 27,657 | 1,815 | 1,433 | — | 30,905 |
| Commercial, secured by real estate | 285,160 | 1,957 | 10,615 | — | 297,732 |
| Residential real estate | 208,654 | 1,774 | 4,731 | 53 | 215,212 |
| Consumer | 12,978 | — | 40 | — | 13,018 |
| Agricultural | 3,245 | — | — | — | 3,245 |
| Other | 58 | — | — | — | 58 |
| Total | \$ 537,752 | 5,546 | 16,819 | 53 | 560,170 |
| Total: | | | | | |
| Commercial & industrial | \$ 27,669 | 1,815 | 1,762 | — | 31,246 |
| Commercial, secured by real estate | 285,160 | 2,723 | 14,101 | — | 301,984 |
| Residential real estate | 208,654 | 1,774 | 6,077 | 53 | 216,558 |
| Consumer | 12,978 | — | 40 | — | 13,018 |
| Agricultural | 3,245 | — | — | — | 3,245 |
| Other | 58 | — | — | — | 58 |
| Total | \$ 537,764 | 6,312 | 21,980 | 53 | 566,109 |
| December 31, 2012 | | | | | |
| Commercial & industrial | \$ 22,965 | 1,804 | 1,177 | 264 | 26,210 |
| Commercial, secured by real estate | 222,497 | 2,653 | 12,872 | 107 | 238,129 |
| Residential real estate | 168,338 | 2,353 | 4,280 | 298 | 175,269 |
| Consumer | 10,549 | — | 62 | 20 | 10,631 |
| Agricultural | 1,665 | — | 3 | — | 1,668 |
| Other | 1,876 | — | — | — | 1,876 |
| Total | \$ 427,890 | 6,810 | 18,394 | 689 | 453,783 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

A loan portfolio aging analysis at September 30, 2013 and December 31, 2012 is as follows (in thousands):

| | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days Past Due | Total Past Due | Current | Total Loans Receivable | Total Loans Greater Than 90 Days and Accruing |
|---------------------------------------|------------------------|------------------------|--|-------------------|---------|------------------------------|---|
| September 30, 2013 | | | | | | | |
| Acquired credit impaired: | | | | | | | |
| Commercial & industrial | \$— | — | — | — | 341 | 341 | — |
| Commercial, secured by real estate | — | 54 | 127 | 181 | 4,071 | 4,252 | — |
| Residential real estate | — | 45 | 80 | 125 | 1,221 | 1,346 | — |
| Total | \$— | 99 | 207 | 306 | 5,633 | 5,939 | — |
| Other: | | | | | | | |
| Commercial & industrial | \$64 | 99 | 144 | 307 | 30,598 | 30,905 | — |
| Commercial, secured by real estate | 1,362 | 769 | 1,120 | 3,251 | 294,481 | 297,732 | — |
| Residential real estate | 1,200 | 492 | 1,116 | 2,808 | 212,404 | 215,212 | 29 |
| Consumer | 95 | 16 | — | 111 | 12,907 | 13,018 | — |
| Agricultural | — | — | — | — | 3,245 | 3,245 | — |
| Other | 39 | — | — | 39 | 19 | 58 | — |
| Total | \$2,760 | 1,376 | 2,380 | 6,516 | 553,654 | 560,170 | 29 |
| Total: | | | | | | | |
| Commercial & industrial | \$64 | 99 | 144 | 307 | 30,939 | 31,246 | — |
| Commercial, secured by real estate | 1,362 | 823 | 1,247 | 3,432 | 298,552 | 301,984 | — |
| Residential real estate | 1,200 | 537 | 1,196 | 2,933 | 213,625 | 216,558 | 29 |
| Consumer | 95 | 16 | — | 111 | 12,907 | 13,018 | — |
| Agricultural | — | — | — | — | 3,245 | 3,245 | — |
| Other | 39 | — | — | 39 | 19 | 58 | — |
| Total | \$2,760 | 1,475 | 2,587 | 6,822 | 559,287 | 566,109 | 29 |
| December 31, 2012 | | | | | | | |
| Commercial & industrial | \$— | 1 | 264 | 265 | 25,945 | 26,210 | — |
| Commercial, secured by real estate | 346 | 79 | 788 | 1,213 | 236,916 | 238,129 | — |
| Residential real estate | 791 | 212 | 1,172 | 2,175 | 173,094 | 175,269 | 103 |
| Consumer | 61 | 57 | 25 | 143 | 10,488 | 10,631 | 25 |
| Agricultural | — | — | — | — | 1,668 | 1,668 | — |
| Other | 72 | — | — | 72 | 1,804 | 1,876 | — |

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| | | | | | | | |
|-------|---------|-----|-------|-------|---------|---------|-----|
| Total | \$1,270 | 349 | 2,249 | 3,868 | 449,915 | 453,783 | 128 |
|-------|---------|-----|-------|-------|---------|---------|-----|

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

Impaired loans, excluding acquired credit impaired loans, at September 30, 2013 and December 31, 2012 are as follows (in thousands):

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|-------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| September 30, 2013 | | | | | |
| With no related allowance recorded: | | | | | |
| Commercial & industrial | \$— | — | — | — | — |
| Commercial, secured by real estate | 3,067 | 3,143 | — | 3,143 | 85 |
| Residential real estate | 344 | 344 | — | 382 | 6 |
| Consumer | — | — | — | 1 | — |
| Total | \$3,411 | 3,487 | — | 3,526 | 91 |
| With an allowance recorded: | | | | | |
| Commercial & industrial | \$166 | 271 | 1 | 193 | 1 |
| Commercial, secured by real estate | 11,377 | 11,431 | 766 | 10,710 | 278 |
| Residential real estate | 1,199 | 1,462 | 190 | 1,201 | 23 |
| Consumer | 35 | 35 | 1 | 21 | 2 |
| Total | \$12,777 | 13,199 | 958 | 12,125 | 304 |
| Total: | | | | | |
| Commercial & industrial | \$166 | 271 | 1 | 193 | 1 |
| Commercial, secured by real estate | 14,444 | 14,574 | 766 | 13,853 | 363 |
| Residential real estate | 1,543 | 1,806 | 190 | 1,583 | 29 |
| Consumer | 35 | 35 | 1 | 22 | 2 |
| Total | \$16,188 | 16,686 | 958 | 15,651 | 395 |
| December 31, 2012 | | | | | |
| With no related allowance recorded: | | | | | |
| Commercial & industrial | \$— | — | — | 975 | 43 |
| Commercial, secured by real estate | 9,541 | 9,936 | — | 9,310 | 350 |
| Residential real estate | 417 | 417 | — | 397 | 5 |
| Consumer | 20 | 20 | — | 23 | 2 |
| Total | \$9,978 | 10,373 | — | 10,705 | 400 |
| With an allowance recorded: | | | | | |
| Commercial & industrial | \$264 | 822 | 159 | 374 | — |
| Commercial, secured by real estate | 4,258 | 4,360 | 660 | 4,765 | 171 |
| Residential real estate | 658 | 853 | 85 | 707 | 2 |
| Consumer | — | — | — | 4 | — |
| Total | \$5,180 | 6,035 | 904 | 5,850 | 173 |
| Total: | | | | | |
| Commercial & industrial | \$264 | 822 | 159 | 1,349 | 43 |
| Commercial, secured by real estate | 13,799 | 14,296 | 660 | 14,075 | 521 |
| Residential real estate | 1,075 | 1,270 | 85 | 1,104 | 7 |

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| | | | | | |
|----------|----------|--------|-----|--------|-----|
| Consumer | 20 | 20 | — | 27 | 2 |
| Total | \$15,158 | 16,408 | 904 | 16,555 | 573 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

Loan modifications that were classified as troubled debt restructurings during the three and nine months ended September 30, 2013 and 2012 are as follows (dollars in thousands):

| | 2013 Number of Loans | Balance at Modification | 2012 Number of Loans | Balance at Modification |
|------------------------------------|-------------------------------|----------------------------|-------------------------------|----------------------------|
| Three Months Ended September 30, | | | | |
| Commercial and industrial | — | \$— | — | \$— |
| Commercial, secured by real estate | 1 | 702 | — | — |
| Residential real estate | — | — | 1 | 100 |
| Consumer | — | — | 2 | 20 |
| Total | 1 | \$ 702 | 3 | \$ 120 |
| Nine Months Ended September 30, | | | | |
| Commercial and industrial | 1 | \$ 22 | — | \$— |
| Commercial, secured by real estate | 1 | 702 | — | — |
| Residential real estate | 2 | 335 | 3 | 273 |
| Consumer | 2 | 27 | 2 | 20 |
| Total | 6 | \$ 1,086 | 5 | \$ 293 |

Each restructured loan is separately negotiated with the borrower and includes terms and conditions that reflect the borrower's ability to pay the debt as modified. Modifications may include interest only payments for a period of time, temporary or permanent reduction of the loan's interest rate, capitalization of delinquent interest, or extensions of the maturity date.

LCNB is not committed to lend additional funds to borrowers whose loan terms were modified in a troubled debt restructuring.

A restructured automobile loan with a balance of \$13,000 was charged off during the first quarter 2013, which was within twelve months of the loan's modification date. There were no other troubled debt restructurings that subsequently defaulted within twelve months of the restructuring date for the three and nine months ended September 30, 2013 and 2012.

Note 5 – Other Real Estate Owned

Other real estate owned includes property acquired through foreclosure or deed-in-lieu of foreclosure and also includes property deemed to be in-substance foreclosed and are included in "other assets" in the consolidated balance sheets. Changes in other real estate owned are as follows (in thousands):

| | Nine Months Ended September 30, | |
|----------------------------|------------------------------------|-------|
| | 2013 | 2012 |
| Balance, beginning of year | \$2,189 | 1,619 |
| Additions | 126 | 771 |

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| | | | |
|---|---------|---|-------|
| Additions due to merger | 127 | — | |
| Reductions due to sales | (843 |) | — |
| Reductions due to valuation write downs | (38 |) | (76) |
| Balance, end of period | \$1,561 | | 2,314 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 5 –Other Real Estate Owned (continued)

Other real estate owned at September 30, 2013 and December 31, 2012 consisted of (dollars in thousands):

| | September 30, 2013 | | December 31, 2012 | |
|-------------------------|--------------------|---------|-------------------|---------|
| | Number | Balance | Number | Balance |
| Commercial real estate | 2 | \$1,443 | 2 | \$1,875 |
| Residential real estate | 5 | 118 | 8 | 314 |
| | 7 | \$1,561 | 10 | \$2,189 |

Note 6 – Premises and Equipment

Premises and equipment at September 30, 2013 and December 31, 2012 are summarized as follows (in thousands):

| | September 30, 2013 | December 31, 2012 |
|-------------------------------|-----------------------|----------------------|
| Land | \$5,353 | 4,708 |
| Buildings | 18,756 | 15,616 |
| Equipment | 11,952 | 11,280 |
| Construction in progress | 75 | — |
| Total | 36,136 | 31,604 |
| Less accumulated depreciation | 16,078 | 15,040 |
| Premises and equipment, net | \$20,058 | 16,564 |

Depreciation charged to expense was \$370,000 and \$322,000 for the three months ended September 30, 2013 and 2012, respectively, and \$1,070,000 and \$927,000 for the nine months ended September 30, 2013 and 2012, respectively.

Note 7 – Borrowings

Funds borrowed from the Federal Home Loan Bank of Cincinnati ("FHLB") at September 30, 2013 and December 31, 2012 are as follows (dollars in thousands):

| | Interest Rate | September 30, 2013 | December 31, 2012 |
|--|------------------|-----------------------|----------------------|
| Fixed Rate Advances, due at maturity: | | | |
| Advance due January 2015 | 2.00 | % \$5,000 | 5,000 |
| Advance due March 2017 | 5.25 | % 5,000 | 5,000 |
| Fixed Rate Advances, with monthly principal and interest payments: | | | |
| Advance due March 2014 | 2.45 | % 528 | 1,308 |
| Advance due March 2019 | 2.82 | % 1,918 | 2,397 |
| | | \$12,446 | 13,705 |

All advances from the FHLB are secured by a blanket pledge of LCNB's 1-4 family first lien mortgage loans in the amount of approximately \$181 million and \$142 million at September 30, 2013 and December 31, 2012, respectively. Additionally, LCNB is required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 7 – Borrowings (continued)

Short-term borrowings at September 30, 2013 and December 31, 2012 are as follows (dollars in thousands):

| | September 30, 2013 | | December 31, 2012 | | |
|-------------------------|--------------------|------|-------------------|------|---|
| | Amount | Rate | Amount | Rate | |
| Line of credit | \$11,946 | 0.75 | % \$2,661 | 0.75 | % |
| FHLB short-term advance | — | — | % — | — | % |
| Repurchase agreements | 10,865 | 0.10 | % 11,095 | 0.10 | % |
| | \$22,811 | 0.44 | % \$13,756 | 0.23 | % |

Note 8 – Income Taxes

A reconciliation between the statutory income tax and LCNB's effective tax rate on income from continuing operations follows:

| | For the three months ended September 30, | | For the nine months ended September 30, | | |
|--|---|---------|--|---------|----|
| | 2013 | 2012 | 2013 | 2012 | |
| Statutory tax rate | 34.0 | % 34.0 | % 34.0 | % 34.0 | % |
| Increase (decrease) resulting from: | | | | | |
| Tax exempt interest | (6.8 |)% (8.3 |)% (7.4 |)% (7.3 |)% |
| Tax exempt income on bank owned life insurance | (1.8 |)% (2.0 |)% (2.0 |)% (1.8 |)% |
| Other, net | — | % (0.1 |)% 0.4 | % — | % |
| Effective tax rate | 25.4 | % 23.6 | % 25.0 | % 24.9 | % |

Note 9 - Commitments and Contingent Liabilities

LCNB is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

Exposure to credit loss in the event of nonperformance by the other parties to financial instruments for commitments to extend credit is represented by the contract amount of those instruments.

LCNB offers the Bounce Protection product, a customer deposit overdraft program, which is offered as a service and does not constitute a contract between the customer and LCNB.

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(Unaudited)

(Continued)

Note 9 – Commitments and Contingent Liabilities (continued)

LCNB uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Financial instruments whose contract amounts represent off-balance-sheet credit risk at September 30, 2013 and December 31, 2012 are as follows (in thousands):

| | September 30, 2013 | December 31, 2012 |
|--|-----------------------|----------------------|
| Commitments to extend credit: | | |
| Commercial loans | \$12,663 | 13,625 |
| Other loans | | |
| Fixed rate | 3,824 | 4,602 |
| Adjustable rate | 1,039 | 1,238 |
| Unused lines of credit: | | |
| Fixed rate | 4,386 | 3,368 |
| Adjustable rate | 59,636 | 45,199 |
| Unused overdraft protection amounts on demand and NOW accounts | 9,538 | 9,665 |
| Standby letters of credit | 445 | 5,109 |
| | \$91,531 | 82,806 |

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. Unused lines of credit include amounts not drawn on line of credit loans. Commitments to extend credit and unused lines of credit generally have fixed expiration dates or other termination clauses.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. At September 30, 2013 and December 31, 2012, outstanding guarantees of approximately \$445,000 and \$346,000, respectively, were issued to developers and contractors. These guarantees generally are fully secured and have varying maturities. At December 31, 2012, LCNB had a participation in four letters of credit totaling \$4.8 million securing payment of principal and interest on a bond issue. These letters of credit were terminated on July 11, 2013.

LCNB evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable; inventory; property, plant and equipment; residential realty; and income-producing commercial properties.

Capital expenditures include the construction or acquisition of new office buildings, improvements to LCNB's offices, purchases of furniture and equipment, and additions or improvements to LCNB's information technology system. Commitments outstanding for capital expenditures as of September 30, 2013 totaled approximately \$100,000.

Management believes that LCNB has sufficient liquidity to fund its lending and capital expenditure commitments.

LCNB and its subsidiary are parties to various claims and proceedings arising in the normal course of business.

Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such proceedings and claims will not be material to the consolidated financial position or results of operations.

Note 10 – Regulatory Capital

The Bank and LCNB are required by regulators to meet certain minimum levels of capital adequacy. These are expressed in the form of certain ratios. Capital is separated into Tier 1 capital (essentially shareholders' equity less goodwill and other intangibles) and Tier 2 capital (essentially the allowance for loan losses limited to 1.25% of risk-weighted assets). The first two ratios, which are based on the degree of credit risk in LCNB's assets, provide for weighting assets based on assigned risk factors and include off-balance sheet items such as loan commitments and stand-by letters of credit. The leverage ratio supplements the risk-based capital guidelines.

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(Unaudited)

(Continued)

Note 10 – Regulatory Capital (continued)

For various regulatory purposes, financial institutions are classified into categories based upon capital adequacy.

| | Minimum Requirement | | To Be Considered Well-Capitalized | |
|---|------------------------|---|---|---|
| Ratio of tier 1 capital to risk-weighted assets | 4.0 | % | 6.0 | % |
| Ratio of total capital (tier 1 capital plus tier 2 capital) to risk-weighted assets | 8.0 | % | 10.0 | % |
| Leverage ratio (tier 1 capital to adjusted quarterly average total assets) | 3.0 | % | 5.0 | % |

As of the most recent notification from their regulators, the Bank and LCNB were categorized as "well-capitalized" under the regulatory framework for prompt corrective action. Management believes that no conditions or events have occurred since the last notification that would change the Bank's or LCNB's category.

A summary of the regulatory capital and capital ratios of LCNB follows (dollars in thousands):

| | At September 30, 2013 | | At December 31, 2012 | |
|---|-----------------------------|---|----------------------------|---|
| Regulatory Capital: | | | | |
| Shareholders' equity | \$92,215 | | 82,006 | |
| Goodwill and other intangibles | (16,405 |) | (6,019 |) |
| Accumulated other comprehensive (income) loss | 508 | | (4,721 |) |
| Tier 1 risk-based capital | 76,318 | | 71,266 | |
| Eligible allowance for loan losses | 3,423 | | 3,437 | |
| Total risk-based capital | \$79,741 | | 74,703 | |
| Capital ratios: | | | | |
| Tier 1 risk-based | 13.26 | % | 15.13 | % |
| Total risk-based | 13.86 | % | 15.86 | % |
| Leverage | 8.19 | % | 8.98 | % |

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Note 11 – Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income for the nine months ended September 30, 2013 and 2012 are as follows (in thousands):

| | Unrealized Gains and Losses on Available-for-Sale Securities | Changes in Pension Plan Assets and Benefit Obligations | Total |
|--------------------------------|---|--|----------|
| 2013 | | | |
| Balance at beginning of period | \$ 4,875 | (154) | 4,721 |
| Before reclassifications | (4,758) | 26 | (4,732) |
| Reclassifications | (497) | — | (497) |
| Balance at end of period | \$ (380) | (128) | (508) |
| 2012 | | | |
| Balance at beginning of period | \$ 5,180 | (152) | 5,028 |
| Before reclassifications | 1,529 | 25 | 1,554 |
| Reclassifications | (586) | — | (586) |
| Balance at end of period | \$ 6,123 | (127) | 5,996 |

Reclassifications out of accumulated other comprehensive income during the three months and nine months ended September 30, 2013 and 2012 and the affected line items in the consolidated statements of income are as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------|------------------------------------|------|
| | 2013 | 2012 | 2013 | 2012 |
| Realized gain on sale of securities | \$58 | 427 | 753 | 886 |
| Less provision for income taxes | 20 | 145 | 256 | 300 |
| Reclassification adjustment, net of taxes | \$38 | 282 | 497 | 586 |

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Note 12 – Retirement Plans

LCNB participates in a noncontributory defined benefit retirement multi-employer plan that covers substantially all regular full-time employees hired before January 1, 2009.

Employees of LCNB also participate in a defined contribution retirement plan. Employees hired on or after January 1, 2009 receive a 50% employer match on their contributions into the 401(k) plan, up to a maximum LCNB contribution of 3% of each individual employee's annual compensation. Employees hired before January 1, 2009 who received a benefit reduction under certain amendments to the defined benefit retirement plan receive an automatic contribution of 5% or 7% of annual compensation, depending on the sum of an employee's age and vesting service, into the 401(k) plan, regardless of the contributions made by the employees. This contribution is made annually and these employees do not receive any employer matches to their 401(k) contributions.

Funding and administrative costs of the qualified noncontributory defined benefit retirement plan and 401(k) plan charged to pension and other employee benefits in the consolidated statements of income for the three and nine-month periods ended September 30, 2013 and 2012 are as follows (in thousands):

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|------|--|------|
| | 2013 | 2012 | 2013 | 2012 |
| Qualified noncontributory defined benefit retirement plan | \$31 | 230 | 93 | 521 |
| 401(k) plan | 75 | 88 | 229 | 198 |

Certain highly compensated employees participate in a nonqualified defined benefit retirement plan. The nonqualified plan ensures that participants receive the full amount of benefits to which they would have been entitled under the noncontributory defined benefit retirement plan in the absence of limits on benefit levels imposed by certain sections of the Internal Revenue Code.

The components of net periodic pension cost of the nonqualified defined benefit retirement plan for the three and nine months ended September 30, 2013 and 2012 are summarized as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------|------------------------------------|------|
| | 2013 | 2012 | 2013 | 2012 |
| Service cost | \$18 | 22 | 54 | 66 |
| Interest cost | 12 | 11 | 35 | 33 |
| Amortization of unrecognized net (gain) loss | 6 | 5 | 18 | 15 |
| Amortization of unrecognized prior service cost | 7 | 7 | 21 | 21 |
| Net periodic pension cost | \$43 | 45 | 128 | 135 |

Amounts recognized in accumulated other comprehensive income, net of tax, at September 30, 2013 and December 31, 2012 for the nonqualified defined benefit retirement plan consists of (in thousands):

| | September 30, 2013 | December 31, 2012 |
|--------------------|-----------------------|----------------------|
| Net actuarial loss | \$113 | 125 |
| Past service cost | 14 | 29 |

Citizens National Bank had a qualified noncontributory defined benefit pension plan which covered employees hired before May 1, 2005. LCNB assumed this plan at the time of the merger.

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(Continued)

Note 13 - Stock Based Compensation

LCNB established an Ownership Incentive Plan (the "Plan") during 2002 that allows for stock-based awards to eligible employees, as determined by the Board of Directors. The awards may be in the form of stock options, share awards, and/or appreciation rights. The Plan provides for the issuance of up to 200,000 shares.

Options granted to date vest ratably over a five year period and expire ten years after the date of grant. Stock options outstanding at September 30, 2013 are as follows:

| Exercise Price Range | Outstanding Stock Options | | | Exercisable Stock Options | | |
|----------------------|---------------------------|---------------------------------|---|---------------------------|---------------------------------|---|
| | Number | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) | Number | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) |
| \$9.00 - \$10.99 | 23,494 | \$9.00 | 5.3 | 18,419 | \$9.00 | 5.3 |
| \$11.00 - \$12.99 | 63,354 | 12.05 | 6.8 | 31,362 | 12.06 | 6.1 |
| \$17.00 - \$18.99 | 18,118 | 18.19 | 2.1 | 18,118 | 18.19 | 2.1 |
| | 104,966 | 12.43 | 5.6 | 67,899 | 12.86 | 4.8 |

The following table summarizes stock option activity for the periods indicated:

| | 2013 | | 2012 | |
|---------------------------|---------|---------------------------------|---------|---------------------------------|
| | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price |
| Outstanding, January 1 | 110,586 | \$12.42 | 124,123 | \$12.54 |
| Granted | — | — | 14,491 | 12.60 |
| Exercised | (5,620) | 12.32 | (2,144) | 13.09 |
| Outstanding, September 30 | 104,966 | 12.43 | 136,470 | 12.54 |
| Exercisable, September 30 | 67,899 | 12.86 | 81,193 | 13.25 |

The aggregate intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) for options outstanding at September 30, 2013 that were "in the money" (market price greater than exercise price) was \$708,000. The aggregate intrinsic value at that date for only the options that were exercisable was \$428,000. The aggregate intrinsic value for options outstanding at September 30, 2012 that were in the money was \$233,000 and the aggregate intrinsic value at that date for only the options that were exercisable was \$127,000. The intrinsic value changes based upon fluctuations in the market value of LCNB's stock.

Total expense related to options included in salaries and employee benefits in the consolidated statements of income for the three and nine months ended September 30, 2013 were \$9,000 and \$28,000, respectively, and \$10,000 and \$30,000 for the three and nine months ended September 30, 2012, respectively.

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Note 14 - Earnings per Common Share

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is adjusted for the dilutive effects of stock options, warrant, and restricted stock. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock options, warrant, and restricted stock with proceeds used to purchase treasury shares at the average market price for the period. The computations are as follows for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands, except share and per share data):

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|-----------|--|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income | \$2,357 | 1,847 | 6,433 | 6,111 |
| Weighted average number of shares outstanding used in the calculation of basic earnings per common share | 7,636,098 | 6,721,699 | 7,592,818 | 6,713,959 |
| Add dilutive effect of: | | | | |
| Stock options | 29,601 | 10,089 | 23,262 | 8,898 |
| Stock warrants | 121,399 | 65,887 | 106,606 | 64,143 |
| Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share | 7,787,098 | 6,797,675 | 7,722,686 | 6,787,000 |
| Earnings per common share: | | | | |
| Basic | \$0.31 | 0.27 | 0.85 | 0.91 |
| Diluted | 0.30 | 0.27 | 0.83 | 0.90 |

Note 15 - Fair Value Measurements

LCNB measures certain assets at fair value using various valuation techniques and assumptions, depending on the nature of the asset. Fair value is defined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.

The inputs to valuation techniques used to measure fair value are assigned to one of three broad levels:

Level 1 – quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.

Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs may include quoted prices for similar assets in active markets, quoted prices for identical assets or liabilities in markets that are not active, inputs other than quoted prices (such as interest rates or yield curves) that are observable for the asset or liability, and inputs that are derived from or corroborated by observable market data.

Level 3 - inputs that are unobservable for the asset or liability.

The majority of LCNB's financial debt securities are classified as available-for-sale. The securities are reported at fair value with unrealized holding gains and losses reported net of income taxes in accumulated other comprehensive income.

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(Continued)

Note 15 - Fair Value Measurements (continued)

LCNB utilizes a pricing service for determining the fair values of most of its investment securities. Fair value for U.S. Treasury notes and corporate securities are determined based on market quotations (level 1). Fair value for most of the other investment securities is calculated using the discounted cash flow method for each security. The discount rates for these cash flows are estimated by the pricing service using rates observed in the market (level 2). Cash flow streams are dependent on estimated prepayment speeds and the overall structure of the securities given existing market conditions. In addition, LCNB has invested in two mutual funds that invest in debt securities or loans that qualify for credit under the Community Reinvestment Act. The investment in one of the mutual funds is considered to have level 1 inputs because it is publicly traded in an active market and it publishes a daily net asset value. The investment in the other mutual fund is considered to have level 2 inputs because, although its shares are not traded in an active market, an investor can have its interest in the fund redeemed for the balance of its capital account at any quarter-end assuming the fund is given a 60 day notice. The investment in this fund is carried at cost and approximates fair value. Additionally, LCNB owns trust preferred securities in various financial institutions, equity securities in various financial and non-financial companies, and a mutual fund that invests primarily in floating rate loans. Market quotations (level 1) are used to determine fair values for these investments. The investment in the mutual fund is considered to have level 1 inputs because it is publicly traded in an active market and it publishes a daily net asset value.

Assets that may be recorded at fair value on a nonrecurring basis include impaired loans, other real estate owned, and other repossessed assets. A loan is considered impaired when management believes it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate or the fair value of collateral if the loan is collateral dependent, if this value is less than the loan balance. When the fair value of the collateral is based on an observable market price or current appraised value, the inputs are considered to be level 2.

When an appraised value is not available and there is not an observable market price, the inputs are considered to be level 3.

Other real estate owned is adjusted to fair value upon transfer of the loan to foreclosed assets, usually based on an appraisal of the property. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. The inputs for a valuation based on current appraised value are considered to be level 2.

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(Continued)

Note 15 - Fair Value Measurements (continued)

The following table summarizes the valuation of LCNB's assets recorded at fair value by input levels as of September 30, 2013 and December 31, 2012 (in thousands):

| | Fair Value Measurements | Fair Value Measurements at the End of the Reporting Period Using | | | Total Gains (Losses) |
|--|-------------------------|--|---|---|----------------------|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| September 30, 2013 | | | | | |
| Recurring fair value measurements: | | | | | |
| Investment securities available-for-sale: | | | | | |
| U.S. Treasury notes | \$8,707 | 8,707 | — | — | |
| U.S. Agency notes | 110,779 | — | 110,779 | — | |
| U.S. Agency mortgage-backed securities | 45,576 | — | 45,576 | — | |
| Certificates of deposit with other banks | 1,501 | — | 1,501 | — | |
| Municipal securities: | | | | | |
| Non-taxable | 80,509 | — | 80,509 | — | |
| Taxable | 19,685 | — | 19,685 | — | |
| Mutual funds | 2,385 | 1,385 | 1,000 | — | |
| Trust preferred securities | 147 | 147 | — | — | |
| Equity securities | 2,015 | 2,015 | — | — | |
| Total recurring fair value measurements | \$271,304 | 12,254 | 259,050 | — | |
| Nonrecurring fair value measurements: | | | | | |
| Impaired loans | \$11,819 | — | 650 | 11,169 | — |
| Other real estate owned and repossessed assets (a) | 1,561 | — | 1,561 | — | 175 |
| Total nonrecurring fair value measurements | \$13,380 | — | 2,211 | 11,169 | 175 |
| December 31, 2012 | | | | | |
| Recurring fair value measurement: | | | | | |
| Investment securities available-for-sale: | | | | | |
| U.S. Treasury notes | \$18,686 | 18,686 | — | — | |
| U.S. Agency notes | 90,606 | — | 90,606 | — | |
| U.S. Agency mortgage-backed securities | 52,541 | — | 52,541 | — | |
| Corporate securities | 3,067 | 3,067 | — | — | |
| Municipal securities: | | | | | |
| Non-taxable | 73,882 | — | 73,882 | — | |
| Taxable | 15,841 | — | 15,841 | — | |
| Mutual funds | 2,168 | 1,168 | 1,000 | — | |
| Trust preferred securities | 245 | 245 | — | — | |

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| | | | | | |
|--|-----------|--------|---------|-------|--------|
| Equity securities | 1,470 | 1,470 | — | — | |
| Total recurring fair value measurements | \$258,506 | 24,636 | 233,870 | — | |
| Nonrecurring fair value measurements: | | | | | |
| Impaired loans | \$4,276 | — | 161 | 4,115 | — |
| Other real estate owned and repossessed assets (b) | 2,189 | — | 2,189 | — | (295) |
| Total nonrecurring fair value measurements | \$6,465 | — | 2,350 | 4,115 | (295) |

Six other real estate owned properties with a total carrying amount of \$277,000 were written down to their combined fair value of \$239,000, resulting in an impairment charge of \$38,000. Eight other real estate owned (a) properties with a total carrying amount of \$843,000 were sold for a combined total of \$1,054,000, resulting in a net gain of \$211,000. A repossessed asset with a carrying value of \$6,000 was sold for \$8,000, resulting in a net gain of \$2,000. The write-downs, losses, and gains were included in other non-interest expense for the period.

Eight other real estate owned properties with a total carrying amount of \$1,809,000 were written down to their combined fair value of \$1,525,000, resulting in an impairment charge of \$284,000. Another property was sold at a (b) loss of \$8,000. Repossessed assets with a carrying value of \$23,000 were sold for a combined total of \$20,000, resulting in a net loss of \$3,000. The write-downs and losses were included in other non-interest expense for the period.

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(Continued)

Note 15 - Fair Value Measurements (continued)

Carrying amounts and estimated fair values of financial instruments as of September 30, 2013 and December 31, 2012 are as follows (in thousands):

| | September 30, 2013 | | December 31, 2012 | |
|-------------------------------|--------------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| FINANCIAL ASSETS: | | | | |
| Cash and cash equivalents | \$ 14,687 | 14,687 | 13,475 | 13,475 |
| Investment securities: | | | | |
| Available-for-sale | 271,304 | 271,304 | 258,506 | 258,506 |
| Held-to-maturity | 21,058 | 21,058 | 15,424 | 15,424 |
| Federal Reserve Bank stock | 1,603 | 1,603 | 949 | 949 |
| Federal Home Loan Bank stock | 2,854 | 2,854 | 2,091 | 2,091 |
| Loans, net | 562,686 | 564,402 | 450,346 | 453,060 |
| FINANCIAL LIABILITIES: | | | | |
| Deposits | 808,335 | 811,412 | 671,471 | 675,964 |
| Short-term borrowings | 22,811 | 22,811 | 13,756 | 13,756 |
| Long-term debt | 12,446 | 13,251 | 13,705 | 14,724 |

The fair value of off-balance-sheet financial instruments at September 30, 2013 and December 31, 2012 was not material.

Fair values of financial instruments are based on various assumptions, including the discount rate and estimates of future cash flows. Therefore, the fair values presented may not represent amounts that could be realized in actual transactions. In addition, because the required disclosures exclude certain financial instruments and all nonfinancial instruments, any aggregation of the fair value amounts presented would not represent the underlying value of LCNB.

The following methods and assumptions were used to estimate the fair value of certain financial instruments:

Cash and cash equivalents

The carrying amounts presented are deemed to approximate fair value.

Investment securities

Fair values for securities, excluding Federal Home Loan Bank and Federal Reserve Bank stock, are based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities and/or discounted cash flow analyses or other methods. The carrying value of Federal Home Loan Bank and Federal Reserve Bank stock approximates fair value based on the respective redemptive provisions.

Loans

Fair value is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, incorporating assumptions of current and projected prepayment speeds. These current rates approximate market rates.

Deposits

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities, which approximates market rates.

Borrowings

The carrying amounts of federal funds purchased, repurchase agreements, and U.S. Treasury demand note borrowings are deemed to approximate fair value of short-term borrowings. For long-term debt, fair values are estimated based on the discounted value of expected net cash flows using current interest rates.

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Note 15 - Fair Value Measurements (continued)

The following table summarizes the categorization by input level as of September 30, 2013 and December 31, 2012 of LCNB's financial assets and liabilities not recorded at fair value but for which fair value is disclosed (in thousands):

| | | Fair Value Measurements at the End of the Reporting Period Using | | |
|--|----------------------------|--|--|--|
| | Fair Value Measurements | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| September 30, 2013 | | | | |
| Assets: | | | | |
| Loans, net | \$552,583 | — | 552,583 | — |
| Investment securities, non-taxable, held-to-maturity | 21,058 | — | — | 21,058 |
| Federal Reserve Bank stock | 1,603 | 1,603 | — | — |
| Federal Home Loan Bank stock | 2,854 | 2,854 | — | — |
| Liabilities: | | | | |
| Deposits | 811,412 | — | 811,412 | — |
| Long-term debt | 13,251 | — | 13,251 | — |
| December 31, 2012 | | | | |
| Assets: | | | | |
| Loans, net | \$448,784 | — | 448,784 | — |
| Investment securities, non-taxable, held-to-maturity | 15,424 | — | — | 15,424 |
| Federal Reserve Bank stock | 949 | 949 | — | — |
| Federal Home Loan Bank stock | 2,091 | 2,091 | — | — |
| Liabilities: | | | | |
| Deposits | 675,964 | — | 675,964 | — |
| Long-term debt | 14,724 | — | 14,724 | — |

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Note 16 – Subsequent Events

On October 28, 2013, LCNB and Colonial Banc Corp. (“CBC”), the holding company for Eaton National Bank & Trust Co. of Eaton, Ohio (“Eaton National”), signed a definitive stock purchase agreement whereby LCNB will purchase 100% of the outstanding stock of Eaton National from CBC for \$24.75 million in cash. The transaction is expected to close in the first quarter of 2014, subject to receipt of CBC shareholder approval, customary regulatory approvals, and the completion of an underwritten public offering of \$25 million of LCNB voting common stock. Upon the consummation of the transaction, Eaton National will be merged into LCNB National Bank and its offices will become branches of LCNB National Bank.

Eaton National operates five full-service branches in Preble County, Ohio and has approximately \$191 million in assets, \$136 million in loans, and \$168 million in deposits.

The underwritten public offering referred to above was completed on November 5, 2013, when LCNB issued 1,642,857 shares of its common stock at a price to the public of \$17.50 per share. The net proceeds to LCNB after deducting underwriting discounts and commissions and estimated offering expenses was approximately \$27.1 million. LCNB intends to use the proceeds to fund the acquisition of Eaton National and the remaining amount will be used for general corporate purposes.

Note 17 – Recent Accounting Pronouncements

Accounting Standards Update (“ASU”) No. 2013-01, “Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities”

ASU No. 2013-01 was issued in January 2013 and clarifies that the scope of ASU No. 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities,” applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with applicable accounting guidance or subject to an enforceable master netting arrangement or similar agreement. ASU No. 2013-01 is to be applied retrospectively and was effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance, which involves disclosure only, will not impact LCNB’s results of operations or financial position. LCNB currently does not net its financial instruments on its balance sheets.

ASU No. 2013-04, “Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date”

ASU No. 2013-04 was issued in February 2013 and requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date as the sum of (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors.

The entity is also required to disclose information about the obligation, including its nature and amount. ASU No. 2013-04 is effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2013. The ASU is effective for nonpublic companies for fiscal years, and interim periods within those

years, beginning after December 15, 2014. The adoption of this guidance is not anticipated to have a material impact on LCNB's results of operations or financial position.

ASU No. 2013-10, "Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes"

ASU No. 2013-10 was issued in July 2013 and permits the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes in addition to interest rates on U.S. Treasury obligations and LIBOR. The update also removes a restriction on using different benchmark rates for similar hedges. ASU No. 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this guidance will not impact LCNB's results of operations or financial position. LCNB currently does not use hedged transactions as part of its asset/liability management activities.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 17 – Recent Accounting Pronouncements (continued)

ASU No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists”

ASU No. 2013-11 was issued in July 2013 and requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. No new recurring disclosures are required. ASU No. 2013-11 is effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2013 and are to be applied prospectively to all unrecognized tax benefits that exist at the effective date. The adoption of ASU No. 2013-11 is not expected to have a material impact on the LCNB’s results of operations or financial position.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
LCNB Corp.
Lebanon, Ohio

We have reviewed the accompanying consolidated balance sheet of LCNB Corp. and subsidiaries ("LCNB") as of September 30, 2013, and the related consolidated statements of income and comprehensive income for each of the three-month and nine-month periods ended September 30, 2013 and 2012, and the related consolidated statements of shareholders' equity and cash flows for each of the nine-month periods ended September 30, 2013 and 2012. These interim financial statements are the responsibility of LCNB's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of LCNB as of December 31, 2012 and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated February 25, 2013, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2012, is fairly stated in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ J.D. Cloud & Co. L.L.P.

Cincinnati, Ohio
November 7, 2013

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LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

Certain matters disclosed herein may be deemed to be forward-looking statements that involve risks and uncertainties. Forward looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualifying words and their derivatives such as "expects," "anticipates," "believes," "estimates," "plans," "projects," or other statements concerning opinions or judgments of LCNB and its management about future events. Factors that could influence the accuracy of such forward looking statements include, but are not limited to, regulatory policy changes, interest rate fluctuations, loan demand, loan delinquencies and losses, general economic conditions and other risks. Such forward-looking statements represent management's judgment as of the current date. Actual strategies and results in future time periods may differ materially from those currently expected. LCNB disclaims, however, any intent or obligation to update such forward-looking statements. LCNB intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Results of Operations

Net income for the three and nine months ended September 30, 2013 was \$2,357,000 (total basic and diluted earnings per common share of \$0.31 and \$0.30, respectively) and \$6,433,000 (total basic and diluted earnings per common share of \$0.85 and \$0.83, respectively), respectively. This compares to net income of \$1,847,000 (total basic and diluted earnings per common share of \$0.27) and \$6,111,000 (total basic and diluted earnings per common share of \$0.91 and \$0.90) for the same three and nine-month periods in 2012. Results for 2013 were significantly affected by the completion of a merger with First Capital Bancshares, Inc. and its subsidiary, Citizens National Bank of Chillicothe, on January 11, 2013.

Net interest income for the three and nine months ended September 30, 2013 increased \$1,241,000 and \$2,871,000, respectively, from the comparative periods in 2012 due primarily to the increased volume of average interest earning assets provided by the merger.

The provision for loan losses for the three and nine months ended September 30, 2013 was \$258,000 and \$373,000 less than the comparable periods in 2012. Net loan charge-offs for the first nine months of 2013 and 2012 totaled \$383,000 and \$807,000, respectively. Non-accrual loans and loans past due 90 days or more and still accruing interest totaled \$2,857,000 or 0.50% of total loans at September 30, 2013, compared to \$2,411,000 or 0.53% of total loans at December 31, 2012. Other real estate owned (which includes property acquired through foreclosure or deed-in-lieu of foreclosure and also includes property deemed to be in-substance foreclosed) and other repossessed assets decreased from \$2,189,000 at December 31, 2012 to \$1,561,000 at September 30, 2013 primarily due the sale of commercial real estate property during the first quarter 2013.

Non-interest income for the three-month period in 2013 was \$158,000 less than the comparable period in 2012 and \$436,000 greater for the nine-month period. The three-month period was less primarily due to decreases in gains from sales of investment securities and mortgage loans, partially offset by increases in service charges and fees on deposit accounts. For the nine-month period, decreased gains from sales of investment securities and mortgage loans were more than offset by increases in service charges and fees on deposit accounts. The increases in service charges and fees were primarily due to a greater number of deposit accounts resulting from the merger.

Non-interest expense for the three and nine months ended September 30, 2013 was \$599,000 and \$3,236,000 greater than the comparable periods in 2012. Salaries and employee benefits, as well as a variety of other expense items, increased significantly due to the increased number of employees and offices resulting from the merger. The nine-month period ended September 30, 2013 also includes \$1,326,000 in costs related to the merger with Citizens National Bank that were recognized during the first and second quarters. These expense increases during the nine-month period were partially offset by a gain recognized on the sale of other real estate owned property during the first quarter 2013.

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LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Net Interest Income

Three Months Ended September 30, 2013 vs. 2012.

LCNB's primary source of earnings is net interest income, which is the difference between earnings from loans and other investments and interest paid on deposits and other liabilities. The following table presents, for the three months ended September 30, 2013 and 2012, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resulting average yields earned or rates paid.

| | Three Months Ended September 30, | | | | | | |
|---|----------------------------------|--------------------------|------------------------|-----------------------------|--------------------------|------------------------|---|
| | 2013 | | | 2012 | | | |
| | Average Outstanding Balance | Interest Earned/ Paid | Average Yield/ Rate | Average Outstanding Balance | Interest Earned/ Paid | Average Yield/ Rate | |
| | (Dollars in thousands) | | | | | | |
| Loans (1) | \$561,345 | 6,902 | 4.88 | % \$457,138 | 5,822 | 5.05 | % |
| Interest-bearing demand deposits | 4,724 | 2 | 0.17 | % 10,175 | 4 | 0.16 | % |
| Federal Reserve Bank stock | 1,602 | — | — | % 949 | — | — | % |
| Federal Home Loan Bank stock | 2,854 | 30 | 4.17 | % 2,091 | 22 | 4.17 | % |
| Investment securities: | | | | | | | |
| Taxable | 195,711 | 862 | 1.75 | % 197,971 | 941 | 1.89 | % |
| Non-taxable (2) | 100,603 | 991 | 3.91 | % 85,135 | 932 | 4.34 | % |
| Total earnings assets | 866,839 | 8,787 | 4.02 | % 753,459 | 7,721 | 4.07 | % |
| Non-earning assets | 83,069 | | | 63,687 | | | |
| Allowance for loan losses | (3,412) | | | (2,925) | | | |
| Total assets | \$946,496 | | | \$814,221 | | | |
| Interest-bearing deposits | \$652,371 | 875 | 0.53 | % \$579,128 | 1,050 | 0.72 | % |
| Short-term borrowings | 24,622 | 11 | 0.18 | % 14,544 | 4 | 0.11 | % |
| Long-term debt | 12,564 | 109 | 3.44 | % 17,561 | 136 | 3.07 | % |
| Total interest-bearing liabilities | 689,557 | 995 | 0.57 | % 611,233 | 1,190 | 0.77 | % |
| Demand deposits | 161,725 | | | 114,053 | | | |
| Other liabilities | 4,166 | | | 7,369 | | | |
| Capital | 91,048 | | | 81,566 | | | |
| Total liabilities and capital | \$946,496 | | | \$814,221 | | | |
| Net interest rate spread (3) | | | 3.45 | % | | 3.30 | % |
| Net interest income and net interest margin on a taxable-equivalent basis (4) | | 7,792 | 3.57 | % | 6,531 | 3.44 | % |
| Ratio of interest-earning assets to interest-bearing liabilities | 125.71 | % | | 123.27 | % | | |

(1) Includes nonaccrual loans, if any.

(2)

Income from tax-exempt securities is included in interest income on a taxable-equivalent basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34%.

- (3) The net interest spread is the difference between the average rate on total interest-earning assets and interest-bearing liabilities.
- (4) The net interest margin is the taxable-equivalent net interest income divided by average interest-earning assets.

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LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table presents the changes in taxable-equivalent basis interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the three months ended September 30, 2013 as compared to the same period in 2012. Changes not solely attributable to rate or volume have been allocated to volume and rate changes in proportion to the relationship of absolute dollar amounts of the changes in each.

| | Three Months Ended September 30, 2013 vs. 2012 | | | |
|----------------------------------|---|-------|---------|---|
| | Increase (decrease) due to: | | | |
| | Volume | Rate | Total | |
| | (In thousands) | | | |
| Interest-earning Assets: | | | | |
| Loans | \$1,287 | (207 |) 1,080 | |
| Interest-bearing demand deposits | (2 |) — | (2 |) |
| Federal Reserve Bank stock | — | — | — | |
| Federal Home Loan Bank stock | 8 | — | 8 | |
| Investment securities: | | | | |
| Taxable | (11 |) (68 |) (79 |) |
| Non-taxable | 158 | (99 |) 59 | |
| Total interest income | 1,440 | (374 |) 1,066 | |
| Interest-bearing Liabilities: | | | | |
| Deposits | 121 | (296 |) (175 |) |
| Short-term borrowings | 4 | 3 | 7 | |
| Long-term debt | (42 |) 15 | (27 |) |
| Total interest expense | 83 | (278 |) (195 |) |
| Net interest income | \$1,357 | (96 |) 1,261 | |

Net interest income on a fully tax-equivalent basis for the three months ended September 30, 2013 totaled \$7,792,000, an increase of \$1,261,000 over the comparable period in 2012. Total interest income increased \$1,066,000 and total interest expense decreased \$195,000.

The increase in total interest income was primarily due to a \$113.4 million increase in average total earning assets, partially offset by a 5 basis point (a basis point equals 0.01%) decrease in the average rate earned on earning assets.

The increase in average interest earning assets was primarily due to interest-earning assets acquired through the merger with First Capital. The decrease in the average rate earned reflects a general decrease in market rates, partially offset by the recognition of accretable income resulting from the payoff of certain acquired credit impaired loans.

The decrease in total interest expense was primarily due to a 20 basis point decrease in the average rate paid on interest-bearing liabilities, partially offset by an \$78.3 million increase in average interest-bearing liabilities. The increase in average interest-bearing liabilities was primarily due to an \$73.2 million increase in average interest-bearing deposits primarily due to the merger and a \$10.1 million increase in average short-term borrowings, partially offset by a \$5.0 million decrease in average long-term debt. Long-term debt decreased because of the

payment in full of a \$6.0 million Federal Home Loan Bank advance in August 2012. The decrease in the average rate paid on deposits also reflects a general decrease in market rates.

Nine Months Ended September 30, 2013 vs. 2012.

The following table presents, for the nine months ended September 30, 2013 and 2012, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resultant average yields earned or rates paid.

The following table presents the changes in taxable-equivalent basis interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the nine months ended September 30, 2013 as compared to the same period in 2012.

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LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

| | Nine Months Ended September 30, 2013 vs. 2012 Increase (decrease) due to: | | |
|----------------------------------|---|----------|--------|
| | Volume | Rate | Total |
| | (In thousands) | | |
| Interest-earning Assets: | | | |
| Loans | \$3,407 | (1,059) | 2,348 |
| Federal funds sold | 1 | — | 1 |
| Interest-bearing demand deposits | (6) | 2 | (4) |
| Federal Reserve Bank stock | 12 | (2) | 10 |
| Federal Home Loan Bank stock | 23 | — | 23 |
| Investment securities: | | | |
| Taxable | 83 | (337) | (254) |
| Non-taxable | 510 | (357) | 153 |
| Total interest income | 4,030 | (1,753) | 2,277 |
| Interest-bearing Liabilities: | | | |
| Deposits | 412 | (955) | (543) |
| Short-term borrowings | 4 | 2 | 6 |
| Long-term debt | (166) | 57 | (109) |
| Total interest expense | 250 | (896) | (646) |
| Net interest income | \$3,780 | (857) | 2,923 |

Net interest income on a fully tax-equivalent basis for the first nine months of 2013 totaled \$22,788,000, a \$2,923,000 increase from the same nine-month period of 2012. Total interest income increased \$2,277,000 and total interest expense decreased \$646,000.

The increase in total interest income was primarily due to a \$112.0 million increase in average total earning assets, partially offset by a 19 basis point decrease in the average rate earned on earning assets. The increase in average interest earning assets was primarily due to interest-earning assets acquired through the merger with First Capital.

The decrease in the average rate earned reflects a general decrease in market rates, partially offset by the recognition of accretable income resulting from the payoff of certain acquired credit impaired loans.

The decrease in total interest expense was primarily due to a 22 basis point decrease in the average rate paid on interest-bearing liabilities, partially offset by a \$75.6 million increase in average interest-bearing liabilities. The increase in average interest-bearing liabilities was primarily due to an \$78.3 million increase in average interest-bearing deposits primarily due to the merger, partially offset by a \$6.7 million decrease in average long-term debt. Long-term debt decreased because of the previously described payment in full of a Federal Home Loan Bank advance in August 2012. The decrease in the average rate paid on interest-bearing liabilities reflects a general decrease in market rates.

Provision and Allowance For Loan Losses

The total provision for loan losses is determined based upon management's evaluation as to the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, and current economic conditions that may affect borrowers' ability to pay. The provision for loan losses for the three months ended September 30, 2013 and 2012 was \$178,000 and \$436,000, respectively, and \$369,000 and \$742,000 for the nine months ended September 30, 2013 and 2012, respectively. The decrease in the provision reflects stabilization in the credit quality of the loan portfolio in part due to relatively stable regional market conditions.

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LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The fair value of loans acquired through the merger was estimated by discounting at current rates the cash flows expected to be received on Citizens' loan portfolio. Since the estimation of cash flows recognized the probability that LCNB would not be able to collect all contractually required principal and interest payments, Citizens' allowance for loan losses was not carried forward.

Non-Interest Income

Three Months Ended September 30, 2013 vs. 2012.

Total non-interest income for the third quarter 2013 was \$158,000 less than for the third quarter 2012 primarily due to a \$369,000 decrease in net gains on sales of investment securities and a \$94,000 decrease in net gains from sales of mortgage loans. The decreases reflect declines in the volume of investment securities and loans sold.

These decreases were partially offset by a \$151,000 increase in service charges and fees on deposit accounts and a \$96,000 increase in trust income. Service charges and fees on deposit accounts increased primarily due to a greater number of deposit accounts resulting from the merger. Trust income increased primarily due to an increase in the fair value of trust assets and brokerage accounts managed along with fee adjustments that became effective July 1, 2013.

Nine Months Ended September 30, 2013 vs. 2012.

Non-interest income for the first nine months of 2013 was \$436,000 greater than the comparable period in 2012. The increase was largely due to a \$416,000 increase in service charges and fees on deposit accounts for substantially the same reasons mentioned above. Net gain on sales of securities decreased \$133,000 and net gains from sales of mortgage loans decreased \$55,000 for substantially the same reasons mentioned above.

Non-Interest Expense

Three Months Ended September 30, 2013 vs. 2012.

Non-interest expense for the third quarter 2013 was \$599,000 greater than for the third quarter 2012 due primarily to a \$188,000 increase in salaries and employee benefits and a \$220,000 increase in other non-interest expense. The increase in salaries and employee benefits primarily reflects the additional staff needed to operate the six additional offices LCNB acquired as a result of the merger. Equipment expenses and net occupancy expense increased slightly due to increased costs for the additional offices. FDIC insurance premiums increased due to a higher level of deposit accounts. Other non-interest expense increased due to smaller increases in various accounts.

Nine Months Ended September 30, 2013 vs. 2012.

Non-interest expense for the first nine months of 2013 was \$3,236,000 greater than for the same period in 2012 due primarily to a \$779,000 increase in salaries and employee benefits, a \$119,000 increase in equipment expenses, a \$287,000 increase in net occupancy expense, and a \$1,897,000 increase in other non-interest expense. Salaries and employee benefits, equipment expenses, and net occupancy expense increased for substantially the same reasons mentioned above. Other non-interest expense for the nine-month period in 2013 included \$1,326,000 in costs related to the merger and data system conversion. Increases in intangible amortization expense of \$205,000 and other expenses associated with the operations of the newly acquired branches also contributed to the overall increase in

other non-interest expense in 2013.

Partially offsetting these increased costs was a \$265,000 decrease in net costs related to other real estate owned, including a gain recognized in the first quarter 2013 on the sale of commercial real estate property and a decrease in impairment write-downs and other holding costs.

Income Taxes

LCNB's effective tax rates for the nine months ended September 30, 2013 and 2012 were 25.0% and 24.9%, respectively. The difference between the statutory rate of 34.0% and the effective tax rate is primarily due to tax-exempt interest income from municipal securities and tax-exempt earnings from bank owned life insurance.

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LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Financial Condition

The carrying values of loans, securities available-for-sale, premises and equipment, and deposits were greatly influenced by the merger. See Note 2 - Acquisition to the Financial Statements for a description of the merger and a summary of the fair values of First Capital's assets and liabilities added to LCNB's consolidated balance sheet.

In addition to the merger, a \$37.1 million increase in public fund deposits by local government entities was a secondary reason for the increase in total deposits. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities.

Common stock in the shareholders' equity section of the consolidated balance sheet at September 30, 2013 was \$12.7 million greater than the balance shown for December 31, 2012 due primarily to the merger. LCNB issued 888,811 shares of stock, valued at \$12.4 million on the date of the merger, and paid approximately \$7.8 million in cash to effect the merger.

Liquidity

LCNB depends on dividends from its subsidiaries for the majority of its liquid assets, including the cash needed to pay dividends to its shareholders. National banking law limits the amount of dividends the Bank may pay to the sum of retained net income for the current year plus retained net income for the previous two years. Prior approval from the Office of the Comptroller of the Currency, the Bank's primary regulator, is necessary for the Bank to pay dividends in excess of this amount. In addition, dividend payments may not reduce capital levels below minimum regulatory guidelines. Management believes the Bank will be able to pay anticipated dividends to LCNB Corp. without needing to request approval. The Bank is not aware of any reasons why it would not receive such approval.

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. Asset liquidity is provided by cash and assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash and cash equivalents and securities available for sale. At September 30, 2013, LCNB's liquid assets amounted to \$286.0 million or 30.3% of total assets. This compares to liquid assets totaling \$272.0 million or 34.5% of total assets at December 31, 2012.

Liquidity is also provided by access to core funding sources, primarily core depositors in LCNB's market area.

Approximately 81.1% of total deposits at September 30, 2013 were "core" deposits, compared to 83.6% of deposits at December 31, 2012. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than \$100,000. The percentage of core deposits to total deposits decreased because of the growth in public fund deposits discussed above in relation to total growth in deposits.

Secondary sources of liquidity include LCNB's ability to sell loan participations, borrow funds from the Federal Home Loan Bank, purchase federal funds, issue repurchase agreements, or use a line of credit established with another bank.

Management closely monitors the level of liquid assets available to meet ongoing funding needs. It is management's intent to maintain adequate liquidity so that sufficient funds are readily available at a reasonable cost. LCNB experienced no liquidity or operational problems as a result of the current liquidity levels.

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LCNB CORP. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures about Market Risks

Market risk for LCNB is primarily interest rate risk. LCNB attempts to mitigate this risk through asset/liability management strategies designed to decrease the vulnerability of its earnings to material and prolonged changes in interest rates. LCNB does not use derivatives such as interest rate swaps, caps, or floors to hedge this risk. LCNB has not entered into any market risk instruments for trading purposes.

The Bank's Asset and Liability Management Committee ("ALCO") primarily uses a combination of Interest Rate Sensitivity Analysis ("IRSA") and Economic Value of Equity ("EVE") analysis for measuring and managing interest rate risk. IRSA is used to estimate the effect on net interest income during a one-year period of instantaneous and sustained movements in interest rates, also called interest rate shocks, of 100, 200, and 300 basis points. Management considers the results of any significant downward scenarios to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the September 30, 2013 IRSA indicates that an increase in interest rates would have a positive effect on net interest income ("NII"). The changes in NII for all rate assumptions are within LCNB's acceptable ranges.

| Rate Shock Scenario in Basis Points | Amount | \$ Change in NII | % Change in NII | |
|-------------------------------------|------------------------|------------------|-----------------|---|
| | (Dollars in thousands) | | | |
| Up 300 | \$35,552 | 2,274 | 6.83 | % |
| Up 200 | 34,763 | 1,485 | 4.46 | % |
| Up 100 | 34,002 | 724 | 2.18 | % |
| Base | 33,278 | — | — | |

IRSA shows the effect on NII during a one-year period only. A more long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. As shown below, the September 30, 2013 EVE analysis indicates that an increase in interest rates would have a negative effect on the EVE. The changes in eve for all rate assumptions are within LCNB's acceptable ranges.

| Rate Shock Scenario in Basis Points | Amount | \$ Change in EVE | % Change in EVE | |
|-------------------------------------|------------------------|------------------|-----------------|---|
| | (Dollars in thousands) | | | |
| Up 300 | \$83,393 | (7,766) | (8.52) | % |
| Up 200 | 85,292 | (5,867) | (6.44) | % |
| Up 100 | 87,402 | (3,757) | (4.12) | % |
| Base | 91,159 | — | — | |

The IRSA and EVE simulations discussed above are not projections of future income or equity and should not be relied on as being indicative of future operating results. Assumptions used, including the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment or replacement of asset and liability cash flows, are inherently uncertain and, as a result, the models cannot precisely measure future net interest income or equity. Furthermore, the models do not reflect actions that borrowers, depositors, and management may take in response to changing economic conditions and interest rate levels.

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LCNB CORP. AND SUBSIDIARIES

Item 4. Controls and Procedures

a) Disclosure controls and procedures. The Chief Executive Officer and the Chief Financial Officer have carried out an evaluation of the effectiveness of LCNB's disclosure controls and procedures that ensure that information relating to LCNB required to be disclosed by LCNB in the reports that it files or submits under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to LCNB's management, including its principal executive officer and principal financial officer, as appropriate, in order to allow timely decisions to be made regarding required disclosures. Based upon this evaluation, these officers have concluded, that as of September 30, 2013, LCNB's disclosure controls and procedures were effective.

b) Changes in internal control over financial reporting. During the period covered by this report, there were no changes in LCNB's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, LCNB's internal control over financial reporting.

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PART II. OTHER INFORMATION

LCNB CORP. AND SUBSIDIARIES

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

No material changes

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the period of this report, LCNB did not sell any of its securities that were not registered under the Securities Act.

During the period covered by this report, LCNB did not purchase any shares of its equity securities.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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LCNB CORP. AND SUBSIDIARIES

Item 6. Exhibits

| Exhibit No. | Exhibit Description |
|-------------|--|
| 2 | Agreement and Plan of Merger dated as of October 9, 2012 by and between LCNB Corp. and First Capital Bancshares, Inc. – incorporated by reference to the Registrant's Form 8-K filed on October 9, 2012, Exhibit 2.1. |
| 3.1 | Amended and Restated Articles of Incorporation of LCNB Corp., as amended – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010, Exhibit 3.1. |
| 3.2 | Code of Regulations of LCNB Corp. – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005, Exhibit 3(ii). |
| 10.1 | LCNB Corp. Ownership Incentive Plan – incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 15, 2002, Exhibit A (000-26121). |
| 10.2 | Form of Option Grant Agreement under the LCNB Corp. Ownership Incentive Plan – incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2005, Exhibit 10.2. |
| 10.3 | Nonqualified Executive Retirement Plan – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2009, Exhibit 10.4. |
| 31.1 | Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | The following financial information from LCNB Corp.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 is formatted in Extensible Business Reporting Language: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements. |

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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.

LCNB Corp.

November 7, 2013

/s/ Stephen P. Wilson
Stephen P. Wilson, Chief Executive Officer
and
Chairman of the Board of Directors

November 7, 2013

/s/ Robert C. Haines, II
Robert C. Haines, II, Executive Vice President
and Chief Financial Officer