LCNB CORP
Form 10-Q
November 04, 2015

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

.. 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.
x 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).
x 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 o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
¨ Yes x No

The number of shares outstanding of the issuer's common stock, without par value, as of October 30, 2015 was 9,903,736 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, except per share data)

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS:		
Cash and due from banks	$18,844	14,235
Interest-bearing demand deposits	14,367	1,610
Total cash and cash equivalents	33,211	15,845
Investment securities:		
Available-for-sale, at fair value	360,741	285,365
Held-to-maturity, at cost	24,575	22,725
Federal Reserve Bank stock, at cost	2,476	2,346
Federal Home Loan Bank stock, at cost	3,638	3,638
Loans, net	759,875	695,835
Premises and equipment, net	22,434	20,733
Goodwill	30,187	27,638
Core deposit and other intangibles	5,601	4,780
Bank owned life insurance	22,406	21,936
Other assets	10,027	7,225
TOTAL ASSETS	$1,275,171	1,108,066
LIABILITIES:		
Deposits:		
Noninterest-bearing	$238,796	213,303
Interest-bearing	864,717	732,902
Total deposits	1,103,513	946,205
Short-term borrowings	14,931	16,645
Long-term debt	6,016	11,357
Accrued interest and other liabilities	9,860	8,164
TOTAL LIABILITIES	1,134,320	982,371
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 10,656,921 and 10,064,945 shares at September 30, 2015 and December 31, 2014, respectively	76,711	67,181
Retained earnings	73,330	69,394
Treasury shares at cost, 753,627 shares at September 30, 2015 and December 31, 2014	(11,665)	(11,665)
Accumulated other comprehensive income, net of taxes	2,475	785
TOTAL SHAREHOLDERS' EQUITY	140,851	125,695
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,275,171	1,108,066

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

The consolidated balance sheet as of December 31, 2014 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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
INTEREST INCOME:				
Interest and fees on loans	$8,540	8,168	26,572	24,008
Interest on investment securities:				
Taxable	1,094	984	2,983	2,901
Non-taxable	732	716	2,087	2,019
Other investments	43	38	205	182
TOTAL INTEREST INCOME	10,409	9,906	31,847	29,110
INTEREST EXPENSE:				
Interest on deposits	834	800	2,187	2,423
Interest on short-term borrowings	5	10	13	18
Interest on long-term debt	73	101	222	305
TOTAL INTEREST EXPENSE	912	911	2,422	2,746
NET INTEREST INCOME	9,497	8,995	29,425	26,364
PROVISION FOR LOAN LOSSES	240	401	986	737
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,257	8,594	28,439	25,627
NON-INTEREST INCOME:				
Trust income	754	688	2,406	2,071
Service charges and fees on deposit accounts	1,314	1,245	3,655	3,619
Net gain (loss) on sales of securities	—	97	332	93
Bank owned life insurance income	156	165	470	507
Gains from sales of loans	34	24	288	92
Other operating income	128	96	372	311
TOTAL NON-INTEREST INCOME	2,386	2,315	7,523	6,693
NON-INTEREST EXPENSE:				
Salaries and employee benefits	4,340	4,022	13,011	11,896
Equipment expenses	324	337	914	976
Occupancy expense, net	570	541	1,749	1,706
State franchise tax	251	231	753	714
Marketing	176	212	559	541
Amortization of intangibles	189	150	510	424
FDIC insurance premiums	136	183	432	492
Merger-related expenses	49	4	641	1,366
Other non-interest expense	2,053	1,558	5,594	5,395
TOTAL NON-INTEREST EXPENSE	8,088	7,238	24,163	23,510
INCOME BEFORE INCOME TAXES	3,555	3,671	11,799	8,810
PROVISION FOR INCOME TAXES	922	953	3,209	2,158
NET INCOME	$2,633	2,718	8,590	6,652
Dividends declared per common share	$0.16	0.16	0.48	0.48

Earnings per common share:				
Basic	$0.26	0.30	0.89	0.72
Diluted	0.26	0.29	0.88	0.71
Weighted average common shares outstanding:				
Basic	9,898,233	9,299,691	9,637,344	9,293,866
Diluted	10,005,788	9,405,013	9,742,839	9,407,110

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 COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	$2,633	2,718	8,590	6,652
Other comprehensive income (loss):				
Net unrealized gain (loss) on available-for-sale securities (net of taxes of $1,015 and $(353) for the three months ended September 30, 2015 and 2014, respectively and $940 and $962 for the nine months ended September 30, 2015 and 2014 respectively)	1,972	(687)	1,825	1,867
Reclassification adjustment for net realized (gain) loss on sale of available-for-sale securities included in net income (net of taxes of $- and $33 for the three months ended September 30, 2015 and 2014, respectively and $113 and $32 for the nine months ended September 30, 2015 and 2014 respectively)	—	(64)	(219)	(61)
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of $15 and $3 for the three months ended September 30, 2015 and 2014, respectively and $44 and $4 for the nine months ended September 30, 2015 and 2014 respectively)	28	4	84	7
TOTAL COMPREHENSIVE INCOME	$4,633	1,971	10,280	8,465

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 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, 2013	9,287,536	$66,785	65,475	(11,665)	(1,722)	118,873
Net income			6,652			6,652
Other comprehensive income, net of taxes					1,813	1,813
Dividend Reinvestment and Stock Purchase Plan	17,672	283				283
Compensation expense relating to stock options		18				18
Common stock dividends, $0.48 per share			(4,460)			(4,460)
Balance at September 30, 2014	9,305,208	$67,086	67,667	(11,665)	91	123,179
Balance at December 31, 2014	9,311,318	$67,181	69,394	(11,665)	785	125,695
Net income			8,590			8,590
Other comprehensive income, net of taxes					1,690	1,690
Dividend Reinvestment and Stock Purchase Plan	18,395	289				289
Acquisition of BNB Bancorp, Inc.	560,132	9,063				9,063
Exercise of stock options	13,449	152				152
Excess tax benefit on exercise of stock options		13				13
Compensation expense relating to stock options		13				13
Common stock dividends, $0.48 per share			(4,654)			(4,654)
Balance at September 30, 2015	9,903,294	$76,711	73,330	(11,665)	2,475	140,851

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, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$8,590	6,652
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization, and accretion	2,108	2,299
Provision for loan losses	986	737
Increase in cash surrender value of bank owned life insurance	(470)	(507)
Realized gain from sales of securities available-for-sale	(332)	(93)
Realized gain from sales of premises and equipment	(1)	(116)
Realized loss from sales and write-downs of other real estate owned and repossessed assets	146	9
Origination of mortgage loans for sale	(5,237)	(5,024)
Realized gains from sales of loans	(288)	(92)
Proceeds from sales of mortgage loans	5,291	5,066
Compensation expense related to stock options	13	18
Changes in:		
Accrued income receivable	(1,103)	(575)
Other assets	(1,789)	689
Other liabilities	776	(46)
TOTAL ADJUSTMENTS	100	2,365
NET CASH FLOWS FROM OPERATING ACTIVITIES	8,690	9,017
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of investment securities available-for-sale	54,955	55,795
Proceeds from maturities and calls of investment securities:		
Available-for-sale	19,658	24,133
Held-to-maturity	1,574	3,345
Purchases of investment securities:		
Available-for-sale	(89,961)	(76,801)
Held-to-maturity	(3,413)	(10,526)
Purchase of Federal Reserve Bank stock	—	(743)
Proceeds from redemption of Federal Reserve Bank stock	—	41
Proceeds from sale of impaired loans	4,559	—
Net (increase) decrease in loans	(34,281)	3,152
Proceeds from redemption of bank owned life insurance	—	3,633
Proceeds from sale of other real estate owned and repossessed assets	114	711
Additions to other real estate owned	(20)	(20)
Purchases of premises and equipment	(444)	(857)
Proceeds from sale of premises and equipment	22	167
Net cash acquired from (paid for) acquisition	8,993	(9,114)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(38,244)	(7,084)
CASH FLOWS FROM FINANCING ACTIVITIES:		

Net increase in deposits	58,175	5,631
Net (decrease) increase in short-term borrowings	(1,714)	15,648
Principal payments on long-term debt	(5,341)	(670)
Proceeds from issuance of common stock	46	50
Proceeds and excess tax benefit from exercise of stock options	165	—
Cash dividends paid on common stock	(4,411)	(4,227)
NET CASH FLOWS FROM FINANCING ACTIVITIES	46,920	16,432
NET CHANGE IN CASH AND CASH EQUIVALENTS	17,366	18,365
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	15,845	14,688
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$33,211	33,053
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$2,490	2,665
Income taxes paid	3,470	2,000
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Transfer from loans to other real estate owned and repossessed assets	79	435

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") 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, 2014 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 nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the full year ending December 31, 2015. 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 2014 Annual Report on Form 10-K filed with the SEC.

Note 2 – Acquisitions

On December 29, 2014, LCNB and BNB Bancorp, Inc. (“BNB”) entered into an Agreement and Plan of Merger (“Merger Agreement”) pursuant to which BNB was acquired by LCNB on April 30, 2015. Immediately following the merger of BNB into LCNB, Brookville National Bank ("Brookville"), a wholly-owned subsidiary of BNB, was merged into LCNB National Bank. Brookville operated a main office and a branch office, both in Brookville, Ohio. These offices became branches of the Bank after the merger.

Under the terms of the Merger Agreement, the shareholders of BNB common stock received, for each share of BNB common stock, (i) $15.75 in cash and (ii) 2.005 LCNB common shares.

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. ("Eaton National"). Immediately following the acquisition, Eaton National was merged into the Bank. Eaton National 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 mergers with BNB and Eaton National were 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 respective merger dates, as summarized in the following table (in thousands):

	BNB	Eaton National
Consideration Paid:		
Common shares issued	$9,063	—
Cash paid to shareholder(s)	4,403	24,750
Total consideration paid	13,466	24,750
Identifiable Assets Acquired:		
Cash and cash equivalents	13,396	15,635
Investment securities	58,239	35,859
Federal Reserve Bank stock	130	41
Federal Home Loan Bank stock	—	784
Loans	34,661	115,944
Premises and equipment	2,311	1,314
Bank owned life insurance	—	3,618
Core deposit intangible	1,418	2,466
Other real estate owned	—	262
Other assets	527	1,624
Total identifiable assets acquired	110,682	177,547
Liabilities Assumed:		
Deposits	99,133	165,335
Short-term borrowings	—	651
Deferred income taxes	576	—
Other liabilities	57	263
Total liabilities assumed	99,766	166,249
Total Identifiable Net Assets Acquired	10,916	11,298
Goodwill resulting from merger	2,550	13,452

The amount of goodwill recorded reflects LCNB's entrance into new markets and related synergies that are expected to result from the acquisitions and represent 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 for BNB and Eaton National is being amortized over nine and eight years, respectively, using the straight-line method.

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

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

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(Unaudited)
(Continued)

Note 2 – Acquisitions (continued)

The results of operations are included in the consolidated statement of income from the dates of the mergers. The estimated amount of BNB revenue (net interest income plus non-interest income) and net income, excluding merger-related expenses, included in LCNB's consolidated statement of income for the three and nine months ended September 30, 2015 were as follows (in thousands):

	Three Months	Nine Months
Total revenue	$448	773
Net income	131	196

The following table presents unaudited pro forma information as if the merger with BNB had occurred on January 1, 2014 (in thousands). This pro forma information gives effect to certain adjustments, including acquisition accounting fair value adjustments, amortization of the core deposit intangible, and related income tax effects. It does not include merger-related expenses. The pro forma information does not necessarily reflect the results of operations that would have occurred had the merger with BNB occurred in 2014. In particular, expected operational cost savings are not reflected in the pro forma amounts.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Total revenue	$11,849	12,078	37,741	35,201
Net income	2,643	2,869	9,020	6,965
Basic earnings per common share	0.26	0.29	0.91	0.71
Diluted earnings per common share	0.26	0.29	0.90	0.70

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

Note 3 - Investment Securities

The amortized cost and estimated fair value of investment securities at September 30, 2015 and December 31, 2014 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2015				
Available-for-Sale:				
U.S. Treasury notes	$89,925	1,211	4	91,132
U.S. Agency notes	111,825	701	128	112,398
U.S. Agency mortgage-backed securities	26,119	331	122	26,328
Certificates of deposit	2,084	2	—	2,086
Municipal securities:				
Non-taxable	98,114	1,766	111	99,769
Taxable	25,109	550	18	25,641
Mutual funds	2,509	—	29	2,480
Trust preferred securities	49	—	—	49
Equity securities	871	55	68	858
	$356,605	$4,616	480	360,741
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	23,975	178	112	24,041
Taxable	600	—	2	598
	$24,575	178	114	24,639
December 31, 2014				
Available-for-Sale:				
U.S. Treasury notes	$62,406	290	136	62,560
U.S. Agency notes	84,661	188	1,212	83,637
U.S. Agency mortgage-backed securities	37,838	413	219	38,032
Certificates of deposit	3,076	10	—	3,086
Municipal securities:				
Non-taxable	75,727	1,972	304	77,395
Taxable	16,005	465	75	16,395
Mutual funds	2,483	—	22	2,461
Trust preferred securities	50	—	—	50
Equity securities	1,415	372	38	1,749
	$283,661	3,710	2,006	285,365
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	22,525	108	695	21,938

Taxable	200	—	—	200
	$22,725	108	695	22,138

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LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
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Note 3 - Investment Securities (continued)

Information concerning investment securities with gross unrealized losses at September 30, 2015 and December 31, 2014, 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
September 30, 2015				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$—	—	$4,903	4
U.S. Agency notes	4,992	—	22,311	128
U.S. Agency mortgage-backed securities	3,934	36	4,757	86
Municipal securities:				
Non-taxable	9,194	42	8,096	69
Taxable	2,671	5	887	13
Mutual funds	1,209	4	276	25
Trust preferred securities	49	—	—	—
Equity securities	264	29	144	39
	$22,313	116	$41,374	364
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$10	—	4,243	112
Taxable	398	2	—	—
	$408	2	$4,243	112
December 31, 2014				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$9,141	7	$8,774	129
U.S. Agency notes	—	—	65,971	1,212
U.S. Agency mortgage-backed securities	3,795	2	11,456	217
Municipal securities:				
Non-taxable	7,211	58	11,419	246
Taxable	3,117	15	3,668	60
Mutual funds	281	12	1,190	10
Trust preferred securities	50	—	—	—
Equity securities	197	29	123	9
	$23,792	123	$102,601	1,883
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$8,152	540	$4,200	155
Taxable	—	—	—	—

	$8,152	540	$4,200	155

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LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
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Note 3 - Investment Securities (continued)

Management has determined that the unrealized losses at September 30, 2015 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 September 30, 2015 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	$20,324	20,382	4,577	4,593
Due from one to five years	195,313	197,663	3,467	3,456
Due from five to ten years	108,447	109,871	4,534	4,453
Due after ten years	2,973	3,110	11,997	12,137
	327,057	331,026	24,575	24,639
U.S. Agency mortgage-backed securities	26,119	26,328	—	—
Mutual funds	2,509	2,480	—	—
Trust preferred securities	49	49	—	—
Equity securities	871	858	—	—
	$356,605	360,741	24,575	24,639

Investment securities with a market value of $224,053,000 and $175,094,000 at September 30, 2015 and December 31, 2014, 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 nine months ended September 30, 2015 and 2014 was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Proceeds from sales	$—	29,724	54,955	55,795
Gross realized gains	—	169	345	171
Gross realized losses	—	72	13	78

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

Note 4 - Loans

Major classifications of loans at September 30, 2015 and December 31, 2014 are as follows (in thousands):

	September 30, 2015	December 31, 2014
Commercial and industrial	45,325	35,424
Commercial, secured by real estate	407,264	379,141
Residential real estate	274,054	254,087
Consumer	19,283	18,006
Agricultural	16,016	11,472
Other loans, including deposit overdrafts	676	680
	762,618	698,810
Deferred net origination costs (fees)	215	146
	762,833	698,956
Less allowance for loan losses	2,958	3,121
Loans, net	759,875	695,835

All advances from the Federal Home Loan Bank of Cincinnati are secured by a blanket pledge of LCNB's 1-4 family first lien mortgage loans in the amount of approximately $233 million and $212 million at September 30, 2015 and December 31, 2014, respectively. Additionally, LCNB is required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

Loans acquired through mergers 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 BNB on April 30, 2015 and Eaton National on January 24, 2014, not including loans considered to be impaired (in thousands):

	BNB	Eaton National
Contractually required principal at acquisition	$32,174	102,483

Less fair value adjustment	199	1,347
Fair value of acquired loans	$31,975	101,136
Contractual cash flows not expected to be collected	$195	1,702

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Note 4 – Loans (continued)

The following table provides details on acquired impaired loans obtained through the mergers with BNB and Eaton National that are accounted for in accordance with FASB ASC 310-30 (in thousands):

	BNB	Eaton National
Contractually required principal at acquisition	$3,511	23,414
Contractual cash flows not expected to be collected (nonaccretable difference)	(404)	(6,088)
Expected cash flows at acquisition	3,107	17,326
Interest component of expected cash flows (accretable discount)	(413)	(2,163)
Fair value of acquired impaired loans	$2,694	15,163

Non-accrual, past-due, and accruing restructured loans as of September 30, 2015 and December 31, 2014 are as follows (in thousands):

	September 30, 2015	December 31, 2014
Non-accrual loans:		
Commercial and industrial	$—	—
Commercial, secured by real estate	1,302	4,277
Agricultural	39	70
Residential real estate	913	1,252
Total non-accrual loans	2,254	5,599
Past-due 90 days or more and still accruing	130	203
Total non-accrual and past-due 90 days or more and still accruing	2,384	5,802
Accruing restructured loans	13,887	14,269
Total	$16,271	20,071

LCNB sold impaired loans with a carrying value of approximately $4.5 million during the second quarter 2015. The decrease in non-accrual loans at September 30, 2015 as compared to December 31, 2014 is primarily due to this sale.

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Note 4 – Loans (continued)

The allowance for loan losses for the three and nine months ended September 30, 2015 and 2014 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
Three Months Ended September 30, 2015							
Allowance for loan losses:							
Balance, beginning of period	$ 162	1,655	914	62	83	3	2,879
Provision charged to expenses	167	97	(60)	14	9	13	240
Losses charged off	(89)	(29)	(46)	(20)	—	(26)	(210)
Recoveries	3	—	23	12	—	11	49
Balance, end of period	$ 243	1,723	831	68	92	1	2,958
Nine Months Ended September 30, 2015							
Allowance for loan losses:							
Balance, beginning of year	$ 129	1,990	926	63	11	2	3,121
Provision charged to expenses	209	612	57	1	81	26	986
Losses charged off	(100)	(975)	(243)	(49)	(67)	(52)	(1,486)
Recoveries	5	96	91	53	67	25	337
Balance, end of period	$ 243	1,723	831	68	92	1	2,958
Three Months Ended September 30, 2014							
Allowance for loan losses:							
Balance, beginning of period	$ 331	2,068	916	69	8	2	3,394
Provision charged to expenses	75	97	201	5	3	20	401
Losses charged off	(261)	(112)	(106)	(24)	—	(32)	(535)
Recoveries	1	—	1	25	—	11	38
Balance, end of period	$ 146	2,053	1,012	75	11	1	3,298
Nine Months Ended September 30, 2014							
Allowance for loan losses:							
Balance, beginning of year	$ 175	2,520	826	66	—	1	3,588
Provision charged to expenses	221	16	440	19	11	30	737
Losses charged off	(261)	(483)	(281)	(85)	—	(65)	(1,175)
Recoveries	11	—	27	75	—	35	148
Balance, end of period	$ 146	2,053	1,012	75	11	1	3,298

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Note 4 – Loans (continued)

A breakdown of the allowance for loan losses and the loan portfolio by loan segment at September 30, 2015 and December 31, 2014 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
September 30, 2015							
Allowance for loan losses:							
Individually evaluated for impairment	$ 9	295	68	—	—	—	372
Collectively evaluated for impairment	234	1,428	763	68	92	1	2,586
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of period	$ 243	1,723	831	68	92	1	2,958
Loans:							
Individually evaluated for impairment	$ 378	12,421	1,591	51	—	—	14,441
Collectively evaluated for impairment	43,215	386,335	269,809	19,281	15,985	157	734,782
Acquired credit impaired loans	1,754	8,173	3,082	43	39	519	13,610
Balance, end of period	$ 45,347	406,929	274,482	19,375	16,024	676	762,833
December 31, 2014							
Allowance for loan losses:							
Individually evaluated for impairment	$ 10	415	89	—	—	—	514
Collectively evaluated for impairment	119	1,273	836	63	11	2	2,304
Acquired credit impaired loans	—	302	1	—	—	—	303
Balance, end of period	$ 129	1,990	926	63	11	2	3,121
Loans:							
Individually evaluated for impairment	$ 401	13,022	1,701	55	—	—	15,179
Collectively evaluated for impairment	33,941	352,774	249,374	17,954	11,371	167	665,581
Acquired credit impaired loans	1,092	12,984	3,425	81	101	513	18,196
Balance, end of period	$ 35,434	378,780	254,500	18,090	11,472	680	698,956

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Note 4 – Loans (continued)

The risk characteristics of LCNB's material loan portfolio segments are as follows:

Commercial and Industrial Loans. LCNB’s commercial and industrial loan portfolio consists of loans for various purposes, including loans to fund working capital requirements (such as inventory and receivables financing) and purchases of machinery and equipment. LCNB offers a variety of commercial and industrial loan arrangements, including term loans, balloon loans, and lines of credit. Most commercial and industrial loans have a variable rate, with adjustments occurring monthly, annually, every three years, or every five years. Adjustments are generally based on a publicly available index rate plus a margin. The margin varies based on the terms and collateral securing the loan. Commercial and industrial loans are offered to businesses and professionals for short and medium terms on both a collateralized and uncollateralized basis. Commercial and industrial loans typically are underwritten on the basis of the borrower’s ability to make repayment from the cash flow of the business. Collateral, when obtained, may include liens on furniture, fixtures, equipment, inventory, receivables, or other assets. As a result, such loans involve complexities, variables, and risks that require thorough underwriting and more robust servicing than other types of loans.

Commercial, Secured by Real Estate Loans. Commercial real estate loans include loans secured by a variety of commercial, retail, and office buildings, religious facilities, multifamily (more than two-family) residential properties, construction and land development loans, and other land loans. Commercial real estate loan products generally amortize over five to twenty-five years and are payable in monthly principal and interest installments. Some have balloon payments due within one to ten years after the origination date. Many have adjustable interest rates with adjustment periods ranging from one to ten years, some of which are subject to established “floor” interest rates.

Commercial real estate loans are underwritten based on the ability of the property, in the case of income producing property, or the borrower’s business to generate sufficient cash flow to amortize the debt. Secondary emphasis is placed upon global debt service, collateral value, financial strength of any guarantors, and other factors. Commercial real estate loans are generally originated with a 75% maximum loan to appraised value ratio.

Residential Real Estate Loans. Residential real estate loans include loans secured by first or second mortgage liens on one to two-family residential property. Home equity lines of credit and mortgage loans secured by owner-occupied agricultural property are included in this category. First and second mortgage loans are generally amortized over five to thirty years with monthly principal and interest payments. Home equity lines of credit generally have a five year draw period with interest only payments followed by a repayment period with monthly payments based on the amount outstanding. LCNB offers both fixed and adjustable rate mortgage loans. Adjustable rate loans are available with adjustment periods ranging between one to ten years and adjust according to an established index plus a margin, subject to certain floor and ceiling rates. Home equity lines of credit have a variable rate based on the Wall Street Journal prime rate plus a margin.

LCNB does not originate reverse mortgage loans or residential real estate loans generally considered to be “subprime.”

Residential real estate loans are underwritten primarily based on the borrower’s ability to repay, prior credit history, and the value of the collateral. LCNB generally requires private mortgage insurance for first mortgage loans that have a loan to appraised value ratio of greater than 80%.

Consumer Loans. LCNB's portfolio of consumer loans generally includes secured and unsecured loans to individuals for household, family and other personal expenditures. Secured loans include loans to fund the purchase of automobiles, recreational vehicles, boats, and similar acquisitions. Consumer loans made by LCNB generally have fixed rates and terms ranging up to 72 months, depending upon the nature of the collateral, size of the loan, and other relevant factors.

Consumer loans generally have higher interest rates, but pose additional risks of collectability and loss when compared to certain other types of loans. Collateral, if present, is generally subject to damage, wear, and depreciation. The borrower's ability to repay is of primary importance in the underwriting of consumer loans.

Agricultural Loans. LCNB's portfolio of agricultural loans includes loans for financing agricultural production or for financing the purchase of equipment used in the production of agricultural products. LCNB's agricultural loans are generally secured by farm machinery, livestock, crops, vehicles, or other agricultural related collateral.

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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.

A breakdown of the loan portfolio by credit quality indicators at September 30, 2015 and December 31, 2014 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
September 30, 2015					
Commercial & industrial	$44,446	—	901	—	45,347
Commercial, secured by real estate	385,748	8,002	13,179	—	406,929
Residential real estate	268,629	1,241	4,612	—	274,482
Consumer	19,316	—	59	—	19,375
Agricultural	14,781	—	1,243	—	16,024
Other	676	—	—	—	676
Total	$733,596	9,243	19,994	—	762,833
December 31, 2014					
Commercial & industrial	$34,322	—	1,112	—	35,434
Commercial, secured by real estate	353,957	6,421	18,402	—	378,780
Residential real estate	246,335	920	7,245	—	254,500
Consumer	17,979	—	111	—	18,090
Agricultural	11,273	—	199	—	11,472
Other	680	—	—	—	680
Total	$664,546	7,341	27,069	—	698,956

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Note 4 – Loans (continued)

A loan portfolio aging analysis at September 30, 2015 and December 31, 2014 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, 2015							
Commercial & industrial	$43	—	—	43	45,304	45,347	—
Commercial, secured by real estate	242	—	1,302	1,544	405,385	406,929	—
Residential real estate	807	275	779	1,861	272,621	274,482	116
Consumer	69	10	14	93	19,282	19,375	14
Agricultural	30	1,110	—	1,140	14,884	16,024	—
Other	85	—	—	85	591	676	—
Total	$1,276	1,395	2,095	4,766	758,067	762,833	130
December 31, 2014							
Commercial & industrial	$4	—	—	4	35,430	35,434	—
Commercial, secured by real estate	1,000	83	3,179	4,262	374,518	378,780	9
Residential real estate	648	297	1,289	2,234	252,266	254,500	177
Consumer	59	28	17	104	17,986	18,090	17
Agricultural	73	70	—	143	11,329	11,472	—
Other	106	—	—	106	574	680	—
Total	$1,890	478	4,485	6,853	692,103	698,956	203

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Note 4 – Loans (continued)

Impaired loans, including acquired credit impaired loans, at September 30, 2015 and December 31, 2014 are as follows (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance
September 30, 2015			
With no related allowance recorded:			
Commercial & industrial	$1,753	2,059	—
Commercial, secured by real estate	16,615	19,095	—
Residential real estate	3,884	5,127	—
Consumer	94	151	—
Agricultural	39	151	—
Other	519	712	—
Total	$22,904	27,295	—
With an allowance recorded:			
Commercial & industrial	$378	378	9
Commercial, secured by real estate	3,979	4,042	295
Residential real estate	790	889	68
Consumer	—	—	—
Agricultural	—	—	—
Other	—	—	—
Total	$5,147	5,309	372
Total:			
Commercial & industrial	$2,131	2,437	9
Commercial, secured by real estate	20,594	23,137	295
Residential real estate	4,674	6,016	68
Consumer	94	151	—
Agricultural	39	151	—
Other	519	712	—
Total	$28,051	32,604	372
December 31, 2014			
With no related allowance recorded:			
Commercial & industrial	$1,092	2,077	—
Commercial, secured by real estate	21,822	26,715	—
Residential real estate	4,057	5,549	—
Consumer	117	178	—
Agricultural	101	619	—
Other	513	744	—
Total	$27,702	35,882	—

With an allowance recorded:			
Commercial & industrial	$401	406	10
Commercial, secured by real estate	4,184	4,538	717
Residential real estate	1,069	1,265	90
Consumer	19	20	—
Total	$5,673	6,229	817
Total:			
Commercial & industrial	$1,493	2,483	10
Commercial, secured by real estate	26,006	31,253	717
Residential real estate	5,126	6,814	90
Consumer	136	198	—
Agricultural	101	619	—
Other	513	744	—
Total	$33,375	42,111	817

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Note 4 – Loans (continued)

The following presents information related to the average recorded investment and interest income recognized on impaired loans, including acquired credit impaired loans, for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	2015 Average Recorded Investment	Interest Income Recognized	2014 Average Recorded Investment	Interest Income Recognized
Three Months Ended September 30,				
With no related allowance recorded:				
Commercial & industrial	$1,609	34	2,053	38
Commercial, secured by real estate	18,841	270	22,768	310
Residential real estate	4,164	124	4,328	98
Consumer	110	7	158	2
Agricultural	110	11	116	7
Other	516	19	543	10
Total	$25,350	465	29,966	465
With an allowance recorded:				
Commercial & industrial	$382	6	393	6
Commercial, secured by real estate	3,994	29	4,298	46
Residential real estate	808	10	1,341	9
Consumer	—	—	18	—
Agricultural	—	—	—	—
Other	—	—	—	—
Total	$5,184	45	6,050	61
Total:				
Commercial & industrial	$1,991	40	2,446	44
Commercial, secured by real estate	22,835	299	27,066	356
Residential real estate	4,972	134	5,669	107
Consumer	110	7	176	2
Agricultural	110	11	116	7
Other	516	19	543	10
Total	$30,534	510	36,016	526
Nine Months Ended September 30,				
With no related allowance recorded:				
Commercial & industrial	$1,437	175	2,085	76
Commercial, secured by real estate	19,941	1,901	23,549	698
Residential real estate	4,295	364	4,620	179
Consumer	119	15	196	8
Agricultural	107	479	126	9

Other	515	58	560	17
Total	$26,414	2,992	31,136	987
With an allowance recorded:				
Commercial & industrial	$389	17	274	17
Commercial, secured by real estate	3,977	85	4,209	97
Residential real estate	825	29	1,176	39
Consumer	—	—	18	1
Agricultural	—	—	—	—
Other	—	—	—	—
Total	$5,191	131	5,677	154
Total:				
Commercial & industrial	$1,826	192	2,359	93
Commercial, secured by real estate	23,918	1,986	27,758	795
Residential real estate	5,120	393	5,796	218
Consumer	119	15	214	9
Agricultural	107	479	126	9
Other	515	58	560	17
Total	$31,605	3,123	36,813	1,141

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Note 4 – Loans (continued)

Of the interest income recognized on impaired loans during the nine months ended September 30, 2015 and 2014, approximately $96,000 and $0, respectively, were recognized on a cash basis.

Loan modifications that were classified as troubled debt restructurings during the three and nine months ended September 30, 2015 and 2014 are as follows (dollars in thousands):

	2015			2014		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Three Months Ended September 30,						
Commercial & industrial	—	$ —	—	—	$ —	—
Commercial, secured by real estate	—	—	—	1	79	79
Residential real estate	—	—	—	1	5	5
Consumer	1	2	2	—	—	—
Total	1	$ 2	2	2	$ 84	84
Nine Months Ended September 30,						
Commercial & industrial	1	$ 72	74	7	$ 638	638
Commercial, secured by real estate	—	—	—	2	897	897
Residential real estate	4	137	137	2	83	83
Consumer	1	2	2	1	2	2
Total	6	$ 211	213	12	$ 1,620	1,620

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.

There were no troubled debt restructurings that subsequently defaulted within twelve months of the restructuring date for the nine months ended September 30, 2015 and 2014 and that remained in default at period end.

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Note 5 - Acquired Credit Impaired Loans

The following table provides at September 30, 2015 and December 31, 2014 the major classifications of acquired credit impaired loans that are accounted for in accordance with FASB ASC 310-30 (in thousands):

	September 30, 2015	December 31, 2014
Commercial & industrial	$1,754	1,092
Commercial, secured by real estate	8,173	12,984
Residential real estate	3,082	3,425
Consumer	43	81
Agricultural	39	101
Other loans, including deposit overdrafts	519	513
	13,610	18,196
Less allowance for loan losses	—	303
Loans, net	13,610	17,893

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

	September 30, 2015	December 31, 2014
Outstanding balance	$17,923	26,697
Carrying amount	13,610	18,196

Activity during the nine months ended September 30, 2015 and 2014 for the accretable discount related to acquired credit impaired loans is as follows (in thousands):

	2015	2014
Accretable discount at beginning of year	$2,674	1,107
Accretable discount acquired during period	413	2,163
Reclass from nonaccretable discount to accretable discount	957	140
Less disposals	(850)	(99)
Less accretion	(1,540)	(413)
Accretable discount at September 30,	$1,654	2,898

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Note 6 – Other Real Estate Owned

Other real estate owned includes property acquired through foreclosure or deed-in-lieu of foreclosure 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,	
	2015	2014
Balance, beginning of year	$1,370	1,463
Additions	99	455
Additions due to merger	—	262
Reductions due to sales	(105)	(697)
Reductions due to valuation write downs	(156)	(23)
Balance, end of period	$1,208	1,460

Other real estate owned at September 30, 2015 and December 31, 2014 consisted of (dollars in thousands):

	September 30, 2015	December 31, 2014
Commercial real estate	$1,109	$1,265
Residential real estate	99	105
	$1,208	$1,370

The total recorded investment in residential consumer mortgage loans secured by residential real estate that was in the process of foreclosure at September 30, 2015 was $318,000.

Note 7 – Short-Term Borrowings

Short-term borrowings at September 30, 2015 and December 31, 2014 are as follows (dollars in thousands):

	September 30, 2015		December 31, 2014	
	Amount	Rate	Amount	Rate
Line of credit	$—	— %	$5,021	0.75 %
FHLB short-term advance	—	— %	—	— %
Repurchase agreements	14,931	0.10 %	11,624	0.10 %
	$14,931	0.10 %	$16,645	0.30 %

Repurchase agreements are an option customers may use in managing their cash positions and mature the next business day after issuance. Repurchase agreements at September 30, 2015 and December 31, 2014 were secured by U.S. Agency notes.

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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,	
	2015	2014	2015	2014
Statutory tax rate	34.0 %	34.0 %	34.0 %	34.0 %
Increase (decrease) resulting from:				
Tax exempt interest	(6.8)%	(6.5)%	(5.9)%	(7.5)%
Tax exempt income on bank owned life insurance	(1.5)%	(1.5)%	(1.4)%	(2.0)%
Other, net	0.2 %	— %	0.5 %	— %
Effective tax rate	25.9 %	26.0 %	27.2 %	24.5 %

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.

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

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, 2015 and December 31, 2014 are as follows (in thousands):

	September 30, 2015	December 31, 2014
Commitments to extend credit:		
Commercial loans	$6,380	5,152
Other loans		
Fixed rate	3,323	877
Adjustable rate	1,150	2,011
Unused lines of credit:		
Fixed rate	9,209	6,496
Adjustable rate	80,391	67,981
Unused overdraft protection amounts on demand and NOW accounts	10,110	10,206
Standby letters of credit	457	563
	$111,020	93,286

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.

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Note 9 – Commitments and Contingent Liabilities (continued)

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These guarantees generally are fully secured and have varying maturities.

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, residential realty, income-producing commercial property, and property, plant, and equipment.

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, 2015 totaled approximately $10,908,000, which includes estimated costs for a new operations center LCNB is planning to build in Lebanon, Ohio. Cost estimates for the operations center may change because the bid process is not complete.

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

LCNB and its subsidiaries 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 – Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income for the nine months ended September 30, 2015 and 2014 are as follows (in thousands):

	Unrealized Gains and Losses on Available-for-Sale Securities	Changes in Pension Plan Assets and Benefit Obligations	Total
September 30, 2015			
Balance at beginning of period	$ 1,126	(341)	785
Before reclassifications	1,823	86	1,909
Reclassifications	(219)	—	(219)
Balance at end of period	$ 2,730	(255)	2,475
September 30, 2014			
Balance at beginning of period	$ (1,641)	(81)	(1,722)
Before reclassifications	1,867	7	1,874
Reclassifications	(61)	—	(61)
Balance at end of period	$ 165	(74)	91

Reclassifications out of accumulated other comprehensive income during the three and nine months ended September 30, 2015 and 2014 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,		Affected Line Item in the Consolidated Statements of Income
	2015	2014	2015	2014	
Realized gain on sale of securities	$—	97	332	93	Net gain on sale of securities
Less provision for income taxes	—	33	113	32	Provision for income taxes
Reclassification adjustment, net of taxes	$—	64	219	61	

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Note 11 – Retirement Plans

LCNB participates in a noncontributory defined benefit multi-employer retirement plan that covers substantially all regular full-time employees hired before January 1, 2009. Employees hired on or before this date who received a benefit reduction under certain amendments to the defined benefit retirement plan receive an automatic contribution of 5% or 7% of their annual compensation, depending on the sum of an employee's age and vesting service, into their defined contribution plans (401(k) plans), regardless of the contributions made by the employees. These contributions are made annually and these employees do not receive any employer matches to their 401(k) contributions.

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.

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, 2015 and 2014 are as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2014	2015	2014
Qualified noncontributory defined benefit retirement plan	$220	309	763	725
401(k) plan	86	81	263	242

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, 2015 and 2014 are summarized as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Service cost	$10	17	29	51
Interest cost	17	15	51	45
Amortization of unrecognized net loss	—	—	128	—
Amortization of unrecognized prior service cost	43	4	—	12
Net periodic pension cost	$70	36	208	108

Amounts recognized in accumulated other comprehensive income, net of tax, at September 30, 2015 and December 31, 2014 for the nonqualified defined benefit retirement plan consists of (in thousands):

	September 30, 2015	December 31, 2014
Net actuarial loss	$254	339

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Note 12 - Stock Based Compensation

LCNB established an Ownership Incentive Plan (the "2002 Plan") during 2002 that allowed for stock-based awards to eligible employees, as determined by the Board of Directors. The awards were made in the form of stock options, share awards, and/or appreciation rights. The 2002 Plan provided for the issuance of up to 200,000 shares. The 2002 Plan expired on April 16, 2012. Any outstanding unexercised options, however, continue to be exercisable in accordance with their terms.

The 2015 Ownership Incentive Plan (the "2015 Plan") was ratified by LCNB's shareholders at the annual meeting on April 28, 2015 and allows for stock-based awards to eligible employees, as determined by the Compensation Committee of the Board of Directors. Awards may be made in the form of stock options, appreciation rights, restricted shares, and/or restricted share units. The 2015 Plan provides for the issuance of up to 450,000 shares. The 2015 Plan will terminate on April 28, 2025 and is subject to earlier termination by the Compensation Committee. No awards have been granted under the 2015 Plan.

Options granted to date under the 2002 Plan vest ratably over a five-year period and expire ten years after the date of grant.
Stock options outstanding at September 30, 2015 are as follows:

	Outstanding Stock Options			Exercisable Stock Options		
Exercise Price Range	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	17,633	$9.00	3.3	17,633	$9.00	3.3
$11.00 - $12.99	53,266	12.04	4.8	44,477	12.00	4.6
$17.00 - $18.99	12,962	18.41	0.8	12,962	18.41	0.8
	83,861	12.39	3.9	75,072	12.40	3.7

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

	2015		2014	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, January 1,	99,810	$12.16	104,966	$12.43
Granted	—	—	—	—
Exercised	(13,449)	11.31	—	—
Expired	(2,500)	9.00	(5,156)	17.66
Outstanding, September 30,	83,861	12.39	99,810	12.16
Exercisable, September 30,	75,072	12.40	78,705	12.17

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, 2015 that were "in the money" (market price greater than exercise price) was $348,000. The aggregate intrinsic value at that date for only the options that were exercisable was $313,000. The aggregate intrinsic value for options outstanding at September 30, 2014 that were in the money was $330,000 and the aggregate intrinsic value at that date for only the options that were exercisable was $268,000. The intrinsic value changes based upon fluctuations in the market value of LCNB's common stock.

Total expenses related to options included in salaries and employee benefits in the consolidated statements of income for the three and nine months ended September 30, 2015 was $3,000 and $13,000, respectively. Total expenses related to options included in salaries and employee benefits for the three and nine months ended September 30, 2014 was $5,000 and $18,000, respectively.

Note 13 - 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, warrants, and restricted stock. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock options and warrants 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, 2015 and 2014 (dollars in thousands, except share and per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	$2,633	2,718	8,590	6,652
Weighted average number of shares outstanding used in the calculation of basic earnings per common share	9,898,233	9,299,691	9,637,344	9,293,866
Add dilutive effect of:				
Stock options	16,219	17,775	17,199	19,331
Stock warrants	91,336	87,547	88,296	93,913
Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share	10,005,788	9,405,013	9,742,839	9,407,110
Earnings per common share:				
Basic	$0.26	0.30	0.89	0.72
Diluted	0.26	0.29	0.88	0.71

Options to purchase 12,962 and 18,118 shares of common stock at a weighted average price of $18.41 and $18.19 per share were outstanding at September 30, 2015 and 2014, respectively, but were not included in the computation of diluted earnings per common share because the exercise prices of the options were greater than the average market price of the common shares.

Note 14 - 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 from the sale of an asset in an orderly transaction between market participants at the measurement date.

The inputs to the 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.

Note 14 - 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 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 trust preferred securities, equity securities, and four mutual funds that are not priced by the pricing service. Market quotations (level 1) are used to determine fair values for the trust preferred securities and equity securities. Investments in mutual funds that are publicly traded in active markets and that publish daily net asset values are considered to have level 1 inputs. An investment in a mutual fund that is not traded in an active market is considered to have level 2 inputs because 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 fair value, which approximates cost.

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. 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. These inputs are also considered to be level 3.

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Note 14 - 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, 2015 and December 31, 2014 (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, 2015				
Recurring fair value measurements:				
Investment securities available-for-sale:				
U.S. Treasury notes	$91,132	91,132	—	—
U.S. Agency notes	112,398	—	112,398	—
U.S. Agency mortgage-backed securities	26,328	—	26,328	—
Certificates of deposit with other banks	2,086	—	2,086	—
Municipal securities:				
Non-taxable	99,769	—	99,769	—
Taxable	25,641	—	25,641	—
Mutual funds	2,480	1,480	1,000	—
Trust preferred securities	49	49	—	—
Equity securities	858	858	—	—
Total recurring fair value measurements	$360,741	93,519	267,222	—
Nonrecurring fair value measurements:				
Impaired loans	$4,776	—	—	4,776
Other real estate owned and repossessed assets	1,208	—	—	1,208
Total nonrecurring fair value measurements	$5,984	—	—	5,984
December 31, 2014				
Recurring fair value measurements:				
Investment securities available-for-sale:				
U.S. Treasury notes	$62,560	62,560	—	—
U.S. Agency notes	83,637	—	83,637	—
U.S. Agency mortgage-backed securities	38,032	—	38,032	—
Certificates of deposit with other banks	3,086	—	3,086	—
Municipal securities:				
Non-taxable	77,395	—	77,395	—
Taxable	16,395	—	16,395	—
Mutual funds	2,461	1,461	1,000	—
Trust preferred securities	50	50	—	—
Equity securities	1,749	1,749	—	—

Total recurring fair value measurements	$285,365	65,820	219,545	—
Nonrecurring fair value measurements:				
Impaired loans	$4,872	—	—	4,872
Other real estate owned and repossessed assets	1,370	—	—	1,370
Total nonrecurring fair value measurements	$6,242	—	—	6,242

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Note 14 - Fair Value Measurements (continued)

The following table presents quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements at September 30, 2015 and December 31, 2014 (dollars in thousands):

	Fair Value	Valuation Technique	Unobservable Inputs	Range High	Range Low	Weighted Average
September 30, 2015						
Impaired loans	$4,776	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
		Discounted cash flows	Discount rate	8.25 %	4.00 %	5.19 %
Other real estate owned	1,208	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
December 31, 2014						
Impaired loans	$4,872	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
		Discounted cash flows	Discount rate	10.50 %	4.00 %	5.36 %
Other real estate owned	$1,370	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		

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Note 14 - Fair Value Measurements (continued)

Carrying amounts and estimated fair values of financial instruments as of September 30, 2015 and December 31, 2014 are as follows (in thousands):

			Fair Value Measurements at the End of the Reporting Period Using		
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2015					
FINANCIAL ASSETS:					
Cash and cash equivalents	$33,211	33,211	33,211	—	—
Investment securities, held-to-maturity	24,575	24,639	—	—	24,639
Federal Reserve Bank stock	2,476	2,476	2,476	—	—
Federal Home Loan Bank stock	3,638	3,638	3,638	—	—
Loans, net	759,875	756,782	—	—	756,782
Accrued interest receivable	4,181	4,181	411	1,618	2,152
FINANCIAL LIABILITIES:					
Deposits	1,103,513	1,104,523	882,436	222,087	—
Short-term borrowings	14,931	14,931	14,931	—	—
Long-term debt	6,016	6,400	—	6,400	—
Accrued interest payable	345	345	14	331	—
December 31, 2014					
FINANCIAL ASSETS:					
Cash and cash equivalents	$15,845	15,845	15,845	—	—
Investment securities, held-to-maturity	22,725	22,138	—	—	22,138
Federal Reserve Bank stock	2,346	2,346	2,346	—	—
Federal Home Loan Bank stock	3,638	3,638	3,638	—	—
Loans, net	695,835	699,715	—	—	699,715
Accrued interest receivable	2,849	2,849	178	885	1,786
FINANCIAL LIABILITIES:					
Deposits	946,205	947,541	731,766	215,775	—
Short-term borrowings	16,645	16,645	16,645	—	—
Long-term debt	11,357	11,944	—	11,944	—
Accrued interest payable	413	413	13	400	—

Note 14 - Fair Value Measurements (continued)

The fair value of off-balance-sheet financial instruments at September 30, 2015 and December 31, 2014 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 analysis 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.

Accrued interest receivable and Accrued interest payable
Carrying amount approximates fair value and is aligned with the underlying assets or liabilities.

Note 15 – Recent Accounting Pronouncements

ASU No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity"
ASU No. 2014-08 was issued in April 2014 and changes the criteria for reporting discontinued operations and provides for expanded disclosures in this area. The new guidance provides that only disposals representing a strategic

shift in operations should be presented as discontinued operations and that these strategic shifts should have a major effect on an organization's operations and financial results. ASU No. 2014-08 was effective in the first quarter of 2015 for public companies with calendar year-ends.

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Note 15 – Recent Accounting Pronouncements (continued)

ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"
ASU No. 2014-09 was issued in May 2014 and and supersedes most current revenue recognition guidance for contracts to transfer goods or services or other nonfinancial assets. Lease contracts, insurance contracts, and most financial instruments are not included in the scope of this update. ASU No. 2014-09 provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance enumerates five steps that entities should follow in achieving this core principle. Additional disclosures providing information about contracts with customers are required. As extended by ASU No. 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," ASU No. 2014-09 is effective for public companies for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Transitional guidance is included in the update. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Since LCNB's products are substantially financial in nature, adoption of ASU No. 2014-09 is not expected to have a material impact on LCNB's results of operations or financial position.

ASU No. 2014-12, "Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period, a consensus of the FASB Emerging Issues Task Force"
ASU No. 2014-12 was issued in June 2014 and requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition and that current guidance for awards with performance conditions be followed. ASU No. 2014-12 is effective for all entities for annual and interim periods beginning after December 15, 2015 and early adoption is permitted. Entities may apply the amendments in the update either prospectively to all awards granted or modified after the effective date or retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. None of LCNB's currently outstanding stock option grants contain the performance targets described in this update and adoption of ASU No. 2014-11 is not expected to have a material impact on its results of operations or financial position.

ASU No. 2014-13, "Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity (a consensus of the FASB Emerging Issues Task Force)"
ASU No. 2014-13 was issued in August 2014 and applies to entities that are required to (1) consolidate a collateralized financing entity ("CFE") under the guidance for Variable Interest Entities, (2) measure all of the financial assets and financial liabilities of the CFE at fair value, and (3) reflect the changes in fair value in earnings. Under ASU 2014-13, entities that meet these criteria can elect to measure both the financial assets and the financial liabilities of the CFE using the more observable of the fair value of the financial assets and the fair value of the financial liabilities, thereby eliminating the difference between the fair value of financial assets and financial liabilities. If that alternative is not elected, then ASU 2014-13 indicates that the fair value of the financial assets and the fair value of the financial liabilities of the consolidated CFE should be measured in accordance with ASC 820, Fair Value Measurement, and differences between the fair value of the financial assets and the financial liabilities of the consolidated CFE should be reflected in earnings and attributed to the reporting entity in the consolidated statement of income or loss. The provisions of ASU 2014-13 are effective for public business entities for annual periods beginning after December 15, 2015 and interim periods within those annual periods. Early adoption is permitted. LCNB currently does not have any CFE investments and adoption of ASU No. 2014-13 is not expected to

have a material impact on LCNB's results of operations or financial position.

ASU No. 2014-15, "Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern"
ASU No. 2014-15 was issued in August 2014 and requires management to evaluate for each annual and interim reporting period whether it is probable that the entity will not be able to meet its obligations as they become due within one year after the date that financial statements are issued (or are available to be issued, where applicable). Certain disclosures, as described in the update, are required if management identifies substantial doubt about the entity's ability to continue as a going concern. ASU No. 2014-15 will take effect in the annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted. Adoption of ASU No. 2014-15 is not expected to have a material impact on LCNB's results of operations or financial position.

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Note 15 – Recent Accounting Pronouncements (continued)

ASU No. 2014-16, "Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force)"
ASU No. 2014-16 was issued in November 2014 and requires an entity to determine the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid financial instrument, weighing each term and feature on the basis of the relevant facts and circumstances, when evaluating whether the host contract is more akin to a debt or equity instrument. ASU No. 2014-16 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The effects of initially adopting ASU No. 2014-16 should be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a share as of the beginning of the fiscal year for which the update is effective. Retrospective application to all relevant prior periods is permitted. Early adoption, including adoption in an interim period, is permitted. LCNB currently does not have any outstanding hybrid financial instruments issued as a share and adoption of ASU No. 2014-16 is not expected to have a material impact on LCNB's results of operations or financial position.

ASU No. 2015-01, "Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items"
ASU No. 2015-01 was issued in January 2015 and eliminates from the income statement the concept of extraordinary items. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. Adoption of ASU No. 2015-01 is not expected to have a material impact on LCNB's results of operations.

ASU No. 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis"
ASU No. 2015-02 was issued in February 2015 and provides additional guidance for consolidation of legal entities. It (1) modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities, (2) eliminates the presumption that a general partner should consolidate a limited partnership, (3) affects the consolidation analysis of reporting entities that are involved with variable interest entities, and (4) provides a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. Adoption of ASU No. 2015-02 is not expected to have a material impact on LCNB's results of operations or financial position.

ASU No. 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs"
ASU No. 2015-03 was issued in April 2015 and requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability. The amendments in this update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The adoption of ASU No. 2015-03 is to be applied on a retrospective basis, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effects of applying the new guidance. Adoption of ASU No. 2015-03 is not expected to have a material impact on LCNB's results of operations or

financial position.

ASU No. 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement"
ASU No. 2015-05 was issued in April 2015 and provides guidance to customers about whether a cloud computing arrangement includes a software license. Examples of cloud computing arrangements include software as a service, platform as a service, infrastructure as a service, and other similar hosting arrangements. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments in this update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. Adoption of ASU No. 2015-05 is not expected to have a material impact on LCNB's results of operations or financial position.

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

Note 15 – Recent Accounting Pronouncements (continued)

ASU No. 2015-07, "Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)"
ASU No. 2015-07 was issued in May 2015 and applies to entities that measure an investment's fair value using the net asset value per share, or an equivalent, as a practical expedient. ASU No. 2015-07 eliminates the requirement to classify such investments within the fair value hierarchy. Formerly, Topic 820 required certain disclosures for all investments eligible to be assessed at fair value with the net asset value per share practical expedient. ASU No. 2015-07 requires these disclosures only for investments that are actually measured using the practical expedient. The amendments in this update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The amendments are to be applied retrospectively to all periods presented. LCNB measures the fair value of a mutual fund investment using the net asset value per share practical expedient and disclosures concerning this investment will be affected by the adoption of ASU No. 2015-07. Adoption will not have an impact on LCNB's results of operations or financial position.

ASU No. 2015-15, "Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting"
ASU No. 2015-15 was issued in August 2015. Given the absence of authoritative guidance within ASU No. 2015-03 for debt issuance costs related to line-of-credit arrangements, the Securities and Exchange Commission ("SEC") staff announced that they will not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The amendments in this update are to be applied on a retrospective basis and are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. Adoption of ASU No. 2015-15 is not expected to have a material impact on LCNB's results of operations or financial position.

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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 statements made in this document regarding LCNB’s financial condition, results of operations, plans, objectives, future performance and business, are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. These forward-looking statements are identified by the fact they are not historical facts and include words such as “anticipate”, “could”, “may”, “feel”, “expect”, “believe”, “plan”, and similar express

These forward-looking statements reflect management's current expectations based on all information available to management and its knowledge of LCNB’s business and operations. Additionally, LCNB’s financial condition, results of operations, plans, objectives, future performance and business are subject to risks and uncertainties that may cause actual results to differ materially. These factors include, but are not limited to:

1. the success, impact, and timing of the implementation of LCNB’s business strategies, including the successful integration of recently completed acquisitions;
2. LCNB may incur increased charge-offs in the future;
3. LCNB may face competitive loss of customers;
4. changes in the interest rate environment may have results on LCNB’s operations materially different from those anticipated by LCNB’s market risk management functions;
5. changes in general economic conditions and increased competition could adversely affect LCNB’s operating results;
6. changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact LCNB’s operating results;
7. LCNB may experience difficulties growing loan and deposit balances;
8. the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations;
9. deterioration in the financial condition of the U.S. banking system may impact the valuations of investments LCNB has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; and
10. the effects of the Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the regulations promulgated and to be promulgated thereunder, which may subject LCNB and its subsidiaries to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses.

Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist shareholders and potential investors in understanding current and anticipated financial operations of LCNB and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. LCNB undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

Critical Accounting Policies

Allowance for Loan Losses. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb inherent losses in the loan portfolio, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrowers' ability to pay. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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The allowance consists of specific and general components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans an allowance is established when the discounted cash flows or collateral value is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors, which include trends in underperforming loans, trends in the volume and terms of loans, economic trends and conditions, concentrations of credit, trends in the quality of loans, and borrower financial statement exceptions.

Based on its evaluations, management believes that the allowance for loan losses will be adequate to absorb estimated losses inherent in the current loan portfolio.

Acquired Credit Impaired Loans. LCNB accounts for acquisitions using the acquisition method of accounting, which requires that assets acquired and liabilities assumed be measured at their fair values at the acquisition date. Acquired loans are reviewed to determine if there is evidence of deterioration in credit quality since inception and if it is probable that LCNB will be unable to collect all amounts due under the contractual loan agreements. The analysis includes expected prepayments and estimated cash flows including principal and interest payments at the date of acquisition. The amount in excess of the estimated future cash flows is not accreted into earnings. The amount in excess of the estimated future cash flows over the book value of the loan is accreted into interest income over the remaining life of the loan (accretable yield). LCNB records these loans on the acquisition date at their net realizable value. Thus, an allowance for estimated future losses is not established on the acquisition date. Subsequent to the date of acquisition, expected future cash flows on loans acquired are updated and any losses or reductions in estimated cash flows which arise subsequent to the date of acquisition are reflected as a charge through the provision for loan losses. An increase in the expected cash flows adjusts the level of the accretable yield recognized on a prospective basis over the remaining life of the loan. Due to the number, size, and complexity of loans within the acquired loan portfolio, there is always a possibility of inherent undetected losses.

Accounting for Intangibles. LCNB’s intangible assets at September 30, 2015 are composed primarily of goodwill and core deposit intangibles related to acquisitions of other financial institutions. It also includes mortgage servicing rights recorded from sales of mortgage loans to the Federal Home Loan Mortgage Corporation and mortgage servicing rights acquired through the acquisition of Eaton National Bank & Trust Co. ("Eaton National"). Goodwill is not subject to amortization, but is reviewed annually for impairment. Core deposit intangibles are being amortized on a straight line basis over their respective estimated weighted average lives. Mortgage servicing rights are capitalized by allocating the total cost of loans between mortgage servicing rights and the loans based on their estimated fair values. Capitalized mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income, subject to periodic review for impairment.

Results of Operations
Net income for the three and nine months ended September 30, 2015 was $2,633,000 (total basic and diluted earnings per share of $0.26) and $8,590,000 (total basic and diluted earnings per share of $0.89 and $0.88, respectively), respectively. This compares to net income of $2,718,000 (total basic and diluted earnings per share of $0.30 and $0.29) and $6,652,000 (total basic and diluted earnings per share of $0.72 and $0.71) for the same three and nine-month periods in 2014. Results for 2015 and 2014 were significantly affected by the acquisitions of "BNB" on April 30, 2015 and Eaton National Bank & Trust Co. ("Eaton National") on January 24, 2014. In addition, LCNB sold

impaired loans with a carrying value of approximately $4.5 million during the second quarter 2015.

Net interest income for the three and nine months ended September 30, 2015 increased $502,000 and $3,061,000, respectively, from the comparative periods in 2014 due primarily to an increase in the volume of average interest earning assets, primarily loans.

The provision for loan losses for the three months ended September 30, 2015 was $161,000 less than for the same quarter in 2014 and $249,000 greater for the nine-month period. Net loan charge-offs for the first nine months of 2015 and 2014 totaled $1,149,000 and $1,027,000, respectively. Non-accrual loans and loans past due 90 days or more and still accruing interest decreased $3,418,000, from $5,802,000, or 0.83% of total loans, at December 31, 2014 to $2,384,000, or 0.31% of total loans, at September 30, 2015 primarily due to the impaired loan sale mentioned above. Other real estate owned (which includes property acquired through foreclosure or deed-in-lieu of foreclosure) decreased from $1,370,000 at December 31, 2014 to $1,208,000 at September 30, 2015 due to a write-down recognized on commercial property.

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Non-interest income for the three months ended September 30, 2015 was $71,000 greater than the comparable period in 2014 primarily due to increases in trust income and service charges and fees on deposit accounts, partially offset by a decrease in gains from sales of investment securities due to no sales during the third quarter 2015. Non-interest income for the nine months ended September 30, 2015 was $830,000 greater than the comparable period in 2014 primarily due to increases in trust income, gains from sales of investment securities, and gains from sale of loans. Gains from sales of investment securities increased on a year-to-date basis because of a greater volume of sales.

Non-interest expense for the three and nine months ended September 30, 2015 was $850,000 and $653,000 greater than the comparable periods in 2014 primarily due to increases in salaries and employee benefits, other real estate owned expenses, and smaller decreases on other accounts. Salaries and employee benefits increased primarily due to salary and wage increases, employees retained from the BNB and Eaton National acquisitions, an increase in the number of employees outside of the acquisitions, and an increase in retirement plan expenses.

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

Net Interest Income

Three Months Ended September 30, 2015 vs. 2014

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, 2015 and 2014, 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,					
	2015			2014		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
			(Dollars in thousands)			
Loans (1)	$760,159	8,540	4.46 %	$688,972	8,168	4.70 %
Interest-bearing demand deposits	15,257	7	0.18 %	3,426	2	0.23 %
Federal Reserve Bank stock	2,476	—	— %	2,346	—	— %
Federal Home Loan Bank stock	3,638	36	3.93 %	3,638	36	3.93 %
Investment securities:						
Taxable	259,090	1,094	1.68 %	234,629	984	1.66 %
Non-taxable (2)	120,149	1,109	3.66 %	107,856	1,085	3.99 %
Total earnings assets	1,160,769	10,786	3.69 %	1,040,867	10,275	3.92 %
Non-earning assets	109,287			103,343		
Allowance for loan losses	(2,885)			(3,288)		
Total assets	$1,267,171			$1,140,922		
Savings deposits	$637,331	143	0.09 %	$558,208	122	0.09 %
IRA and time certificates	$225,506	691	1.22 %	$224,340	678	1.20 %
Short-term borrowings	13,450	5	0.15 %	22,547	10	0.18 %
Long-term debt	6,040	73	4.80 %	11,457	101	3.50 %
Total interest-bearing liabilities	882,327	912	0.41 %	816,552	911	0.44 %
Demand deposits	236,893			193,561		
Other liabilities	8,919			7,002		
Capital	139,032			123,807		
Total liabilities and capital	$1,267,171			$1,140,922		
Net interest rate spread (3)			3.28 %			3.48 %
Net interest income and net interest margin on a taxable-equivalent basis (4)		9,874	3.37 %		9,364	3.57 %
	131.56 %			127.47 %		

Ratio of interest-earning assets
to interest-bearing liabilities

(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, 2015 as compared to the same period in 2014. 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, 2015 vs. 2014 Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
Interest-earning Assets:			
Loans	$815	(443)	372
Federal funds sold	—	—	—
Interest-bearing demand deposits	6	(1)	5
Federal Reserve Bank stock	—	—	—
Federal Home Loan Bank stock	—	—	—
Investment securities:			
Taxable	103	7	110
Non-taxable	118	(94)	24
Total interest income	1,042	(531)	511
Interest-bearing Liabilities:			
Savings deposits	18	3	21
IRA and time certificates	4	9	13
Short-term borrowings	(4)	(1)	(5)
Long-term debt	(58)	30	(28)
Total interest expense	(40)	41	1
Net interest income	$1,082	(572)	510

Net interest income on a fully tax-equivalent basis for the three months ended September 30, 2015 totaled $9,874,000, an increase of $510,000 over the comparable period in 2014. Total interest income increased $511,000 and total interest expense increased $1,000.

The increase in total interest income was due to a $119.9 million increase in average total earning assets, partially offset by a 23 basis point (a basis point equals 0.01%) decrease in the average rate earned on earning assets. The increase in average total earning assets was due to a $71.2 million increase in average loans, an $11.8 million increase in interest-bearing demand deposits, and a $36.8 million increase in average total investment securities. The increase in average loans was partially due to the acquisition of BNB and partially due to organic loan growth.

The small increase in total interest expense was due primarily to a 130 basis point increase in the average rate paid on long-term debt caused by the payment in full of a comparatively lower rate $5.0 million advance from the Federal Home Loan Bank of Cincinnati, thus increasing the average rate on the remaining advances. Also contributing to the increase was a 2 basis point increase in the average rate paid on IRA and time certificates. These rate-related increases were largely offset by a $65.8 million increase in average total interest-bearing liabilities. Average savings deposits increased $79.1 million, partially offset by a $9.1 million decrease in average short-term borrowings and a $5.4 million decrease in average long-term debt. Average savings deposits increased largely due to the acquisition of BNB.

Nine Months Ended September 30, 2015 vs. 2014

The following table presents, for the nine months ended September 30, 2015 and 2014, 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.

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	Nine Months Ended September 30,							
	2015				2014			
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate		Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	
			(Dollars in thousands)					
Loans (1)	$732,600	26,572	4.85	%	$674,181	24,008	4.76	%
Federal funds sold	604	1	0.22	%	—	—	—	%
Interest-bearing demand deposits	12,756	21	0.22	%	9,656	18	0.25	%
Federal Reserve Bank stock	2,421	74	4.09	%	2,017	55	3.65	%
Federal Home Loan Bank stock	3,638	109	4.01	%	3,549	109	4.11	%
Investment securities:								
Taxable	236,412	2,983	1.69	%	225,306	2,901	1.72	%
Non-taxable (2)	110,920	3,162	3.81	%	102,328	3,059	4.00	%
Total earnings assets	1,099,351	32,922	4.00	%	1,017,037	30,150	3.96	%
Non-earning assets	108,431				105,701			
Allowance for loan losses	(2,873)				(3,342)			
Total assets	$1,204,909				$1,119,396			
Savings deposits	$599,371	397	0.09	%	$546,393	354	0.09	%
IRA and time certificates	$219,720	1,790	1.09	%	$225,589	2,069	1.23	%
Short-term borrowings	13,358	13	0.13	%	15,697	18	0.15	%
Long-term debt	6,247	222	4.75	%	11,602	305	3.51	%
Total interest-bearing liabilities	838,696	2,422	0.39	%	799,281	2,746	0.46	%
Demand deposits	223,788				191,539			
Other liabilities	8,169				6,731			
Capital	134,256				121,845			
Total liabilities and capital	$1,204,909				$1,119,396			
Net interest rate spread (3)			3.61	%			3.50	%
Net interest income and net interest margin on a taxable-equivalent basis (4)		30,500	3.71	%		27,404	3.60	%
Ratio of interest-earning assets to interest-bearing liabilities	131.08 %				127.24 %			

(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.

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, 2015 as compared to the same period in 2014. 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.

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LCNB CORP. AND SUBSIDIARIES

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	Nine Months Ended September 30, 2015 vs. 2014 Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
Interest-earning Assets:			
Loans	$2,112	452	2,564
Federal funds sold	1	—	1
Interest-bearing demand deposits	5	(1)	4
Federal Reserve Bank stock	12	7	19
Federal Home Loan Bank stock	3	(3)	—
Investment securities:			
Taxable	141	(59)	82
Non-taxable	249	(146)	103
Total interest income	2,523	250	2,773
Interest-bearing Liabilities:			
Savings deposits	35	8	43
IRA and time certificates	(53)	(226)	(279)
Short-term borrowings	(2)	(3)	(5)
Long-term debt	(169)	86	(83)
Total interest expense	(189)	(135)	(324)
Net interest income	$2,712	385	3,097

Net interest income on a fully tax-equivalent basis for the nine months ended September 30, 2015 totaled $30,501,000, an increase of $3,097,000 over the comparable period in 2014. Total interest income increased $2,773,000 and total interest expense decreased $324,000.

The increase in total interest income was due primarily to a $82.3 million increase in average total earning assets and secondarily to a 4 basis point increase in the average rate earned on earning assets. The increase in average total earning assets was due to a $58.4 million increase in average loans and to a $19.7 million increase in average total investment securities. The increase in average loans was partially due to the acquisition of BNB and partially due to organic loan growth.

The decrease in total interest expense was due to a $5.4 million decrease in average long-term debt and to a $5.9 million decrease in average IRA and time certificates and to a 7 basis point decrease in the average rate paid on interest-bearing liabilities. Average long-term debt decreased due to the payment in full during January 2015 of a $5.0 million advance from the Federal Home Loan Bank of Cincinnati.

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. Net charge-offs for the three and nine months ended September 30, 2015 totaled $161,000 and $1,149,000, respectively, as compared to $496,000 and $1,027,000 for the same periods in 2014. The provision for loan losses for the three and nine months ended September 30, 2015 was $240,000 and $986,000, respectively, as compared to $401,000 and $737,000 for the same periods in 2014. Net charge-offs and the provision for loan losses had elevated balances during the second quarter 2015 due to the sale of impaired loans during that quarter.

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

Non-Interest Income

Three Months Ended September 30, 2015 vs. 2014

Total non-interest income for the third quarter 2015 was $71,000 greater than for the third quarter 2014 primarily due to a $66,000 increase in trust income, a $69,000 increase in service charges and fees on deposit accounts, and a $32,000 increase in other operating income. The increase in trust income reflects growth in the average fair value of assets managed. The increase in service charges and fees on deposit accounts reflects a greater number of deposit accounts resulting from the merger with BNB. The increase in other operating income is primarily due to an increase in earnings from the Bank's 49% investment in LCNB Title Services. These increases were partially offset by a $97,000 decrease in net gains on sales of securities due to no sales of securities during the third quarter 2015.

Nine Months Ended September 30, 2015 vs. 2014

Total non-interest income for the first nine months of 2015 was $830,000 greater than for the first nine months of 2014 primarily due to a $335,000 increase in trust income, a $239,000 increase in net gains from sales of securities, and a $196,000 increase in gains from sales of loans. Trust income increased for substantially the same reason mentioned above. Gains from sales of securities and loans increased due to a greater volume of loans sales during the first nine months of 2015.

Non-Interest Expense

Three Months Ended September 30, 2015 vs. 2014

Non-interest expense for the third quarter 2015 was $850,000 greater than for the third quarter 2014 primarily due to a $318,000 increase in salaries and employee benefits and a $495,000 increase in other non-interest expense. Salaries and employee benefits increased primarily due to salary and wage increases, employees retained from the BNB and Eaton National acquisitions, an increase in the number of employees outside of the acquisitions, and increased retirement plan expenses. The increase in other non-interest expense included a $206,000 increase in OREO related expenses and impairment charges and a $108,000 decrease in net gains from sales of fixed assets.

Nine Months Ended September 30, 2015 vs. 2014

Non-interest expense for the first nine months of 2015 was $653,000 greater than for the first nine months of 2014 primarily due to a $1,115,000 increase in salaries and employee benefits, partially offset by a $725,000 decrease in merger-related expenses. Salaries and employee benefits increased for substantially the same reasons mentioned above. Costs related to the acquisition of BNB in April 2015 were less than costs associated with the acquisition of Eaton National in January 2014.

Income Taxes

LCNB's effective tax rates for the nine months ended September 30, 2015 and 2014 were 27.2% and 24.5%, 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.

Financial Condition

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

Net loans at September 30, 2015 were $64.0 million greater than at December 31, 2014 partially due to the acquisition of BNB, which increased LCNB's loan balance by $34.7 million, and partially due to organic growth in the portfolio.

Available-for-sale investment securities at September 30, 2015 were $75.4 million greater than at December 31, 2014. Included in the increase were $58.2 in investment securities obtained through the acquisition of BNB. During the first nine months of 2015, LCNB purchased $90.0 million in new securities. The purchases were largely offset by sales, maturities, and calls of investment securities.

Goodwill at September 30, 2015 was $2.5 million greater than at December 31, 2014 due to goodwill recorded on the BNB acquisition.

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Total deposits at September 30, 2015 was $157.3 million greater than at December 31, 2014. Included in this increase were $99.1 million in new deposits obtained through the BNB acquisition and a $36.3 million increase in public fund deposits by local government entities. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities.

Shareholders' equity at September 30, 2015 was $15.2 million greater than at December 31, 2014. LCNB issued 560,132 shares of common stock during the second quarter 2015 as partial payment for BNB shares of stock, resulting in a $9.1 million increase in the common shares account.

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). Common Equity Tier 1 Capital is the sum of common stock, related surplus, and retained earnings net of treasury stock, accumulated other comprehensive income, and other adjustments. These three 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 standby letters of credit. The leverage ratio supplements the risk-based capital guidelines.

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

	Minimum Requirement		To Be Considered Well-Capitalized	
Ratio of Common Equity Tier 1 Capital to risk-weighted assets	4.5	%	6.5	%
Ratio of Tier 1 Capital to risk-weighted assets	6.0	%	8.0	%
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)	4.0	%	5.0	%

A new rule requiring a Capital Conservation Buffer will begin phase-in on January 1, 2016. Under the fully-implemented rule, a financial institution will need to maintain a Capital Conservation Buffer composed of Common Equity Tier 1 Capital of at least 2.5% above its minimum risk-weighted capital requirements to avoid limitations on its ability to make capital distributions, including dividend payments to shareholders and certain discretionary bonus payments to executive officers. A financial institution with a buffer below 2.5% will be subject to increasingly stringent limitations on capital distributions as the buffer approaches zero.

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.

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LCNB CORP. AND SUBSIDIARIES

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

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

	September 30, 2015	December 31, 2014
Regulatory Capital:		
Shareholders' equity	$140,851	125,695
Goodwill and other intangibles	(32,226)	(31,886)
Accumulated other comprehensive income	(2,503)	(785)
Tier 1 risk-based capital	106,122	93,024
Eligible allowance for loan losses	2,958	3,121
Total risk-based capital	$109,080	96,145
Capital ratios:		
Common Equity Tier 1 Capital to risk-weighted assets	13.54 %	N/A
Tier 1 Capital to risk-weighted assets	13.54 %	13.92 %
Total Capital to risk-weighted assets	13.92 %	14.38 %
Leverage	8.60 %	8.53 %

Liquidity

LCNB depends on dividends from the Bank 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, 2015, LCNB's liquid assets amounted to $394.0 million or 30.9% of total assets. This compares to liquid assets totaling $301.2 million, or 27.2% of total assets, at December 31, 2014.

Liquidity is also provided by access to core funding sources, primarily core depositors in LCNB's market area. Approximately 81.0% of total deposits at September 30, 2015 were "core" deposits, compared to 84.3% of deposits at December 31, 2014. 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 ("NII") 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, 2015 IRSA indicates that an increase in interest rates will 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	$42,125	3,284	8.45 %
Up 200	40,997	2,156	5.55 %
Up 100	39,889	1,048	2.70 %
Base	38,841	—	— %

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, 2015 EVE analysis indicates that an increase in interest rates will 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	$140,149	(563)	(0.40)%
Up 200	139,905	(807)	(0.57)%
Up 100	139,470	(1,242)	(0.88)%
Base	140,712	—	— %

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, 2015, 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
2.1	Stock Purchase Agreement dated as of October 28, 2013 by and between LCNB Corp. and Colonial Banc Corp. – incorporated by reference to the Registrant's Form 8-K filed on October 28, 2013, Exhibit 2.1.
2.2	Agreement and Plan of Merger dated as of December 29, 2014 by and between LCNB Corp. and BNB Bancorp, Inc. - incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 2, 2015, 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	LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 13, 2015, Exhibit A (001-35292)
10.3	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.
10.4	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, 2015 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 2, 2015	/s/ Stephen P. Wilson Stephen P. Wilson, Chief Executive Officer and Chairman of the Board of Directors
November 2, 2015	/s/ Robert C. Haines, II Robert C. Haines, II, Executive Vice President and Chief Financial Officer