

LCNB CORP
Form 10-Q
August 06, 2014

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 June 30, 2014

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 August 4, 2014 was 9,298,829 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)

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS:		
Cash and due from banks	\$18,771	10,410
Interest-bearing demand deposits	110	4,278
Total cash and cash equivalents	18,881	14,688
Investment securities:		
Available-for-sale, at fair value	327,740	258,241
Held-to-maturity, at cost	23,843	16,323
Federal Reserve Bank stock, at cost	2,346	1,603
Federal Home Loan Bank stock, at cost	3,638	2,854
Loans, net	688,325	570,766
Premises and equipment, net	21,230	19,897
Goodwill	27,638	14,186
Bank owned life insurance	21,607	21,280
Other assets	15,861	12,500
TOTAL ASSETS	\$1,151,109	932,338
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$201,928	164,912
Interest-bearing	784,896	620,849
Total deposits	986,824	785,761
Short-term borrowings	23,523	8,655
Long-term debt	11,506	12,102
Accrued interest and other liabilities	6,672	6,947
TOTAL LIABILITIES	1,028,525	813,465
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 10,051,897 and 10,041,163 shares at June 30, 2014 and December 31, 2013, respectively	66,974	66,785
Retained earnings	66,437	65,475
Treasury shares at cost, 753,627 shares at June 30, 2014 and December 31, 2013	(11,665)	(11,665)
Accumulated other comprehensive income (loss), net of taxes	838	(1,722)
TOTAL SHAREHOLDERS' EQUITY	122,584	118,873
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,151,109	932,338

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

The consolidated balance sheet as of December 31, 2013 has been derived from the audited consolidated balance sheet as of that day.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
INTEREST INCOME:				
Interest and fees on loans	\$8,144	6,816	15,840	13,396
Interest on investment securities:				
Taxable	1,026	860	1,917	1,694
Non-taxable	657	655	1,303	1,278
Other investments	99	74	144	113
TOTAL INTEREST INCOME	9,926	8,405	19,204	16,481
INTEREST EXPENSE:				
Interest on deposits	814	931	1,623	1,914
Interest on short-term borrowings	5	4	8	7
Interest on long-term debt	101	110	204	222
TOTAL INTEREST EXPENSE	920	1,045	1,835	2,143
NET INTEREST INCOME	9,006	7,360	17,369	14,338
PROVISION FOR LOAN LOSSES	255	42	336	191
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	8,751	7,318	17,033	14,147
NON-INTEREST INCOME:				
Trust income	728	609	1,383	1,184
Service charges and fees on deposit accounts	1,252	1,073	2,374	2,052
Net gain (loss) on sales of securities	—	108	(4) 695
Bank owned life insurance income	170	172	342	344
Gains from sales of mortgage loans	53	119	68	248
Other operating income	98	97	215	162
TOTAL NON-INTEREST INCOME	2,301	2,178	4,378	4,685
NON-INTEREST EXPENSE:				
Salaries and employee benefits	3,956	3,242	7,874	6,536
Equipment expenses	345	298	639	590
Occupancy expense, net	514	518	1,165	1,024
State franchise tax	239	211	483	427
Marketing	197	157	329	301
FDIC insurance premiums	160	119	309	247
Merger-related expenses	70	271	1,362	1,326
Other non-interest expense	2,119	1,508	4,111	2,964
TOTAL NON-INTEREST EXPENSE	7,600	6,324	16,272	13,415
INCOME BEFORE INCOME TAXES	3,452	3,172	5,139	5,417
PROVISION FOR INCOME TAXES	841	824	1,205	1,341
NET INCOME	\$2,611	2,348	3,934	4,076
Dividends declared per common share	\$0.16	0.16	0.32	0.32
Earnings per common share:				
Basic	\$0.28	0.31	0.42	0.54

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Diluted	0.28	0.30	0.42	0.53
Weighted average common shares outstanding:				
Basic	9,293,382	7,627,900	9,290,905	7,570,817
Diluted	9,402,343	7,759,438	9,407,964	7,686,890

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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$2,611	2,348	3,934	4,076
Other comprehensive income (loss):				
Net unrealized gain (loss) on available-for-sale securities (net of taxes of \$822 and \$2,667 for the three months ended June 30, 2014 and 2013, respectively, and \$1,315 and \$2,843 for the six months ended June 30, 2014 and 2013, respectively)	1,598	(5,176)) 2,554	(5,518)
Reclassification adjustment for net realized (gain) loss on sale of available-for-sale securities included in net income (net of taxes of \$- and \$36 for the three months ended June 30, 2014 and 2013, respectively, and \$1 and \$236 for the six months ended June 30, 2014 and 2013, respectively)	—	(72)) 3	(459)
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of \$- and \$4 for the three months ended June 30, 2014 and 2013, respectively, and \$1 and \$9 for the six months ended June 30, 2014 and 2013)	1	10	3	18
TOTAL COMPREHENSIVE INCOME (LOSS)	\$4,210	(2,890)) 6,494	(1,883)

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, 2012	6,731,900	\$27,107	61,843	(11,665)	4,721	82,006
Net income			4,076			4,076
Other comprehensive loss, net of taxes					(5,959)	(5,959)
Dividend Reinvestment and Stock Purchase Plan	9,568	163				163
Exercise of stock options	3,400	43				43
Acquisition of First Capital Bancshares, Inc.	888,811	12,321				12,321
Compensation expense relating to stock options		19				19
Common stock dividends, \$0.32 per share			(2,440)			(2,440)
Balance at June 30, 2013	7,633,679	\$39,653	63,479	(11,665)	(1,238)	90,229
Balance at December 31, 2013	9,287,536	\$66,785	65,475	(11,665)	(1,722)	118,873
Net income			3,934			3,934
Other comprehensive income, net of taxes					2,560	2,560
Dividend Reinvestment and Stock Purchase Plan	10,734	176				176
Compensation expense relating to stock options		13				13
Common stock dividends, \$0.32 per share			(2,972)			(2,972)
Balance at June 30, 2014	9,298,270	\$66,974	66,437	(11,665)	838	122,584

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)

	Six Months Ended June 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$3,934	4,076
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization, and accretion	1,482	1,390
Provision for loan losses	336	191
Increase in cash surrender value of bank owned life insurance	(342)	(344)
Realized (gain) loss from sales of securities available-for-sale	4	(695)
Realized (gain) loss from sales of premises and equipment	(7)	—
Realized (gain) loss from sales and write-downs of other real estate owned and repossessed assets	68	(196)
Origination of mortgage loans for sale	(3,480)	(14,397)
Realized gains from sales of mortgage loans	(68)	(248)
Proceeds from sales of mortgage loans	3,514	14,504
Compensation expense related to stock options	13	19
Changes in:		
Accrued income receivable	56	(184)
Other assets	(532)	1,110
Other liabilities	(534)	(1,601)
TOTAL ADJUSTMENTS	510	(451)
NET CASH FLOWS FROM OPERATING ACTIVITIES	4,444	3,625
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of investment securities available-for-sale	26,071	38,005
Proceeds from maturities and calls of investment securities:		
Available-for-sale	19,863	11,170
Held-to-maturity	3,006	3,680
Purchases of investment securities:		
Available-for-sale	(76,330)	(57,099)
Held-to-maturity	(10,526)	(9,435)
Purchase of Federal Reserve Bank stock	(743)	(497)
Proceeds from redemption of Federal Reserve Bank stock	41	—
Net (increase) decrease in loans	(2,252)	(3,614)
Proceeds from redemption of bank owned life insurance	3,633	—
Proceeds from sale of other real estate owned and repossessed assets	203	988
Additions to other real estate owned	(17)	—
Purchases of premises and equipment	(770)	(362)
Proceeds from sale of premises and equipment	38	—
Net cash acquired from (paid for) acquisition	(9,115)	9,771
NET CASH FLOWS FROM INVESTING ACTIVITIES	(46,898)	(7,393)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	35,822	(7,374)

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Net increase (decrease) in short-term borrowings	14,217	22,516
Principal payments on long-term debt	(596) (2,709
Proceeds from issuance of common stock	24	20
Proceeds from exercise of stock options	—	43
Cash dividends paid on common stock	(2,820) (2,297
NET CASH FLOWS FROM FINANCING ACTIVITIES	46,647	10,199
NET CHANGE IN CASH AND CASH EQUIVALENTS	4,193	6,431
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	14,688	13,475
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$18,881	19,906
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$1,710	2,140
Income taxes paid	1,700	1,745
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Transfer from loans to other real estate owned and repossessed assets	435	6

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 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.

The consolidated balance sheet as of December 31, 2013 has been derived from the audited consolidated balance sheet as of that day.

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 six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the full year ending December 31, 2014. 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 2013 Annual Report on Form 10-K filed with the SEC.

Note 2 – Acquisitions

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.

On October 28, 2013, LCNB and Colonial Banc Corp. ("Colonial") entered into a Stock Purchase Agreement ("Purchase Agreement") pursuant to which LCNB purchased from Colonial on January 24, 2014 all of the issued and outstanding shares of Eaton National Bank & Trust Co. ("ENB") in a cash transaction valued at \$24.75 million. Immediately

following the acquisition, ENB was merged into the Bank. ENB operated five full-service branches with a main office and another facility in Eaton, Ohio and branch offices in each of West Alexandria, Ohio, New Paris, Ohio, and Lewisburg, Ohio. These offices became branches of the Bank after the merger.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 – Acquisitions (continued)

The merger with ENB 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:

Cash paid to shareholder	\$24,750
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Identifiable Assets Acquired:

Cash and cash equivalents	15,635
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Investment securities:

Available-for-sale	35,859
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Federal Reserve Bank stock	41
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Federal Home Loan Bank stock	784
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Loans	115,944
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Premises and equipment	1,314
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Bank owned life insurance	3,618
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Core deposit intangible	2,466
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Other real estate owned	262
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Other assets	1,624
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Total identifiable assets acquired	177,547
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Liabilities Assumed:

Deposits	165,335
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Short-term borrowings	651
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Other liabilities	263
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Total liabilities assumed	166,249
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Total Identifiable Net Assets Acquired	11,298
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Goodwill resulting from merger	\$13,452
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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 on LCNB's financial records, but is deductible for tax purposes. The core deposit intangible will be amortized over eight years using the straight-line method.

Prior to the end of the one-year measurement period for finalizing the purchase allocation, if information becomes available which would indicate adjustments to the purchase price allocation, such adjustments will be included in the purchase price retrospectively.

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 March 31, 2014 (in thousands):

Goodwill at March 31, 2014	\$13,238
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Effect of adjustments to:	
Loans	189
Other assets	21
Other liabilities	4
Goodwill at June 30, 2014	\$13,452

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 – Acquisitions (continued)

Direct costs related to the acquisition were expensed as incurred and are recorded in merger-related expense in the consolidated statements of income.

The results of operations are included in the consolidated statement of income from the date of the merger. The estimated amount of ENB 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 six months ended June 30, 2014 were as follows (in thousands):

Total revenue	\$2,639
Net income	984

The following table presents unaudited pro forma information as if the merger with ENB had occurred on January 1, 2013 (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 ENB occurred in 2013. In particular, expected operational cost savings are not reflected in the pro forma amounts.

	Six Months Ended	
	June 30,	
	2014	2013
Total revenue	\$22,205	23,537
Net income	4,963	5,175
Basic earnings per common share	0.53	0.56
Diluted earnings per common share	0.53	0.55

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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 June 30, 2014 and December 31, 2013 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2014				
Available-for-Sale:				
U.S. Treasury notes	\$60,677	206	162	60,721
U.S. Agency notes	118,416	431	1,525	117,322
U.S. Agency mortgage-backed securities	41,979	540	369	42,150
Certificates of deposit	3,078	15	—	3,093
Municipal securities:				
Non-taxable	83,067	2,044	374	84,737
Taxable	15,177	406	126	15,457
Mutual funds	2,436	—	17	2,419
Trust preferred securities	50	—	1	49
Equity securities	1,474	343	25	1,792
	\$326,354	3,985	2,599	327,740
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	23,443	119	215	23,347
Taxable	400	1	—	401
	\$23,843	120	215	23,748
December 31, 2013				
Available-for-Sale:				
U.S. Treasury notes	\$13,184	—	290	12,894
U.S. Agency notes	110,248	141	3,714	106,675
U.S. Agency mortgage-backed securities	40,602	555	848	40,309
Certificates of deposit	1,492	9	—	1,501
Municipal securities:				
Non-taxable	74,185	2,116	968	75,333
Taxable	17,020	503	214	17,309
Mutual funds	2,419	—	39	2,380
Trust preferred securities	149	4	6	147
Equity securities	1,429	329	65	1,693
	\$260,728	3,657	6,144	258,241
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	15,923	159	285	15,797
Taxable	400	—	1	399

\$16,323	159	286	16,196
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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 June 30, 2014 and December 31, 2013, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (dollars in thousands):

	Less than Twelve Months		Twelve Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2014				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	\$9,185	1	\$8,743	161
U.S. Agency notes	—	—	73,891	1,525
U.S. Agency mortgage-backed securities	12	—	12,076	369
Municipal securities:				
Non-taxable	6,771	35	16,805	339
Taxable	2,162	17	4,301	109
Mutual funds	—	—	1,160	17
Trust preferred securities	49	1	—	—
Equity securities	155	11	217	14
	\$18,334	65	\$117,193	2,534
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$5,022	215	—	—
Taxable	—	—	—	—
	\$5,022	215	\$—	—
December 31, 2013				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	\$12,894	290	\$—	—
U.S. Agency notes	89,080	2,880	9,636	834
U.S. Agency mortgage-backed securities	17,557	575	5,130	273
Municipal securities:				
Non-taxable	15,641	398	10,751	570
Taxable	4,903	202	1,252	12
Mutual funds	1,380	39	—	—
Trust preferred securities	—	—	93	6
Equity securities	300	44	93	21
	\$141,755	4,428	\$26,955	1,716
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$4,890	285	\$—	—
Taxable	399	1	—	—

\$5,289

286

\$—

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Investment Securities (continued)

Management has determined that the unrealized losses at June 30, 2014 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.

Contractual maturities of investment securities at June 30, 2014 were as follows (in thousands). Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	\$13,154	13,238	2,086	2,097
Due from one to five years	146,077	147,276	4,130	4,131
Due from five to ten years	111,848	111,583	5,117	4,939
Due after ten years	9,336	9,233	12,510	12,581
	280,415	281,330	23,843	23,748
U.S. Agency mortgage-backed securities	41,979	42,150	—	—
Mutual funds	2,436	2,419	—	—
Trust preferred securities	50	49	—	—
Equity securities	1,474	1,792	—	—
	\$326,354	327,740	23,843	23,748

Investment securities with a market value of \$202,316,000 and \$157,956,000 at June 30, 2014 and December 31, 2013, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Certain information concerning the sale of investment securities available-for-sale for the three and six months ended June 30, 2014 and 2013 was as follows (in thousands):

	For the three months ended		For the six months ended	
	June 30, 2014	2013	June 30, 2014	2013
Proceeds from sales	\$—	14,611	26,071	38,005
Gross realized gains	—	109	2	701
Gross realized losses	—	1	6	6

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 - Loans

Major classifications of loans at June 30, 2014 and December 31, 2013 are as follows (in thousands):

	June 30, 2014	December 31, 2013
Commercial and industrial	38,919	29,337
Commercial, secured by real estate	377,806	314,252
Residential real estate	243,966	215,587
Consumer	20,015	12,643
Agricultural	8,466	2,472
Other loans, including deposit overdrafts	2,594	91
	691,766	574,382
Deferred net origination costs (fees)	(47) (28
	691,719	574,354
Less allowance for loan losses	3,394	3,588
Loans, net	688,325	570,766

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 \$203 million and \$183 million at June 30, 2014 and December 31, 2013, respectively. Additionally, LCNB is required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

Loans acquired from the mergers with First Capital and ENB 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.

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 ENB, not including loans considered to be impaired (in thousands):

Contractually required principal at acquisition	\$ 102,483
Less fair value adjustment	1,347
Fair value of acquired loans	\$ 101,136

Contractual cash flows not expected to be collected

\$1,702

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 – Loans (continued)

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

Contractually required principal at acquisition	\$23,414
Contractual cash flows not expected to be collected (nonaccretable difference)	(6,088)
Expected cash flows at acquisition	17,326
Interest component of expected cash flows (accretable discount)	(2,163)
Fair value of acquired impaired loans	\$15,163

Non-accrual, past-due, and accruing restructured loans as of June 30, 2014 and December 31, 2013 are as follows (in thousands):

	June 30, 2014	December 31, 2013
Non-accrual loans:		
Commercial and industrial	262	144
Commercial, secured by real estate	4,596	1,418
Agricultural	67	—
Residential real estate	1,318	1,399
Total non-accrual loans	6,243	2,961
Past-due 90 days or more and still accruing	130	250
Total non-accrual and past-due 90 days or more and still accruing	6,373	3,211
Accruing restructured loans	14,512	15,151
Total	20,885	18,362

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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 six months ended June 30, 2014 and 2013 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
June 30, 2014							
Allowance for loan losses:							
Balance, beginning of year	\$ 175	2,520	826	66	—	1	3,588
Provision charged to expenses	146	(81)	239	14	8	10	336
Losses charged off							