

LCNB CORP
Form 10-Q
August 08, 2017

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

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 001-35292

LCNB Corp.

(Exact name of registrant as specified in its charter)

Ohio

31-1626393

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

2 North Broadway, Lebanon, Ohio 45036

(Address of principal executive offices, including Zip Code)

(513) 932-1414

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The number of shares outstanding of the issuer's common stock, without par value, as of August 7, 2017 was 10,008,122 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 CONDENSED BALANCE SHEETS
(Dollars in thousands, except per share data)

| | June 30, 2017 (Unaudited) | December 31, 2016 |
|--|---------------------------------|----------------------|
| ASSETS: | | |
| Cash and due from banks | \$19,399 | \$ 18,378 |
| Interest-bearing demand deposits | 10,568 | 487 |
| Total cash and cash equivalents | 29,967 | 18,865 |
| Investment securities: | | |
| Available-for-sale, at fair value | 328,788 | 320,659 |
| Held-to-maturity, at cost | 38,437 | 41,003 |
| Federal Reserve Bank stock, at cost | 2,732 | 2,732 |
| Federal Home Loan Bank stock, at cost | 3,638 | 3,638 |
| Loans, net | 823,551 | 816,228 |
| Premises and equipment, net | 34,980 | 30,244 |
| Goodwill | 30,183 | 30,183 |
| Core deposit and other intangibles | 4,202 | 4,582 |
| Bank owned life insurance | 27,604 | 27,307 |
| Other assets | 11,489 | 11,358 |
| TOTAL ASSETS | \$1,335,571 | \$ 1,306,799 |
| LIABILITIES: | | |
| Deposits: | | |
| Noninterest-bearing | \$275,346 | \$ 271,332 |
| Interest-bearing | 868,574 | 839,573 |
| Total deposits | 1,143,920 | 1,110,905 |
| Short-term borrowings | 31,712 | 42,040 |
| Long-term debt | 402 | 598 |
| Accrued interest and other liabilities | 11,610 | 10,312 |
| TOTAL LIABILITIES | 1,187,644 | 1,163,855 |
| COMMITMENTS AND CONTINGENT LIABILITIES | — | — |
| SHAREHOLDERS' EQUITY: | | |
| Preferred shares – no par value, authorized 1,000,000 shares, none outstanding | — | — |
| Common shares – no par value; authorized 19,000,000 shares; issued 10,767,631 and 10,751,652 shares at June 30, 2017 and December 31, 2016, respectively | 76,785 | 76,490 |
| Retained earnings | 83,782 | 80,736 |
| Treasury shares at cost, 753,627 shares at June 30, 2017 and December 31, 2016 | (11,665) | (11,665) |
| Accumulated other comprehensive income (loss), net of taxes | (975) | (2,617) |

| | | |
|--|-------------|--------------|
| TOTAL SHAREHOLDERS' EQUITY | 147,927 | 142,944 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$1,335,571 | \$ 1,306,799 |

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

The consolidated condensed balance sheet as of December 31, 2016 has been derived from the audited consolidated balance sheet as of that day.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------------|------------------------------|-----------------|
| | 2017 | 2016 | 2017 | 2016 |
| INTEREST INCOME: | | | | |
| Interest and fees on loans | \$8,823 | \$ 8,892 | \$17,738 | \$ 17,519 |
| Interest on investment securities: | | | | |
| Taxable | 1,149 | 1,187 | 2,242 | 2,376 |
| Non-taxable | 795 | 794 | 1,594 | 1,552 |
| Other investments | 167 | 135 | 224 | 182 |
| TOTAL INTEREST INCOME | 10,934 | 11,008 | 21,798 | 21,629 |
| INTEREST EXPENSE: | | | | |
| Interest on deposits | 846 | 870 | 1,689 | 1,693 |
| Interest on short-term borrowings | 12 | 8 | 42 | 22 |
| Interest on long-term debt | 3 | 5 | 7 | 17 |
| TOTAL INTEREST EXPENSE | 861 | 883 | 1,738 | 1,732 |
| NET INTEREST INCOME | 10,073 | 10,125 | 20,060 | 19,897 |
| PROVISION FOR LOAN LOSSES | 222 | 396 | 237 | 486 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 9,851 | 9,729 | 19,823 | 19,411 |
| NON-INTEREST INCOME: | | | | |
| Trust income | 881 | 837 | 1,733 | 1,600 |
| Service charges and fees on deposit accounts | 1,312 | 1,243 | 2,534 | 2,436 |
| Net gain on sales of securities | 140 | 279 | 140 | 650 |
| Bank owned life insurance income | 297 | 191 | 486 | 360 |
| Gains from sales of loans | 63 | 61 | 102 | 102 |
| Other operating income | 97 | 139 | 225 | 244 |
| TOTAL NON-INTEREST INCOME | 2,790 | 2,750 | 5,220 | 5,392 |
| NON-INTEREST EXPENSE: | | | | |
| Salaries and employee benefits | 4,703 | 4,532 | 9,229 | 9,095 |
| Equipment expenses | 264 | 239 | 475 | 488 |
| Occupancy expense, net | 636 | 588 | 1,204 | 1,157 |
| State franchise tax | 286 | 276 | 570 | 557 |
| Marketing | 216 | 201 | 359 | 368 |
| Amortization of intangibles | 188 | 188 | 373 | 375 |
| FDIC insurance premiums | 108 | 162 | 212 | 327 |
| Contracted services | 375 | 223 | 623 | 450 |
| Other real estate owned | — | 356 | 5 | 385 |
| Other non-interest expense | 1,835 | 1,703 | 3,529 | 3,558 |
| TOTAL NON-INTEREST EXPENSE | 8,611 | 8,468 | 16,579 | 16,760 |
| INCOME BEFORE INCOME TAXES | 4,030 | 4,011 | 8,464 | 8,043 |
| PROVISION FOR INCOME TAXES | 1,027 | 1,043 | 2,215 | 2,111 |
| NET INCOME | \$3,003 | \$ 2,968 | \$6,249 | \$ 5,932 |

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| | | | | |
|---|------------|------------|------------|-----------|
| Dividends declared per common share | \$0.16 | \$ 0.16 | \$0.32 | \$ 0.32 |
| Earnings per common share: | | | | |
| Basic | \$0.30 | \$ 0.30 | \$0.62 | \$ 0.60 |
| Diluted | 0.30 | 0.29 | 0.62 | 0.59 |
| Weighted average common shares outstanding: | | | | |
| Basic | 10,004,422 | 10,222,024 | 9,999,765 | 9,919,070 |
| Diluted | 10,011,311 | 9,940,323 | 10,007,192 | 9,969,302 |

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

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------------|----------------|---------------------------------|-----------------|
| | 2017 | 2016 | 2017 | 2016 |
| Net income | \$3,003 | \$2,968 | \$6,249 | \$5,932 |
| Other comprehensive income: | | | | |
| Net unrealized gain on available-for-sale securities (net of taxes of \$638 and \$742 for the three months ended June 30, 2017 and 2016, respectively, and \$894 and \$2,332 for the six months ended June 30, 2017 and 2016, respectively) | 1,206 | 1,439 | 1,734 | 4,526 |
| Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of taxes of \$48 and \$95 for the three months ended June 30, 2017 and 2016, respectively, and \$48 and \$221 for the six months ended June 30, 2017 and 2016, respectively) | (92) | (184) | (92) | (429) |
| Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of \$0 and \$14 for the three months ended June 30, 2017 and 2016, respectively, and \$0 and \$28 for the six months ended June 30, 2017 and 2016, respectively) | — | 28 | — | 56 |
| Other comprehensive income, net of tax | 1,114 | 1,283 | 1,642 | 4,153 |
| TOTAL COMPREHENSIVE INCOME | \$4,117 | \$4,251 | \$7,891 | \$10,085 |

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

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LCNB CORP. AND SUBSIDIARIES
 CONSOLIDATED CONDENSED 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 | Total Shareholders' Equity |
|--|---------------------------------|-----------------|----------------------|--------------------|---|----------------------------------|
| Balance at December 31, 2015 | 9,925,547 | \$76,908 | \$74,629 | \$(11,665) | \$ 236 | \$ 140,108 |
| Net income | | | 5,932 | | | 5,932 |
| Other comprehensive income, net of taxes | | | | | 4,153 | 4,153 |
| Dividend Reinvestment and Stock Purchase Plan | 11,715 | 192 | | | | 192 |
| Repurchase of stock warrants | | (1,545) | | | | (1,545) |
| Compensation expense relating to stock options | | 2 | | | | 2 |
| Compensation expense relating to restricted stock | | 45 | | | | 45 |
| Common stock dividends, \$0.32 per share | | | (3,177) | | | (3,177) |
| Balance at June 30, 2016 | 9,937,262 | \$75,602 | \$77,384 | \$(11,665) | \$ 4,389 | \$ 145,710 |
| Balance at December 31, 2016 | 9,998,025 | \$76,490 | \$80,736 | \$(11,665) | \$ (2,617) | \$ 142,944 |
| Net income | | | 6,249 | | | 6,249 |
| Other comprehensive income, net of taxes | | | | | 1,642 | 1,642 |
| Dividend Reinvestment and Stock Purchase Plan | 8,554 | 180 | | | | 180 |
| Exercise of stock options | 3,398 | 51 | | | | 51 |
| Compensation expense relating to stock options | | 1 | | | | 1 |
| Compensation expense relating to restricted stock | 4,027 | 63 | | | | 63 |
| Common stock dividends, \$0.32 per share | | | (3,203) | | | (3,203) |
| Balance at June 30, 2017 | 10,014,004 | \$76,785 | \$83,782 | \$(11,665) | \$ (975) | \$ 147,927 |

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

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

| | Six Months Ended June 30, | |
|--|------------------------------|------------------|
| | 2017 | 2016 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$6,249 | \$5,932 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation, amortization, and accretion | 1,668 | 1,680 |
| Provision for loan losses | 237 | 486 |
| Increase in cash surrender value of bank owned life insurance | (379) | (360) |
| Bank owned life insurance mortality benefits in excess of cash surrender value | (107) | — |
| Realized gain from sales of securities available-for-sale | (140) | (650) |
| Realized (gain) loss from sales of premises and equipment | (23) | 35 |
| Realized loss from sales and write-downs of other real estate owned and repossessed assets | 3 | 346 |
| Origination of mortgage loans for sale | (4,416) | (4,850) |
| Realized gains from sales of loans | (102) | (102) |
| Proceeds from sales of mortgage loans | 4,464 | 4,907 |
| Penalty for prepayment of long-term debt | — | 251 |
| Compensation expense related to stock options | 1 | 2 |
| Compensation expense related to restricted stock | 63 | 45 |
| Changes in: | | |
| Accrued income receivable | 63 | (224) |
| Other assets | (1,039) | 46 |
| Other liabilities | 1,297 | (613) |
| TOTAL ADJUSTMENTS | 1,590 | 999 |
| NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES | 7,839 | 6,931 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sales of investment securities available-for-sale | 12,243 | 36,529 |
| Proceeds from maturities and calls of investment securities: | | |
| Available-for-sale | 8,288 | 33,025 |
| Held-to-maturity | 7,941 | 3,342 |
| Purchases of investment securities: | | |
| Available-for-sale | (26,950) | (38,915) |
| Held-to-maturity | (5,375) | (20,156) |
| Net (increase) decrease in loans | (8,222) | (29,740) |
| Purchase of bank owned life insurance | — | (4,000) |
| Proceeds from bank owned life insurance mortality benefits | 189 | — |
| Proceeds from sale of other real estate owned and repossessed assets | 971 | — |
| Additions to other real estate owned | — | (182) |
| Purchases of premises and equipment | (5,561) | (3,565) |
| Proceeds from sale of premises and equipment | 220 | 61 |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (16,256) | (23,601) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in deposits | 33,015 | 37,538 |

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| | | |
|---|-----------------|-----------------|
| Net decrease in short-term borrowings | (10,328) | (6,846) |
| Principal payments on long-term debt | (196) | (5,221) |
| Penalty for prepayment of long-term debt | — | (251) |
| Proceeds from issuance of common stock | 21 | 30 |
| Repurchase of stock warrants | — | (1,545) |
| Proceeds from exercise of stock options | 51 | — |
| Cash dividends paid on common stock | (3,044) | (3,015) |
| NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES | 19,519 | 20,690 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 11,102 | 4,020 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 18,865 | 14,987 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$29,967 | \$19,007 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Interest paid | \$1,768 | \$1,780 |
| Income taxes paid | 1,400 | 2,160 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES: | | |
| Transfer from loans to other real estate owned and repossessed assets | 974 | — |

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

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

Note 1 - Basis of Presentation

The accompanying unaudited interim consolidated condensed financial statements include LCNB Corp. ("LCNB") and its wholly-owned subsidiaries: LCNB National Bank (the "Bank") and LCNB Risk Management, Inc., a captive insurance company which was incorporated in Nevada during the second quarter 2017. All material intercompany transactions and balances are eliminated in consolidation.

The unaudited interim consolidated condensed 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"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. 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 condensed balance sheet as of December 31, 2016 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.

Accounting Standards Update ("ASU") No. 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," was issued by the Financial Accounting Standards Board ("FASB") in March 2016 and affects all entities that issue share-based payment awards to their employees. The new guidance involves several aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Under ASU No. 2016-09, any excess tax benefits or tax deficiencies should be recognized as income tax expense or benefit in the income statement. Excess tax benefits are to be classified as an operating activity in the statement of cash flows. In accruing compensation cost, an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, as required under current guidance, or account for forfeitures when they occur. For an award to qualify for equity classification, an entity cannot partially settle the award in excess of the employer's maximum statutory withholding requirements. Such cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity in the statement of cash flows. The amendments in ASU No. 2016-09 were effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. Accordingly, LCNB adopted the update as of January 1, 2017. Adoption did not have a material impact on LCNB's results of operations or financial position.

ASU No. 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities," was issued by the FASB in March 2017 and applies to all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). The ASU requires the premium to be amortized to the earliest call date, not the maturity date. The amendments do not require an accounting change for securities held at a discount;

the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted and management elected to adopt the update as of January 1, 2017. Adoption did not have a material impact on LCNB's results of operations or financial position.

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, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. 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 2016 Annual Report on Form 10-K filed with the SEC.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities

The amortized cost and estimated fair value of investment securities at June 30, 2017 and December 31, 2016 are summarized as follows (in thousands):

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|--|-------------------|---------------------|----------------------|---------------|
| June 30, 2017 | | | | |
| Available-for-Sale: | | | | |
| U.S. Treasury notes | \$ 21,135 | \$ 77 | \$ 3 | \$21,209 |
| U.S. Agency notes | 96,921 | 161 | 1,134 | 95,948 |
| U.S. Agency mortgage-backed securities | 74,949 | 73 | 1,061 | 73,961 |
| Municipal securities: | | | | |
| Non-taxable | 111,651 | 902 | 758 | 111,795 |
| Taxable | 22,420 | 246 | 63 | 22,603 |
| Mutual funds | 2,546 | — | 39 | 2,507 |
| Trust preferred securities | 49 | 1 | — | 50 |
| Equity securities | 632 | 88 | 5 | 715 |
| | \$ 330,303 | \$ 1,548 | \$ 3,063 | \$328,788 |
| Held-to-Maturity: | | | | |
| Municipal securities: | | | | |
| Non-taxable | \$ 33,282 | \$ 95 | \$ 122 | \$33,255 |
| Taxable | 5,155 | — | 124 | 5,031 |
| | \$ 38,437 | \$ 95 | \$ 246 | \$38,286 |
| December 31, 2016 | | | | |
| Available-for-Sale: | | | | |
| U.S. Treasury notes | \$ 28,180 | \$ 41 | \$ 76 | \$28,145 |
| U.S. Agency notes | 87,098 | 150 | 1,848 | 85,400 |
| U.S. Agency mortgage-backed securities | 72,402 | 89 | 1,444 | 71,047 |
| Municipal securities: | | | | |
| Non-taxable | 114,064 | 574 | 1,623 | 113,015 |
| Taxable | 19,710 | 220 | 85 | 19,845 |
| Mutual funds | 2,527 | — | 45 | 2,482 |
| Trust preferred securities | 49 | — | 1 | 48 |
| Equity securities | 632 | 55 | 10 | 677 |
| | \$ 324,662 | \$ 1,129 | \$ 5,132 | \$320,659 |
| Held-to-Maturity: | | | | |
| Municipal securities: | | | | |
| Non-taxable | \$ 31,015 | \$ 56 | \$ 352 | \$30,719 |
| Taxable | 9,988 | — | 217 | 9,771 |

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\$ 41,003 \$ 56 \$ 569 \$40,490

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities (continued)

Information concerning investment securities with gross unrealized losses at June 30, 2017 and December 31, 2016, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (dollars in thousands):

| | Less than Twelve Months | | Twelve Months or Greater | |
|--|----------------------------|----------------------|-----------------------------|----------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| June 30, 2017 | | | | |
| Available-for-Sale: | | | | |
| U.S. Treasury notes | \$1,300 | \$ 3 | \$— | \$ — |
| U.S. Agency notes | 78,483 | 1,134 | — | — |
| U.S. Agency mortgage-backed securities | 58,733 | 939 | 3,271 | 122 |
| Municipal securities: | | | | |
| Non-taxable | 39,578 | 758 | — | — |
| Taxable | 10,833 | 62 | 450 | 1 |
| Mutual funds | 1,225 | 30 | 282 | 9 |
| Trust preferred securities | — | — | — | — |
| Equity securities | 24 | 1 | 29 | 4 |
| | \$190,176 | \$ 2,927 | \$4,032 | \$ 136 |
| Held-to-Maturity: | | | | |
| Municipal securities: | | | | |
| Non-taxable | \$19,188 | 78 | 2,622 | 44 |
| Taxable | 3,176 | 124 | — | — |
| | \$22,364 | \$ 202 | \$2,622 | \$ 44 |
| December 31, 2016 | | | | |
| Available-for-Sale: | | | | |
| U.S. Treasury notes | \$16,076 | \$ 76 | \$— | \$ — |
| U.S. Agency notes | 69,784 | 1,848 | — | — |
| U.S. Agency mortgage-backed securities | 64,564 | 1,310 | 3,518 | 134 |
| Municipal securities: | | | | |
| Non-taxable | 72,867 | 1,621 | 451 | 2 |
| Taxable | 9,721 | 82 | 450 | 3 |
| Mutual funds | 1,205 | 37 | 277 | 8 |
| Trust preferred securities | 49 | 1 | — | — |
| Equity securities | 201 | 10 | — | — |
| | \$234,467 | \$ 4,985 | \$4,696 | \$ 147 |
| Held-to-Maturity: | | | | |
| Municipal securities: | | | | |
| Non-taxable | \$20,429 | \$ 251 | \$2,564 | \$ 101 |

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| | | | | |
|---------|----------|--------|---------|--------|
| Taxable | 8,030 | 217 | — | — |
| | \$28,459 | \$ 468 | \$2,564 | \$ 101 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities (continued)

Management has determined that the unrealized losses at June 30, 2017 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because LCNB does not have the intent to sell the investments and it is more likely than not that LCNB will not be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, LCNB does not consider these investments to be other-than-temporarily impaired.

Contractual maturities of investment securities at June 30, 2017 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 | \$12,940 | \$12,981 | \$6,191 | \$6,221 |
| Due from one to five years | 110,596 | 111,142 | 4,082 | 4,064 |
| Due from five to ten years | 121,060 | 120,190 | 10,322 | 10,266 |
| Due after ten years | 7,531 | 7,242 | 17,842 | 17,735 |
| | 252,127 | 251,555 | 38,437 | 38,286 |
| U.S. Agency mortgage-backed securities | 74,949 | 73,961 | — | — |
| Mutual funds | 2,546 | 2,507 | — | — |
| Trust preferred securities | 49 | 50 | — | — |
| Equity securities | 632 | 715 | — | — |
| | \$330,303 | \$328,788 | \$38,437 | \$38,286 |

Investment securities with a market value of \$195,610,000 and \$149,990,000 at June 30, 2017 and December 31, 2016, respectively, were pledged to secure public deposits and for other purposes required or as permitted by law.

Certain information concerning the sale of investment securities available-for-sale for the three and six months ended June 30, 2017 and 2016 was as follows (in thousands):

| | Three Months | | Six Months | |
|-----------------------|---------------------|---------------------|---------------------|---------------------|
| | Ended June 30, 2017 | Ended June 30, 2016 | Ended June 30, 2017 | Ended June 30, 2016 |
| Proceeds from sales | \$12,243 | \$16,100 | \$12,243 | \$36,529 |
| Gross realized gains | 140 | 300 | 140 | 671 |
| Gross realized losses | — | 21 | — | 21 |

Realized gains or losses from the sale of securities are computed using the specific identification method.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Loans

Major classifications of loans at June 30, 2017 and December 31, 2016 are as follows (in thousands):

| | June 30, 2017 | December 31, 2016 |
|---|------------------|----------------------|
| Commercial and industrial | \$38,651 | \$ 41,878 |
| Commercial, secured by real estate | 495,255 | 477,275 |
| Residential real estate | 258,710 | 265,788 |
| Consumer | 17,475 | 19,173 |
| Agricultural | 16,014 | 14,802 |
| Other loans, including deposit overdrafts | 547 | 633 |
| | 826,652 | 819,549 |
| Deferred origination costs (fees), net | 281 | 254 |
| | 826,933 | 819,803 |
| Less allowance for loan losses | 3,382 | 3,575 |
| Loans, net | \$823,551 | \$ 816,228 |

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 Accounting Standards Codification ("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.

Non-accrual, past-due, and accruing restructured loans as of June 30, 2017 and December 31, 2016 are as follows (in thousands):

| | June 30, 2017 | December 31, 2016 |
|------------------------------------|------------------|----------------------|
| Non-accrual loans: | | |
| Commercial and industrial | \$— | \$— |
| Commercial, secured by real estate | 2,493 | 4,312 |
| Residential real estate | 1,076 | 1,079 |

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| | | |
|---|----------|-----------|
| Consumer | — | — |
| Agricultural | 178 | 334 |
| Total non-accrual loans | 3,747 | 5,725 |
| Past-due 90 days or more and still accruing | 141 | 23 |
| Total non-accrual and past-due 90 days or more and still accruing | 3,888 | 5,748 |
| Accruing restructured loans | 11,287 | 11,731 |
| Total | \$15,175 | \$ 17,479 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

The allowance for loan losses for the three and six months ended June 30, 2017 and 2016 are as follows (in thousands):

| | Commercial & Industrial | Commercial, Secured by Real Estate | Residential Real Estate | Consumer | Agricultural | Other | Total |
|---|----------------------------|--|----------------------------|----------|--------------|-------|---------|
| Three Months Ended June 30, 2017 | | | | | | | |
| Balance, beginning of period | \$ 353 | \$ 2,007 | \$ 809 | \$ 91 | \$ 66 | \$ 2 | \$3,328 |
| Provision charged to expenses | (90) | 206 | 109 | (20) | (5) | 22 | 222 |
| Losses charged off | — | (82) | (118) | (9) | — | (31) | (240) |
| Recoveries | 10 | 5 | 22 | 24 | — | 11 | 72 |
| Balance, end of period | \$ 273 | \$ 2,136 | \$ 822 | \$ 86 | \$ 61 | \$ 4 | \$3,382 |
| Six Months Ended June 30, 2017 | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Balance, beginning of year | \$ 350 | \$ 2,179 | \$ 885 | \$ 96 | \$ 60 | \$ 5 | \$3,575 |
| Provision charged to expenses | (92) | 296 | 2 | 3 | 1 | 27 | 237 |
| Losses charged off | — | (344) | (135) | (54) | — | (61) | (594) |
| Recoveries | 15 | 5 | 70 | 41 | — | 33 | 164 |
| Balance, end of period | \$ 273 | \$ 2,136 | \$ 822 | \$ 86 | \$ 61 | \$ 4 | \$3,382 |
| Three Months Ended June 30, 2016 | | | | | | | |
| Balance, beginning of period | \$ 247 | \$ 1,868 | \$ 896 | \$ 81 | \$ 56 | \$ 2 | \$3,150 |
| Provision charged to expenses | 74 | 320 | (1) | (12) | 6 | 9 | 396 |
| Losses charged off | (49) | (117) | (14) | (9) | — | (19) | (208) |
| Recoveries | 1 | — | 4 | 20 | — | 10 | 35 |
| Balance, end of period | \$ 273 | \$ 2,071 | \$ 885 | \$ 80 | \$ 62 | \$ 2 | \$3,373 |
| Six Months Ended June 30, 2016 | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Balance, beginning of year | \$ 244 | \$ 1,908 | \$ 854 | \$ 54 | \$ 66 | \$ 3 | 3,129 |
| Provision charged to expenses | 74 | 285 | 65 | 49 | (4) | 17 | 486 |
| Losses charged off | (49) | (140) | (42) | (53) | — | (42) | (326) |
| Recoveries | 4 | 18 | 8 | 30 | — | 24 | 84 |
| Balance, end of period | \$ 273 | \$ 2,071 | \$ 885 | \$ 80 | \$ 62 | \$ 2 | \$3,373 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

A breakdown of the allowance for loan losses and the loan portfolio by loan segment at June 30, 2017 and December 31, 2016 are as follows (in thousands):

| | Commercial & Industrial | Commercial, Secured by Real Estate | Residential Real Estate | Consumer | Agricultural | Other | Total |
|---------------------------------------|----------------------------|--|----------------------------|-----------|--------------|--------|------------|
| June 30, 2017 | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Individually evaluated for impairment | \$ 7 | \$ 129 | \$ 51 | \$ 8 | \$ — | \$ — | \$ 195 |
| Collectively evaluated for impairment | 266 | 2,007 | 771 | 78 | 61 | 4 | 3,187 |
| Acquired credit impaired loans | — | — | — | — | — | — | — |
| Balance, end of period | \$ 273 | \$ 2,136 | \$ 822 | \$ 86 | \$ 61 | \$ 4 | \$ 3,382 |
| Loans: | | | | | | | |
| Individually evaluated for impairment | \$ 320 | \$ 12,005 | \$ 1,428 | \$ 61 | \$ 177 | \$ — | \$ 13,991 |
| Collectively evaluated for impairment | 37,504 | 478,574 | 255,360 | 17,513 | 15,851 | 114 | 804,916 |
| Acquired credit impaired loans | 865 | 4,331 | 2,392 | 5 | — | 433 | 8,026 |
| Balance, end of period | \$ 38,689 | \$ 494,910 | \$ 259,180 | \$ 17,579 | \$ 16,028 | \$ 547 | \$ 826,933 |
| December 31, 2016 | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Individually evaluated for impairment | \$ 9 | \$ 55 | \$ 100 | \$ 13 | \$ — | \$ — | \$ 177 |
| Collectively evaluated for impairment | 341 | 1,832 | 785 | 83 | 60 | 5 | 3,106 |
| Acquired credit impaired loans | — | 292 | — | — | — | — | 292 |
| Balance, end of period | \$ 350 | \$ 2,179 | \$ 885 | \$ 96 | \$ 60 | \$ 5 | \$ 3,575 |
| Loans: | | | | | | | |
| Individually evaluated for impairment | \$ 337 | \$ 12,580 | \$ 1,518 | \$ 52 | \$ 334 | \$ — | \$ 14,821 |
| Collectively evaluated for impairment | 41,466 | 458,059 | 262,266 | 19,192 | 14,475 | 178 | 795,636 |
| Acquired credit impaired loans | 98 | 6,305 | 2,471 | 17 | — | 455 | 9,346 |
| Balance, end of period | \$ 41,901 | \$ 476,944 | \$ 266,255 | \$ 19,261 | \$ 14,809 | \$ 633 | \$ 819,803 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – 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 adjustment periods ranging from one month to 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 an 80% 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 84 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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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – 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 as 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 June 30, 2017 and December 31, 2016 is as follows (in thousands):

| | Pass | OAEM | Substandard | Doubtful | Total |
|------------------------------------|-----------|---------|-------------|----------|------------|
| June 30, 2017 | | | | | |
| Commercial & industrial | \$37,988 | \$218 | \$483 | \$ | —\$38,689 |
| Commercial, secured by real estate | 467,419 | 4,497 | 22,994 | — | 494,910 |
| Residential real estate | 255,321 | 120 | 3,739 | — | 259,180 |
| Consumer | 17,490 | — | 89 | — | 17,579 |
| Agricultural | 14,710 | — | 1,318 | — | 16,028 |
| Other | 547 | — | — | — | 547 |
| Total | \$793,475 | \$4,835 | \$28,623 | \$ | —\$826,933 |
| December 31, 2016 | | | | | |
| Commercial & industrial | \$41,178 | \$304 | \$419 | \$ | —\$41,901 |
| Commercial, secured by real estate | 443,781 | 5,479 | 27,684 | — | 476,944 |
| Residential real estate | 261,839 | 442 | 3,974 | — | 266,255 |
| Consumer | 19,182 | — | 79 | — | 19,261 |
| Agricultural | 13,311 | — | 1,498 | — | 14,809 |
| Other | 633 | — | — | — | 633 |
| Total | \$779,924 | \$6,225 | \$33,654 | \$ | —\$819,803 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

A loan portfolio aging analysis at June 30, 2017 and December 31, 2016 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 |
|------------------------------------|------------------------------|------------------------------|--|----------------------|------------|------------------------------|---|
| June 30, 2017 | | | | | | | |
| Commercial & industrial | \$— | \$— | \$— | \$— | \$38,689 | \$ 38,689 | \$ — |
| Commercial, secured by real estate | 742 | — | 541 | 1,283 | 493,627 | 494,910 | — |
| Residential real estate | 518 | 28 | 1,093 | 1,639 | 257,541 | 259,180 | 118 |
| Consumer | 33 | 27 | 23 | 83 | 17,496 | 17,579 | 23 |
| Agricultural | — | — | 177 | 177 | 15,851 | 16,028 | — |
| Other | 55 | — | — | 55 | 492 | 547 | — |
| Total | \$1,348 | \$ 55 | \$ 1,834 | \$ 3,237 | \$ 823,696 | \$ 826,933 | \$ 141 |
| December 31, 2016 | | | | | | | |
| Commercial & industrial | \$19 | \$— | \$— | \$19 | \$41,882 | \$ 41,901 | \$ — |
| Commercial, secured by real estate | 99 | 69 | 127 | 295 | 476,649 | 476,944 | — |
| Residential real estate | 686 | 80 | 727 | 1,493 | 264,762 | 266,255 | 20 |
| Consumer | 59 | 16 | 3 | 78 | 19,183 | 19,261 | 3 |
| Agricultural | 125 | — | — | 125 | 14,684 | 14,809 | — |
| Other | 115 | — | — | 115 | 518 | 633 | — |
| Total | \$1,103 | \$ 165 | \$ 857 | \$ 2,125 | \$ 817,678 | \$ 819,803 | \$ 23 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

Impaired loans, including acquired credit impaired loans, at June 30, 2017 and December 31, 2016 are as follows (in thousands):

| | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|-------------------------------------|------------------------|--------------------------------|----------------------|
| June 30, 2017 | | | |
| With no related allowance recorded: | | | |
| Commercial & industrial | \$ 874 | \$ 1,006 | \$ — |
| Commercial, secured by real estate | 15,160 | 16,195 | — |
| Residential real estate | 3,223 | 4,329 | — |
| Consumer | 22 | 22 | — |
| Agricultural | 177 | 178 | — |
| Other | 433 | 592 | — |
| Total | \$ 19,889 | \$ 22,322 | \$ — |
| With an allowance recorded: | | | |
| Commercial & industrial | \$ 311 | \$ 315 | \$ 7 |
| Commercial, secured by real estate | 1,176 | 1,176 | 129 |
| Residential real estate | 597 | 598 | 51 |
| Consumer | 44 | 44 | 8 |
| Agricultural | — | — | — |
| Other | — | — | — |
| Total | \$ 2,128 | \$ 2,133 | \$ 195 |
| Total: | | | |
| Commercial & industrial | \$ 1,185 | \$ 1,321 | \$ 7 |
| Commercial, secured by real estate | 16,336 | 17,371 | 129 |
| Residential real estate | 3,820 | 4,927 | 51 |
| Consumer | 66 | 66 | 8 |
| Agricultural | 177 | 178 | — |
| Other | 433 | 592 | — |
| Total | \$ 22,017 | \$ 24,455 | \$ 195 |
| December 31, 2016 | | | |
| With no related allowance recorded: | | | |
| Commercial & industrial | \$ 109 | \$ 263 | \$ — |
| Commercial, secured by real estate | 14,195 | 15,522 | — |
| Residential real estate | 3,238 | 4,286 | — |
| Consumer | 26 | 27 | — |
| Agricultural | 334 | 334 | — |
| Other | 455 | 629 | — |
| Total | \$ 18,357 | \$ 21,061 | \$ — |

With an allowance recorded:

| | | | |
|------------------------------------|----------|----------|--------|
| Commercial & industrial | \$ 326 | \$ 326 | \$ 9 |
| Commercial, secured by real estate | 4,690 | 4,946 | 347 |
| Residential real estate | 751 | 751 | 100 |
| Consumer | 43 | 43 | 13 |
| Agricultural | — | — | — |
| Other | — | — | — |
| Total | \$ 5,810 | \$ 6,066 | \$ 469 |

Total:

| | | | |
|------------------------------------|-----------|-----------|--------|
| Commercial & industrial | \$ 435 | \$ 589 | \$ 9 |
| Commercial, secured by real estate | 18,885 | 20,468 | 347 |
| Residential real estate | 3,989 | 5,037 | 100 |
| Consumer | 69 | 70 | 13 |
| Agricultural | 334 | 334 | — |
| Other | 455 | 629 | — |
| Total | \$ 24,167 | \$ 27,127 | \$ 469 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – 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 six months ended June 30, 2017 and 2016 (in thousands):

| | 2017 | | 2016 | |
|-------------------------------------|------------------------------|----------------------|------------------------------|----------------------|
| | Average Interest Recorded | Income Recognized | Average Interest Recorded | Income Recognized |
| | Investment | | Investment | |
| Three Months Ended June 30, | | | | |
| With no related allowance recorded: | | | | |
| Commercial & industrial | \$261 | \$ 10 | \$964 | \$ 26 |
| Commercial, secured by real estate | 16,488 | 269 | 17,292 | 278 |
| Residential real estate | 3,351 | 47 | 3,855 | 123 |
| Consumer | 30 | 1 | 40 | 8 |
| Agricultural | 217 | — | 423 | 123 |
| Other | 463 | 14 | 495 | 20 |
| Total | \$20,810 | \$ 341 | \$23,069 | \$ 578 |
| With an allowance recorded: | | | | |
| Commercial & industrial | \$314 | \$ 4 | \$358 | \$ 5 |
| Commercial, secured by real estate | 1,087 | 25 | 2,651 | 20 |
| Residential real estate | 603 | 8 | 780 | 8 |
| Consumer | 44 | 1 | 34 | 1 |
| Agricultural | — | — | — | — |
| Other | — | — | — | — |
| Total | \$2,048 | \$ 38 | \$3,823 | \$ 34 |
| Total: | | | | |
| Commercial & industrial | \$575 | \$ 14 | \$1,322 | \$ 31 |
| Commercial, secured by real estate | 17,575 | 294 | 19,943 | 298 |
| Residential real estate | 3,954 | 55 | 4,635 | 131 |
| Consumer | 74 | 2 | 74 | 9 |
| Agricultural | 217 | — | 423 | 123 |
| Other | 463 | 14 | 495 | 20 |
| Total | \$22,858 | \$ 379 | \$26,892 | \$ 612 |
| Six Months Ended June 30, | | | | |
| With no related allowance recorded: | | | | |
| Commercial & industrial | \$261 | \$ 36 | \$964 | \$ 55 |
| Commercial, secured by real estate | 16,736 | 468 | 17,460 | 660 |
| Residential real estate | 3,332 | 136 | 3,823 | 194 |
| Consumer | 31 | 1 | 54 | 15 |
| Agricultural | 267 | — | 422 | 135 |

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| | | | | |
|-------|----------|--------|----------|----------|
| Other | 463 | 32 | 495 | 40 |
| Total | \$21,090 | \$ 673 | \$23,218 | \$ 1,099 |

With an allowance recorded:

| | | | | |
|------------------------------------|---------|-------|---------|-------|
| Commercial & industrial | \$318 | \$ 9 | \$362 | \$ 10 |
| Commercial, secured by real estate | 970 | 33 | 2,671 | 42 |
| Residential real estate | 612 | 16 | 760 | 16 |
| Consumer | 43 | 2 | 34 | 2 |
| Agricultural | — | — | — | — |
| Other | — | — | — | — |
| Total | \$1,943 | \$ 60 | \$3,827 | \$ 70 |

Total:

| | | | | |
|------------------------------------|----------|-------|----------|----------|
| Commercial & industrial | \$579 | \$ 45 | \$1,326 | \$ 65 |
| Commercial, secured by real estate | 17,706 | 501 | 20,131 | 702 |
| Residential real estate | 3,944 | 152 | 4,583 | 210 |
| Consumer | 74 | 3 | 88 | 17 |
| Agricultural | 267 | — | 422 | 135 |
| Other | 463 | 32 | 495 | 40 |
| Total | \$23,033 | 733 | \$27,045 | \$ 1,169 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

Of the interest income recognized on impaired loans during the six months ended June 30, 2017 and 2016, approximately \$3,000 and \$46,000, respectively, were recognized on a cash basis.

Loan modifications that were classified as troubled debt restructurings during the three and six months ended June 30, 2017 and 2016 are as follows (dollars in thousands):

| | 2017 | | 2016 | |
|------------------------------------|--------------------------|------------------------------------|--------------------------|------------------------------------|
| | Number of Recorded Loans | Post-Modification Recorded Balance | Number of Recorded Loans | Post-Modification Recorded Balance |
| Three Months Ended June 30, | | | | |
| Commercial & industrial | — | \$ — | — | \$ — |
| Commercial, secured by real estate | — | — | — | — |
| Residential real estate | — | — | 1 | 27 |
| Consumer | — | — | 1 | 10 |
| Total | — | \$ — | 2 | \$ 37 |
| Six Months Ended June 30, | | | | |
| Commercial & industrial | — | \$ — | — | \$ — |
| Commercial, secured by real estate | — | — | 1 | 299 |
| Residential real estate | 1 | 18 | 2 | 45 |
| Consumer | 1 | 14 | 2 | 27 |
| Total | 2 | \$ 32 | 5 | \$ 371 |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

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, forgiveness of principal, or extensions of the maturity date. Post-modification balances of newly restructured troubled debt by type of modification for the three and six months ended June 30, 2017 and 2016 were as follows (dollars in thousands):

| | Term Modification | Rate Modification | Interest Only | Principal Forgiveness | Combination | Total Modifications |
|---|----------------------|----------------------|------------------|--------------------------|-------------|------------------------|
| Three Months Ended June 30, 2017 | | | | | | |
| Commercial & industrial | \$ — | \$ — | \$ — | —\$ — | \$ — | \$ — |
| Commercial, secured by real estate | — | — | — | — | — | — |
| Residential real estate | — | — | — | — | — | — |
| Consumer | — | — | — | — | — | — |
| Total | \$ — | \$ — | \$ — | —\$ — | \$ — | \$ — |
| Six Months Ended June 30, 2017 | | | | | | |
| Commercial & industrial | \$ — | \$ — | \$ — | —\$ — | \$ — | \$ — |
| Commercial, secured by real estate | — | — | — | — | — | — |
| Residential real estate | — | — | — | 9 | — | 9 |
| Consumer | 14 | — | — | — | — | 14 |
| Total | \$ 14 | \$ — | \$ — | —\$ 9 | \$ — | \$ 23 |
| Three Months Ended June 30, 2016 | | | | | | |
| Commercial & industrial | \$ — | \$ — | \$ — | —\$ — | \$ — | \$ — |
| Commercial, secured by real estate | — | — | — | — | — | — |
| Residential real estate | — | 27 | — | — | — | 27 |
| Consumer | — | 10 | — | — | — | 10 |
| Total | \$ — | \$ 37 | \$ — | —\$ — | \$ — | \$ 37 |
| Six Months Ended June 30, 2016 | | | | | | |
| Commercial & industrial | \$ — | \$ — | \$ — | —\$ — | \$ — | \$ — |
| Commercial, secured by real estate | — | — | — | — | 372 | 372 |
| Residential real estate | 18 | 27 | — | — | — | 45 |
| Consumer | — | 27 | — | — | — | 27 |
| Total | \$ 18 | \$ 54 | \$ — | —\$ — | \$ 372 | \$ 444 |

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

Two commercial, secured by real estate loans to the same borrower totaling \$1,236,000 that were modified during the fourth quarter 2016 subsequently defaulted in February 2017. There were no troubled debt restructurings that subsequently defaulted within twelve months of the restructuring date for the six months ended June 30, 2016 and that remained in default at period end.

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LCNB CORP. AND SUBSIDIARIES

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(Unaudited)

(Continued)

Note 3 – Loans (continued)

No impaired loans without a valuation allowance and approximately \$23,000 of impaired loans with a valuation allowance at June 30, 2017 consisted of loans that were modified during the six months ended June 30, 2017 and were determined to be troubled debt restructurings. Approximately \$379,000 of impaired loans without a valuation allowance and \$60,000 of impaired loans with a valuation allowance at June 30, 2016 consisted of loans that were modified during the six months ended June 30, 2016 and were determined to be troubled debt restructurings.

Mortgage loans sold to and serviced for the Federal Home Loan Mortgage Corporation and other investors are not included in the accompanying consolidated balance sheets. The unpaid principal balances of those loans at June 30, 2017 and December 31, 2016 were approximately \$98,234,000 and \$100,982,000, respectively.

The total recorded investment in residential consumer mortgage loans secured by residential real estate that were in the process of foreclosure at June 30, 2017 was \$683,000.

Note 4 - Acquired Credit Impaired Loans

The following table provides at June 30, 2017 and December 31, 2016 the major classifications of acquired credit impaired loans that are accounted for in accordance with FASB ASC 310-30 (in thousands):

| | June 30, December 31, | |
|---|-----------------------|----------|
| | 2017 | 2016 |
| Commercial & industrial | \$ 865 | \$ 98 |
| Commercial, secured by real estate | 4,331 | 6,305 |
| Residential real estate | 2,392 | 2,471 |
| Consumer | 5 | 17 |
| Agricultural | — | — |
| Other loans, including deposit overdrafts | 433 | 455 |
| | 8,026 | 9,346 |
| Less allowance for loan losses | — | 292 |
| Loans, net | \$ 8,026 | \$ 9,054 |

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

| | June 30, December 31, | |
|---------------------|-----------------------|-----------|
| | 2017 | 2016 |
| Outstanding balance | \$ 10,343 | \$ 12,289 |
| Carrying amount | 8,026 | 9,346 |

Activity during the six months ended June 30, 2017 and 2016 for the accretable discount related to acquired credit impaired loans is as follows (in thousands):

| | 2017 | 2016 |
|--|----------|----------|
| Accretable discount at beginning of year | \$ 1,080 | \$ 1,503 |
| Reclass from nonaccretable discount to accretable discount | 158 | 307 |

| | | |
|--------------------------------------|--------|---------|
| Less disposals | (170) | (3) |
| Less accretion | (217) | (439) |
| Accretable discount at end of period | \$851 | \$1,368 |

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(Unaudited)

(Continued)

Note 5 - Affordable Housing Tax Credit Limited Partnership

LCNB is a limited partner in limited partnerships that sponsor affordable housing projects utilizing the Low Income Housing Tax Credit (LIHTC) pursuant to Section 42 of the Internal Revenue Code. The purpose of the investments is to achieve a satisfactory return on capital, to facilitate the sale of additional affordable housing product offerings, and to assist in achieving goals associated with the Community Reinvestment Act. The primary activities of the limited partnerships include the identification, development, and operation of multi-family housing that is leased to qualifying residential tenants.

The following table presents the balances of LCNB's affordable housing tax credit investments, included in other assets in the consolidated condensed balance sheets, and related unfunded commitments, included in accrued interest and other liabilities in the consolidated condensed balance sheets, at June 30, 2017 and December 31, 2016 (in thousands):

| | June 30, December 31, | |
|--|-----------------------|----------|
| | 2017 | 2016 |
| Affordable housing tax credit investment | \$ 3,000 | \$ 2,000 |
| Less amortization | 175 | 93 |
| Net affordable housing tax credit investment | \$ 2,825 | \$ 1,907 |
| Unfunded commitment | \$ 2,452 | \$ 1,617 |

LCNB expects to fund the unfunded commitment over 10.0 years.

The following table presents other information relating to LCNB's affordable housing tax credit investments for the periods indicated (in thousands):

| | Six Months Ended June 30, 2017/2016 | |
|--|---|-------|
| | 2017 | 2016 |
| Tax credits and other tax benefits recognized | \$79 | \$ 55 |
| Tax credit amortization expense included in provision for income taxes | 82 | 41 |

Note 6 – Borrowings

Short-term borrowings at June 30, 2017 and December 31, 2016 are as follows (dollars in thousands):

| | June 30, 2017 | | December 31, 2016 | |
|-------------------------|---------------|--------|----------------------|--------|
| | Amount | Rate | Amount | Rate |
| FHLB short-term advance | \$25,000 | 1.18 % | \$25,000 | 0.63 % |
| Repurchase agreements | 6,712 | 0.10 % | 17,040 | 0.10 % |

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\$31,712 0.95 % \$42,040 0.42 %

Repurchase agreements are an option customers may use in managing their cash positions and mature the next business day after issuance. Repurchase agreements at June 30, 2017 and December 31, 2016 were fully secured by U.S. Agency notes and such collateral securities were held by the Federal Reserve Bank.

All advances from the Federal Home Loan Bank ("FHLB") of Cincinnati, both long-term and short-term, are secured by a blanket pledge of LCNB's 1-4 family first lien mortgage loans in the amount of approximately \$223 million and \$229 million at June 30, 2017 and December 31, 2016, respectively. Additionally, LCNB is required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 7 – 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 June 30, | | For the Six Months Ended June 30, | |
|--|---|---------|---|---------|
| | 2017 | 2016 | 2017 | 2016 |
| Statutory tax rate | 35.0 % | 34.2 % | 35.0 % | 34.2 % |
| Increase (decrease) resulting from: | | | | |
| Tax exempt interest | (6.7)% | (6.6)% | (6.4)% | (6.4)% |
| Tax exempt income on bank owned life insurance | (2.6)% | (1.6)% | (2.0)% | (1.5)% |
| Other, net | (0.2)% | — % | (0.4)% | (0.1)% |
| Effective tax rate | 25.5 % | 26.0 % | 26.2 % | 26.2 % |

Note 8 - 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 June 30, 2017 and December 31, 2016 are as follows (in thousands):

| | June 30, 2017 | December 31, 2016 |
|-------------------------------|------------------|----------------------|
| Commitments to extend credit: | | |
| Commercial loans | \$2,246 | \$10,350 |
| Other loans | | |
| Fixed rate | 3,482 | 4,425 |
| Adjustable rate | 1,411 | 1,044 |
| Unused lines of credit: | | |
| Fixed rate | 20,778 | 9,731 |
| Adjustable rate | 82,223 | 80,222 |

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| | | |
|--|-----------|-----------|
| Unused overdraft protection amounts on demand and NOW accounts | 16,796 | 17,123 |
| Standby letters of credit | 632 | 657 |
| | \$127,568 | \$123,552 |

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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(Unaudited)

(Continued)

Note 8 – Commitments and Contingent Liabilities (continued)

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.

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.

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 June 30, 2017 totaled approximately \$416,000.

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 9 – Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) for the six months ended June 30, 2017 and the year ended December 31, 2016 are as follows (in thousands):

| | Unrealized Gains and Losses on Available-for-Sale Securities | | Changes in Pension Plan Assets and Benefit Obligations | Total |
|---------------------------------|---|---|--|-----------|
| Six Months Ended June 30, 2017: | | | | |
| Balance at beginning of period | \$ (2,633 |) | \$ 16 | \$(2,617) |
| Before reclassifications | 1,734 | | — | 1,734 |
| Reclassifications | (92 |) | — | (92) |
| Balance at end of period | \$ (991 |) | \$ 16 | \$(975) |
| Year Ended December 31, 2016: | | | | |
| Balance at beginning of period | \$ 469 | | \$ (233) | \$236 |
| Before reclassifications | (2,390 |) | 249 | (2,141) |
| Reclassifications | (712 |) | — | (712) |
| Balance at end of period | \$ (2,633 |) | \$ 16 | \$(2,617) |

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Reclassifications out of accumulated other comprehensive income (loss) during the three and six months ended June 30, 2017 and 2016 and the affected line items in the consolidated condensed statements of income are as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | | Affected Line Item in the Consolidated Condensed Statements of Income |
|---|-----------------------------|-------|---------------------------|-------|---|
| | 2017 | 2016 | 2017 | 2016 | |
| Realized gain on sale of securities | \$ 140 | \$279 | \$ 140 | \$650 | Net gain on sales of securities |
| Less provision for income taxes | 48 | 95 | 48 | 221 | Provision for income taxes |
| Reclassification adjustment, net of taxes | \$92 | 184 | \$92 | \$429 | |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 10 – 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 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 condensed statements of income for the three and six-month periods ended June 30, 2017 and 2016 are as follows (in thousands):

| | For the Three Months Ended June 30, 2017 | | For the Six Months Ended June 30, 2016 | |
|---|---|-----|--|-------|
| Qualified noncontributory defined benefit retirement plan | \$262 | 220 | \$522 | \$440 |
| 401(k) plan | 94 | 77 | 196 | 160 |

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 six months ended June 30, 2017 and 2016 are summarized as follows (in thousands):

| | Three Months Ended June 30, 2017 | | Six Months Ended June 30, 2016 | |
|---------------------------------------|--|----|--|-------|
| Service cost | \$— | 10 | \$— | \$20 |
| Interest cost | 17 | 19 | 34 | 38 |
| Amortization of unrecognized net loss | — | 42 | — | 84 |
| Net periodic pension cost | \$17 | 71 | \$34 | \$142 |

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Amounts recognized in accumulated other comprehensive income (loss), net of tax, at June 30, 2017 and December 31, 2016 for the nonqualified defined benefit retirement plan consists of (in thousands):

| | June 30, 2017 | December 31, 2016 |
|---|---------------------|----------------------|
| Net actuarial (gain) loss | \$(16) | \$ (16) |
| Past service cost | — | — |
| Total recognized in accumulated other comprehensive income (loss), net of tax | \$(16) | \$ (16) |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 11 – 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 of common stock. 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 of common stock. The 2015 Plan will terminate on April 28, 2025 and is subject to earlier termination by the Compensation Committee.

Stock-based awards may be in the form of treasury shares or newly issued shares.

LCNB has not granted stock option awards since 2012. 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 June 30, 2017 were as follows:

| Exercise Price Range | Outstanding Stock Options | | | Exercisable Stock Options | | |
|----------------------|---------------------------|---------------------------------|---|---------------------------|---------------------------------|---|
| | Number | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) | Number | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) |
| \$9.00 - \$10.99 | 4,356 | \$ 9.00 | 1.6 | 4,356 | \$ 9.00 | 1.6 |
| \$11.00 - \$12.99 | 15,909 | 12.08 | 3.1 | 15,909 | 12.08 | 3.1 |
| | 20,265 | 11.42 | 2.8 | 20,265 | 11.42 | 2.8 |

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

| | 2017 | | 2016 | |
|-------------------------|----------|---------------------------------|----------|---------------------------------|
| | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price |
| Outstanding, January 1, | 24,669 | \$ 12.17 | 83,861 | \$ 12.39 |
| Exercised | (3,398) | 14.94 | — | — |
| Expired | (1,006) | 17.88 | (7,802) | 18.76 |
| Outstanding, June 30, | 20,265 | 11.42 | 76,059 | 11.73 |
| Exercisable, June 30, | 20,265 | 11.42 | 74,314 | 11.71 |

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The following table provides information related to stock options exercised during the periods indicated (in thousands):

| | 2017 | 2016 |
|---|-------|------|
| Intrinsic value of options exercised | \$ 25 | \$ — |
| Cash received from options exercised | 51 | — |
| Tax benefit realized from options exercised | 5 | — |

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LCNB CORP. AND SUBSIDIARIES

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(Unaudited)

(Continued)

Note 11 – Stock Based Compensation (continued)

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 June 30, 2017 that were "in the money" (market price greater than exercise price) was \$174,000. The aggregate intrinsic value at that date for only the options that were exercisable was \$174,000. The aggregate intrinsic value for options outstanding at June 30, 2016 that were in the money was \$320,000 and the aggregate intrinsic value at that date for only the options that were exercisable was \$314,000. The intrinsic value changes based upon fluctuations in the market value of LCNB's common stock.

Total expense related to options included in salaries and employee benefits for the three and six months ended June 30, 2017 was \$0 and \$1,000, respectively. The related tax benefit for the three and six months ended June 30, 2017 was \$0 and \$0, respectively. Compensation cost related to option awards was recognized in full during the first quarter 2017. Total expense related to options included in salaries and employee benefits for the three and six months ended June 30, 2016

was \$1,000 and \$2,000, respectively. The related tax benefit for the three and six months ended June 30, 2016 was \$0 and \$1,000, respectively.

Restricted stock awards granted under the 2015 Plan were as follows:

| | 2017 | | 2016 | |
|-------------------------|--------|--|----------|--|
| | Shares | Weighted Average Grant Date Fair Value | Shares | Weighted Average Grant Date Fair Value |
| Outstanding, January 1, | 8,624 | \$ 15.47 | 16,038 | \$ 15.47 |
| Granted | 4,027 | 22.60 | — | — |
| Vested | — | — | (5,255) | 15.47 |
| Forfeited | — | — | — | — |
| Outstanding, June 30, | 12,651 | \$ 17.74 | 10,783 | \$ 15.47 |

Total expense related to restricted stock awards included in salaries and wages in the consolidated condensed statements of income for the three and six months ended June 30, 2017 was \$7,000 and \$63,000, respectively. The related tax benefit for the three and six months ended June 30, 2017 was \$3,000 and \$22,000, respectively.

Unrecognized compensation expense for restricted stock awards was \$96,000 at June 30, 2017 and is expected to be recognized over a period of 4.33 years. Total expense related to restricted stock awards included in salaries and wages in the consolidated condensed statements of income for the three and six months ended June 30, 2016 was \$23,000 and \$45,000, respectively. The related tax benefit for the three and six months ended June 30, 2016 was \$7,000 and \$15,000, respectively.

Note 12 – Earnings per Common Share

LCNB has granted restricted stock awards with non-forfeitable dividend rights, which are considered participating securities. Accordingly, earnings per share is computed using the two-class method as required by FASB ASC

260-10-45. Basic earnings per common share is calculated by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding during the period, which excludes the participating securities. 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.

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(Unaudited)

(Continued)

Note 12 – Earnings per Common Share (continued)

Earnings per share for the three and six months ended June 30, 2017 and 2016 were calculated as follows (dollars in thousands, except share and per share data):

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|------------|---|------------|
| | 2017 | 2016 | 2017 | 2016 |
| Net income | \$3,003 | \$ 2,968 | \$6,249 | \$ 5,932 |
| Less allocation of earnings and dividends to participating securities | 2 | — | 4 | — |
| Net income allocated to common shareholders | \$3,001 | \$ 2,968 | \$6,245 | \$ 5,932 |
| Weighted average common shares outstanding, gross | 10,010,459 | 9,922,024 | 10,005,799 | 9,919,070 |
| Less average participating securities | 6,033 | — | 6,033 | — |
| Weighted average number of shares outstanding used in the calculation of basic earnings per common share | 10,004,426 | 9,922,024 | 9,999,766 | 9,919,070 |
| Add dilutive effect of: | | | | |
| Stock options | 6,890 | 18,299 | 7,427 | 17,767 |
| Stock warrants | — | — | — | 32,465 |
| Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share | 10,011,316 | 10,040,323 | 10,007,193 | 10,069,302 |
| Earnings per common share: | | | | |
| Basic | \$0.30 | \$ 0.30 | \$0.62 | \$ 0.60 |
| Diluted | 0.30 | 0.29 | 0.62 | 0.59 |

Options to purchase 0 and 5,160 shares of common stock at a weighted average price of \$0.00 and \$17.88 per share were outstanding at June 30, 2017 and 2016, 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 13 - 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 (loss).

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(Unaudited)

(Continued)

Note 13 - Fair Value Measurements (continued)

LCNB utilizes a pricing service for determining the fair values of most of its investment securities. Methods and significant assumptions used to estimate fair value are as follows:

Fair value for U.S. Treasury notes are determined based on market quotations (level 1).

Fair values for the other debt securities are 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.

Fair value for trust preferred and equity securities are determined based on market quotations (level 1). These securities are not priced by the pricing service.

LCNB has investments in three mutual funds. These investments are not priced by the pricing service. Investments in two of the mutual funds are measured at fair value using net asset values ("NAV") per share as a practical expedient and are not required to be classified in the fair value hierarchy. These funds can be redeemed at any time at their current NAVs. The investment in the remaining mutual fund, which 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. These 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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(Unaudited)

(Continued)

Note 13 - Fair Value Measurements (continued)

The following table summarizes the valuation of LCNB's assets recorded at fair value by input levels as of June 30, 2017 and December 31, 2016 (in thousands):

| | Fair Value Measurements | Fair Value Measurements at the End of the Reporting Period Using Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|-------------------------|---|---|---|
| June 30, 2017 | | | | |
| Recurring fair value measurements: | | | | |
| Investment securities available-for-sale: | | | | |
| U.S. Treasury notes | \$ 21,209 | \$21,209 | \$ — | \$ — |
| U.S. Agency notes | 95,948 | — | 95,948 | — |
| U.S. Agency mortgage-backed securities | 73,961 | — | 73,961 | — |
| Municipal securities: | | | | |
| Non-taxable | 111,795 | — | 111,795 | — |
| Taxable | 22,603 | — | 22,603 | — |
| Mutual fund | 1,000 | — | 1,000 | — |
| Mutual funds measured at net asset value (a) | 1,507 | — | — | — |
| Trust preferred securities | 50 | 50 | — | — |
| Equity securities | 715 | 715 | — | — |
| Total recurring fair value measurements | \$ 328,788 | \$21,974 | \$ 305,307 | \$ — |
| Nonrecurring fair value measurements: | | | | |
| Impaired loans | \$ 1,932 | \$— | \$ — | \$ 1,932 |
| December 31, 2016 | | | | |
| Recurring fair value measurements: | | | | |
| Investment securities available-for-sale: | | | | |
| U.S. Treasury notes | \$ 28,145 | \$28,145 | \$ — | \$ — |
| U.S. Agency notes | 85,400 | — | 85,400 | — |
| U.S. Agency mortgage-backed securities | 71,047 | — | 71,047 | — |
| Municipal securities: | | | | |
| Non-taxable | 113,015 | — | 113,015 | — |
| Taxable | 19,845 | — | 19,845 | — |
| Mutual fund | 1,000 | — | 1,000 | — |

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| | | | | |
|--|------------|----------|------------|------|
| Mutual funds measured at net asset value (a) | 1,482 | | | |
| Trust preferred securities | 48 | 48 | — | — |
| Equity securities | 677 | 677 | — | — |
| Total recurring fair value measurements | \$ 320,659 | \$28,870 | \$ 290,307 | \$ — |

Nonrecurring fair value measurements:

| | | | | |
|----------------|----------|-----|------|----------|
| Impaired loans | \$ 5,340 | \$— | \$ — | \$ 5,340 |
|----------------|----------|-----|------|----------|

(a) In accordance with Subtopic 820-10, certain investments that are measured at fair value using the net asset value per share practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Condensed Balance Sheets.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 13 - Fair Value Measurements (continued)

The following table presents quantitative information about unobservable inputs used in nonrecurring level 3 fair value measurements at June 30, 2017 and December 31, 2016 (dollars in thousands):

| | Fair Value | Valuation Technique | Unobservable Inputs | Range | | Weighted Average |
|-------------------|------------|-----------------------|---|----------------|-------|------------------|
| | | | | High | Low | |
| June 30, 2017 | | | | | | |
| Impaired loans | \$1,932 | Estimated sales price | Adjustments for comparable properties, discounts to reflect current market conditions | Not applicable | | |
| | | Discounted cash flows | Discount rate | 8.25% | 3.25% | 6.25% |
| December 31, 2016 | | | | | | |
| Impaired loans | \$5,340 | Estimated sales price | Adjustments for comparable properties, discounts to reflect current market conditions | Not applicable | | |
| | | Discounted cash flows | Discount rate | 8.25% | 4.50% | 5.56% |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 13 - Fair Value Measurements (continued)

Carrying amounts and estimated fair values of financial instruments as of June 30, 2017 and December 31, 2016 are as follows (in thousands):

| | Carrying Amount | | Fair Value Measurements at the End of the Reporting Period Using | | | |
|---|-----------------|-----------|--|---|---|---|
| | | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| June 30, 2017 | | | | | | |
| FINANCIAL ASSETS: | | | | | | |
| Cash and cash equivalents | \$29,967 | \$29,967 | \$29,967 | \$ | —\$ | — |
| Investment securities, held-to-maturity | 38,437 | 38,286 | — | — | 38,286 | — |
| Federal Reserve Bank stock | 2,732 | 2,732 | 2,732 | — | — | — |
| Federal Home Loan Bank stock | 3,638 | 3,638 | 3,638 | — | — | — |
| Loans, net | 823,551 | 804,304 | — | — | 804,304 | — |
| Accrued interest receivable | 3,416 | 3,416 | — | 3,416 | — | — |
| FINANCIAL LIABILITIES: | | | | | | |
| Deposits | 1,143,920 | 1,145,612 | 936,054 | 209,558 | — | — |
| Short-term borrowings | 31,712 | 31,712 | 31,712 | — | — | — |
| Long-term debt | 402 | 410 | — | 410 | — | — |
| Accrued interest payable | 278 | 278 | — | 278 | — | — |
| December 31, 2016 | | | | | | |
| FINANCIAL ASSETS: | | | | | | |
| Cash and cash equivalents | \$18,865 | \$18,865 | \$18,865 | \$ | —\$ | — |
| Investment securities, held-to-maturity | 41,003 | 40,490 | — | — | 40,490 | — |
| Federal Reserve Bank stock | 2,732 | 2,732 | 2,732 | — | — | — |
| Federal Home Loan Bank stock | 3,638 | 3,638 | 3,638 | — | — | — |
| Loans, net | 816,228 | 799,791 | — | — | 799,791 | — |
| Accrued interest receivable | 3,559 | 3,559 | — | 3,559 | — | — |
| FINANCIAL LIABILITIES: | | | | | | |
| Deposits | 1,110,905 | 1,113,187 | 896,147 | 217,040 | — | — |
| Short-term borrowings | 42,040 | 42,040 | 42,040 | — | — | — |
| Long-term debt | 598 | 614 | — | 614 | — | — |
| Accrued interest payable | 307 | 307 | — | 307 | — | — |

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 13 - Fair Value Measurements (continued)

The fair values of off-balance-sheet financial instruments such as loan commitments and letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements. The fair values of such instruments were not material at June 30, 2017 and December 31, 2016.

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, held-to-maturity

Fair values for investment securities, held-to-maturity are based on quoted market prices for similar securities and/or discounted cash flow analysis or other methods.

Federal Home Loan Bank stock and Federal Reserve Bank stock

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.

Note 14 – Recent Accounting Pronouncements

From time to time the FASB issues an ASU to communicate changes to U.S. generally accepted accounting principles. The following information provides brief summaries of newly issued but not yet effective ASUs that could have an effect on LCNB's financial position or results of operations:

ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"

ASU No. 2014-09 was issued in May 2014 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.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 14 – Recent Accounting Pronouncements (continued)

Guidance in ASU No. 2014-09 has been clarified by the following ASUs:

• ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)"

• ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing"

• ASU No. 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients"

As extended by ASU No. 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," ASU No. 2014-09 and the clarifying ASUs are 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 updates. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. LCNB's revenue is primarily comprised of net interest income, which is explicitly excluded from the scope of ASU No. 2014-09, and non-interest income. The update may require LCNB to change how it recognizes certain recurring revenue streams related to non-interest income. However, it is not expected to have a material impact on LCNB's results of operations or financial position. Management continues to monitor the guidance from the FASB and the Transition Resource Group for Revenue Recognition in determining the impact of ASU No. 2014-09 on various types of non-interest income. Management is currently evaluating the revenue streams that will be impacted by the amendments. The analysis includes identification of possible contract performance obligations and recognition principles. The financial statement impact of this new standard cannot be reasonably estimated at this time.

ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities"

ASU No. 2016-01 was issued in January 2016 and applies to all entities that hold financial assets or owe financial liabilities. It makes targeted changes to generally accepted accounting principles for public companies as follows:

1. Requires most equity investments to be measured at fair value with changes in fair value recognized in net income. Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.
2. Eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.
3. Requires use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
4. Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
5. Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

For public business entities, the new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. Adoption of ASU No. 2016-01 is not expected to have a material impact on LCNB's results of operations or financial position.

ASU No. 2016-02, "Leases (Topic 842)"

ASU No. 2016-02 was issued in February 2016 and requires a lessee to recognize in the statement of financial position a liability to make lease payments ("the lease liability") and a right-of-use asset representing its right to use the underlying asset for the lease term, initially measured at the present value of the lease payments. When measuring assets and liabilities arising from a lease, the lessee should include payments to be made in optional periods only if the lessee is reasonably certain, as defined, to exercise an option to the lease or not to exercise an option to terminate the lease. Optional payments to purchase the underlying asset should be included if the lessee is reasonably certain it will exercise the purchase option. Most variable lease payments should be excluded except for those that depend on an index or a rate or are in substance fixed payments.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 14 – Recent Accounting Pronouncements (continued)

A lessee shall classify a lease as a finance lease if it meets any of five listed criteria:

1. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
2. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
3. The lease term is for the major part of the remaining economic life of the underlying asset.
4. The present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or exceeds substantially all of the fair value of the underlying asset.
5. The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

For finance leases, a lessee shall recognize in the statement of income interest on the lease liability separately from amortization of the right-of-use asset. Amortization of the right-of-use asset shall be on a straight-line basis, unless another basis is more representative of the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. If the lease does not meet any of the five criteria, the lessee shall classify it as an operating lease and shall recognize a single lease cost on a straight-line basis over the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term.

The amendments in this update are to be applied using a modified retrospective approach, as defined, and are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted. LCNB estimates that it will recognize discounted right-of-use assets and lease liabilities totaling approximately \$5 million for current leases outstanding. This projection is based on various assumptions, including the level of interest rates and no significant increases in leasing activity, that may change between now and the effective date.

ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments"

ASU No. 2016-13 was issued in June 2016 and, once effective, will significantly change current guidance for recognizing impairment of financial instruments. Current guidance requires an "incurred loss" methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. ASU No. 2016-13 replaces the incurred loss impairment methodology with a new methodology that reflects expected credit losses over the lives of the loans and requires consideration of a broader range of information to inform credit loss estimates. The ASU requires an organization to estimate all expected credit losses for financial assets measured at amortized cost, including loans and held-to-maturity debt securities, based on historical experience, current conditions, and reasonable and supportable forecasts. Additional disclosures are required.

ASU No. 2016-13 also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. Under the new guidance, entities will determine whether all or a portion of the unrealized loss on an available-for-sale debt security is a credit loss. Any credit loss will be recognized as an allowance for credit losses on available-for-sale debt securities rather than as a direct reduction of the amortized cost basis of the investment, as is currently required. As a result, entities will recognize improvements to estimated credit losses on available-for-sale debt securities immediately in earnings rather than as interest income over time, as

currently required.

ASU No. 2016-13 eliminates the current accounting model for purchased credit impaired loans and debt securities. Instead, purchased financial assets with credit deterioration will be recorded gross of estimated credit losses as of the date of acquisition and the estimated credit losses amounts will be added to the allowance for credit losses. Thereafter, entities will account for additional impairment of such purchased assets using the models listed above.

ASU No. 2016-13 will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. While LCNB's Loan Committee expects that the implementation of ASU No. 2016-13 will increase the balance of the allowance for loan losses, it is continuing to evaluate the potential impact on LCNB's results of operations and financial position. The Loan Committee is currently analyzing its data collection efforts, pool segmentation, and reporting mechanisms to prepare for adoption of this ASU. The financial statement impact of this new standard cannot be reasonably estimated at this time.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 14 – Recent Accounting Pronouncements (continued)

ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment"
ASU No. 2017-04 was issued in January 2017 and applies to public and other entities that have goodwill reported in their financial statements. To simplify the subsequent measurement of goodwill, this ASU eliminates Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities, including unrecognized assets and liabilities, following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A public business entity that is a U.S. Securities and Exchange Commission (SEC) filer should adopt the amendments in this update on a prospective basis for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019.

ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost"

ASU No. 2017-07 was issued in March 2017 and applies to all employers that offer to their employees defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715. The amendments in this update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost, as defined, are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in ASU No. 2017-07 are effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The amendments in this update are to be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement.

ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting"

ASU No. 2017-09 was issued in May 2017 and applies to any entity that changes the terms or conditions of a share-based payment award. The amendments in this update provide that an entity would not apply modification accounting under the guidance in Topic 718 if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments are to be applied prospectively and are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period. Adoption of ASU No. 2017-09 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 expressions.

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;
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 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 collectibility 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.

The allowance consists of specific and general components. The specific component typically 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.

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LCNB CORP. AND SUBSIDIARIES

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

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 June 30, 2017 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. 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 six months ended June 30, 2017 was \$3,003,000 (total basic and diluted earnings per share of \$0.30) and \$6,249,000 (total basic and diluted earnings per share of \$0.62), respectively. This compares to net income of \$2,968,000 (total basic and diluted earnings per share of \$0.30 and \$0.29, respectively) and \$5,932,000 (total basic and diluted earnings per share of \$0.60 and \$0.59, respectively) for the same three and six-month periods in 2016.

Net interest income for the three months ended June 30, 2017 was \$52,000 less from the comparable period in 2016 primarily due to a decrease in the interest rate margin from 3.55% for the second quarter 2016 to 3.50% for the second quarter 2017. Net interest income for the six months ended June 30, 2017 increased \$163,000 over the comparable period in 2016 due primarily

to growth in LCNB's loan portfolio, partially offset by a decrease in the average rate earned on the portfolio.

The provision for loan losses for the three and six months ended June 30, 2017 decreased by \$174,000 and \$249,000, respectively, as compared to the same periods in 2016. Net loan charge-offs for the three and six months ended June 30, 2017 totaled \$168,000 and \$430,000, respectively. This compares to net charge-offs of \$173,000 and \$242,000 for the three and six months ended June 30, 2016, respectively. Non-accrual loans and loans past due 90 days or more and still accruing interest decreased \$1,860,000, from \$5,748,000 or 0.70% of total loans at December 31, 2016, to \$3,888,000 or 0.47% of total loans at June 30, 2017. The decrease is primarily due to two non-accrual commercial real estate loans to the same borrower with a carrying value of \$1,236,000 at December 31, 2016 that were transferred into other real estate owned and subsequently sold during the first quarter 2017.

Non-interest income for the three months ended June 30, 2017 was \$40,000 greater than the comparable period in 2016

primarily due to increases in trust income, service charges and fees on deposit accounts and income from bank owned life

insurance. These increases were largely offset by decreases in gains from the sale of investment securities.

Non-interest

income for the six months ended June 30, 2017 was \$172,000 less than the comparable period in 2016, primarily due to a

\$510,000 decrease in gains from the sales of investment securities, partially offset by increases in the same line items mentioned previously.

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LCNB CORP. AND SUBSIDIARIES

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

Non-interest expense for the three months ended June 30, 2017 was \$143,000 greater than the comparable period in 2016 primarily due to organizational costs for LCNB Risk Management, Inc., the captive insurance agency incorporated by LCNB Corp. during the second quarter 2017, and to increases in salaries and employee benefits, partially offset by a decrease in other real estate owned expenses. Non-interest expense for the six months ended June 30, 2017 was \$181,000 less than the comparable period in 2016, primarily due to a \$380,000 decrease in other real estate owned expenses and to the absence of a \$251,000 penalty incurred during the first quarter 2016 to pre-pay a Federal Home Loan Bank borrowing bearing an interest rate of 5.25%. The borrowing was paid off to reduce future interest expense on long-term debt. These decreases were partially offset by the increases previously mentioned.

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LCNB CORP. AND SUBSIDIARIES

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

Net Interest Income

Three Months Ended June 30, 2017 vs. 2016

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 June 30, 2017 and 2016, 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 June 30, | | | | | |
|---|-----------------------------|-----------------------|---------------------|-----------------------------|-----------------------|---------------------|
| | 2017 | | 2016 | | | |
| | Average Outstanding Balance | Interest Earned/ Paid | Average Yield/ Rate | Average Outstanding Balance | Interest Earned/ Paid | Average Yield/ Rate |
| | (Dollars in thousands) | | | | | |
| Loans (1) | \$811,186 | \$8,823 | 4.36 % | \$784,324 | \$8,892 | 4.56 % |
| Interest-bearing demand deposits | 17,648 | 42 | 0.95 % | 13,132 | 17 | 0.52 % |
| Federal Reserve Bank stock | 2,732 | 82 | 12.04 % | 2,732 | 82 | 12.07 % |
| Federal Home Loan Bank stock | 3,638 | 43 | 4.74 % | 3,638 | 36 | 3.98 % |
| Investment securities: | | | | | | |
| Taxable | 221,481 | 1,149 | 2.08 % | 251,569 | 1,187 | 1.90 % |
| Non-taxable (2) | 145,444 | 1,223 | 3.37 % | 138,191 | 1,207 | 3.51 % |
| Total earnings assets | 1,202,129 | 11,362 | 3.79 % | 1,193,586 | 11,421 | 3.85 % |
| Non-earning assets | 122,646 | | | 112,590 | | |
| Allowance for loan losses | (3,334) | | | (3,103) | | |
| Total assets | \$1,321,441 | | | \$1,303,073 | | |
| Savings deposits | \$666,318 | 153 | 0.09 % | \$658,090 | 174 | 0.11 % |
| IRA and time certificates | 210,327 | 693 | 1.32 % | 217,390 | 696 | 1.29 % |
| Short-term borrowings | 15,030 | 12 | 0.32 % | 14,355 | 8 | 0.22 % |
| Long-term debt | 441 | 3 | 2.73 % | 747 | 5 | 2.69 % |
| Total interest-bearing liabilities | 892,116 | 861 | 0.39 % | 890,582 | 883 | 0.40 % |
| Demand deposits | 271,561 | | | 257,923 | | |
| Other liabilities | 9,938 | | | 10,383 | | |
| Capital | 147,826 | | | 144,185 | | |
| Total liabilities and capital | \$1,321,441 | | | \$1,303,073 | | |
| Net interest rate spread (3) | | | 3.40 % | | | 3.45 % |
| Net interest income and net interest margin on a taxable-equivalent basis (4) | | \$10,501 | 3.50 % | | \$10,538 | 3.55 % |
| Ratio of interest-earning assets to interest-bearing liabilities | 134.75 % | | | 134.02 % | | |

(1)Includes non-accrual loans.

(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 35.0% for 2017 and 34.2% for 2016.

(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 June 30, 2017 as compared to the same period in 2016. 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 June 30, 2017 vs. 2016 | | |
|--------------------------------------|---|---------|--------|
| | Increase (decrease) due to: | | |
| | Volume | Rate | Total |
| | (In thousands) | | |
| Interest-earning Assets: | | | |
| Loans | \$299 | \$(368) | \$(69) |
| Interest-bearing demand deposits | 7 | 18 | 25 |
| Federal Reserve Bank stock | — | — | — |
| Federal Home Loan Bank stock | — | 7 | 7 |
| Investment securities: | | | |
| Taxable | (150) | 112 | (38) |
| Non-taxable | 62 | (46) | 16 |
| Total interest income | 218 | (277) | (59) |
| Interest-bearing Liabilities: | | | |
| Savings deposits | 2 | (23) | (21) |
| IRA and time certificates | (23) | 20 | (3) |
| Short-term borrowings | — | 4 | 4 |
| Long-term debt | (2) | — | (2) |
| Total interest expense | (23) | 1 | (22) |
| Net interest income | \$241 | \$(278) | \$(37) |

Net interest income on a fully taxable-equivalent basis for the three months ended June 30, 2017 totaled \$10,501,000, a decrease of \$37,000 from the comparable period in 2016. Total interest income decreased \$59,000, partially offset by a decrease in total interest expense of \$22,000.

The decrease in total interest income was due primarily to a \$69,000 decrease in loan interest income caused by a 20 basis point (a basis point equals 0.01%) decrease in the average rate earned on loans, partially offset by a \$26.9 million increase in average loans. Also contributing to the total decrease was a \$38,000 decrease in interest income from taxable investment securities caused by a \$30.1 million decrease in average taxable investment securities, partially offset by an 18 basis point increase in the average rate earned on these securities. These decreases were partially offset by a \$25,000 increase in interest from interest-bearing demand deposits and a \$16,000 taxable-equivalent increase in interest from non-taxable investment securities. Interest from interest-bearing demand deposits increased due to a 43 basis point increase in the average rate earned and a \$4.5 million increase in the average balance on deposit. Interest from non-taxable investment securities increased due to a \$7.3 million increase in the

average balance of these securities, partially offset by a 14 basis point decrease in the average rate.

The decrease in total interest expense was due primarily to a 2 basis point decrease in the average rate paid on savings deposits.

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LCNB CORP. AND SUBSIDIARIES

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

Six Months Ended June 30, 2017 vs. 2016

The following table presents, for the six months ended June 30, 2017 and 2016, 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.

| | Six Months Ended June 30, | | | | | |
|---|-----------------------------------|-----------------------------|---------------------------|-----------------------------------|-----------------------------|---------------------------|
| | 2017 | | 2016 | | | |
| | Average Outstanding Balance | Interest Earned/ Paid | Average Yield/ Rate | Average Outstanding Balance | Interest Earned/ Paid | Average Yield/ Rate |
| | (Dollars in thousands) | | | | | |
| Loans (1) | \$812,385 | \$17,738 | 4.40% | \$778,264 | \$17,519 | 4.53 % |
| Interest-bearing demand deposits | 12,993 | 58 | 0.90% | 11,494 | 27 | 0.47 % |
| Federal Reserve Bank stock | 2,732 | 82 | 6.05% | 2,732 | 82 | 6.04 % |
| Federal Home Loan Bank stock | 3,638 | 84 | 4.66% | 3,638 | 73 | 4.04 % |
| Investment securities: | | | | | | |
| Taxable | 218,497 | 2,242 | 2.07% | 252,625 | 2,376 | 1.89 % |
| Non-taxable (2) | 145,049 | 2,452 | 3.41% | 133,894 | 2,359 | 3.54 % |
| Total earnings assets | 1,195,294 | 22,656 | 3.82% | 1,182,647 | 22,436 | 3.82 % |
| Non-earning assets | 123,203 | | | 111,012 | | |
| Allowance for loan losses | (3,445) | | | (3,116) | | |
| Total assets | \$1,315,052 | | | \$1,290,543 | | |
| Savings deposits | \$656,192 | 299 | 0.09% | \$649,930 | 332 | 0.10 % |
| IRA and time certificates | 211,927 | 1,390 | 1.32% | 217,432 | 1,361 | 1.26 % |
| Short-term borrowings | 21,728 | 42 | 0.39% | 17,532 | 22 | 0.25 % |
| Long-term debt | 489 | 7 | 2.89% | 1,002 | 17 | 3.41 % |
| Total interest-bearing liabilities | 890,336 | 1,738 | 0.39% | 885,896 | 1,732 | 0.39 % |
| Demand deposits | 268,776 | | | 251,505 | | |
| Other liabilities | 9,682 | | | 9,826 | | |
| Capital | 146,258 | | | 143,316 | | |
| Total liabilities and capital | \$1,315,052 | | | \$1,290,543 | | |
| Net interest rate spread (3) | | | 3.43% | | | 3.43 % |
| Net interest income and net interest margin on a taxable-equivalent basis (4) | | \$20,918 | 3.53% | | \$20,704 | 3.52 % |
| Ratio of interest-earning assets to interest-bearing liabilities | 134.25 | % | | 133.50 | % | |

(1)Includes non-accrual loans.

(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 35.0% for 2017 and 34.2% for 2016.

(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 six months ended June 30, 2017 as compared to the same period in 2016. 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.

| | Six Months Ended June 30, 2017 vs. 2016 | | |
|----------------------------------|---|---------|-------|
| | Increase (decrease) due to: | | |
| | Volume | Rate | Total |
| | (In thousands) | | |
| Interest-earning Assets: | | | |
| Loans | \$754 | \$(535) | \$219 |
| Interest-bearing demand deposits | 4 | 27 | 31 |
| Federal Reserve Bank stock | — | — | — |
| Federal Home Loan Bank stock | — | 11 | 11 |
| Investment securities: | | | |
| Taxable | (338) | 204 | (134) |
| Non-taxable | 191 | (98) | 93 |
| Total interest income | 611 | (391) | 220 |
| Interest-bearing Liabilities: | | | |
| Savings deposits | 3 | (36) | (33) |
| IRA and time certificates | (35) | 64 | 29 |
| Short-term borrowings | 6 | 14 | 20 |
| Long-term debt | (8) | (2) | (10) |
| Total interest expense | (34) | 40 | 6 |
| Net interest income | \$645 | \$(431) | \$214 |

Net interest income on a fully taxable-equivalent basis for the six months ended June 30, 2017 totaled \$20,918,000, an increase of \$214,000 from the comparable period in 2016. Total interest income increased \$220,000, slightly offset by an increase in total interest expense of \$6,000.

The increase in total interest income was due primarily to a \$219,000 increase in loan interest income caused by a \$34.1 million increase in average loans, partially offset by a 13 basis point decrease in the average rate earned on loans. Also contributing to the total increase was a \$93,000 increase in taxable-equivalent interest income from non-taxable loans caused by an \$11.2 million increase in average non-taxable investment securities, partially offset by a 13 basis point decrease in the average rate earned on these securities. These increases were partially offset by a \$134,000 decrease in interest income from taxable investment securities caused by a \$34.1 million decrease in taxable investment securities, partially offset by an 18 basis point increase in the average rate earned on these securities.

The increase in total interest expense was due primarily to a \$29,000 increase and an \$20,000 increase in interest paid on IRA and time certificates and short-term borrowings, respectively. These increases were partially offset by a \$33,000 decrease and a \$10,000 decrease in interest paid on savings deposits and long-term debt, respectively. IRA and time certificates increased due to a 6 basis point increase in the average rate paid for these certificates, partially offset by a \$5.5 million increase in the average balance of these certificates. Short-term borrowings increased due to a 14 basis point increase in the average rate paid and a \$4.2 million increase in the average balance of the debt. Savings deposits decreased due to a 1 basis point decrease in the average rate paid on these deposits, slightly offset by a \$6.3 million increase in average deposits. Long-term debt decreased due to a \$513,000 decrease in the average balance of the debt and to a 52 basis point decrease in the average rate paid.

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LCNB CORP. AND SUBSIDIARIES

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

Provision and Allowance For Loan Losses

The total provision for loan losses is determined based upon management's evaluation as to the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, and current economic conditions that may affect borrowers' ability to pay. The provision for loan losses for the three and six months ended June 30, 2017 was \$222,000 and \$237,000, respectively, as compared to \$396,000 and \$486,000, respectively, for the same periods in 2016. Net charge-offs for the three and six months ended June 30, 2017 were \$168,000 and \$430,000, respectively, as compared to net charge-offs of \$173,000 and \$242,000, respectively, for the comparable periods in 2016.

Non-Interest Income

Three Months Ended June 30, 2017 vs. 2016

Total non-interest income for the second quarter of 2017 was \$40,000 greater than for the second quarter of 2016 primarily due to a \$106,000 increase in bank owned life insurance income, reflecting mortality benefits received during the second quarter 2017. Also contributing to the increase were a \$44,000 increase in trust income and a \$69,000 increase in service charges and fees on deposit accounts. Service charges and fees on deposit accounts increased due to fee adjustments on certain services and greater customer utilization of other services. These increases were partially offset by a \$139,000 decrease in net gains on sales of securities, reflecting a lower volume of securities sold.

Six Months Ended June 30, 2017 vs. 2016

Total non-interest income for the six months ended June 30, 2017 was \$172,000 less than for the same period in 2016 primarily due to a \$510,000 decrease in net gains from sales of securities, reflecting a lower volume of securities sold. Partially offsetting this decrease were a \$133,000 increase in trust income, a \$98,000 increase in service charges and fees on deposit accounts, and a \$126,000 increase in bank owned life insurance income. These items increased for substantially the same reasons mentioned above.

Non-Interest Expense

Three Months Ended June 30, 2017 vs. 2016

Non-interest expense for the second quarter of 2017 was \$143,000 greater than for the second quarter of 2016 primarily due to a \$171,000 increase in salaries and employee benefits, a \$152,000 increase in contracted services, and a \$132,000 increase in other non-interest expense. Partially offsetting these increases was the absence in 2017 of \$356,000 in other real estate owned expenses recognized during the second quarter of 2016. Salaries and employee benefits increased primarily due to salary and wage increases and an increase in the number of employees. Expenses for contracted services increased largely due to fees paid to professional placement services firms, enhanced utilization of loan review specialists, fees related to an after-hours call answering service, and costs related to moving departments from the Main Office to the new Operations Center. The increase in other non-interest expense is due to \$138,000 in organizational costs for LCNB Risk Management, Inc., a captive insurance agency incorporated by

LCNB during the second quarter 2017. Other real estate owned property held by LCNB during the 2017 period was minimal.

Six Months Ended June 30, 2017 vs. 2016

Non-interest expense for the six months ended June 30, 2017 was \$181,000 less than for the same period in 2016 primarily due to a \$380,000 decrease in other real estate owned expenses, a \$115,000 decrease on FDIC insurance premiums, and the absence of a \$251,000 penalty incurred during the first quarter 2016 to pre-pay a Federal Home Loan Bank borrowing bearing an interest rate of 5.25%. FDIC insurance premiums decreased primarily due to a change in the calculation method used to determine periodic premiums. The borrowing was paid off to reduce future interest expense on long-term debt. These decreases were partially offset by a \$134,000 increase in salaries and employee benefits, a \$173,000 increase in contracted services, and the \$138,000 in organizational costs. The reasons for these increases are substantially the same as those mentioned above.

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LCNB CORP. AND SUBSIDIARIES

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

Income Taxes

LCNB's effective tax rates for the six months ended June 30, 2017 and 2016 were 26.2% and 26.2%, respectively. The difference between the statutory rate of 35.0% for 2017 and the blended statutory rate of 34.2% for 2016 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

Interest-bearing demand deposits, a component of total cash and cash equivalents in the asset section of the balance sheet, was \$10.1 million greater at June 30, 2017 than at December 31, 2016 because of a \$31.8 million increase in public fund deposits. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities. Historically, public fund deposits tend to be at their lowest balances at year-ends.

Available-for-sale investment securities at June 30, 2017 were \$8.1 million greater than at December 31, 2016 and held-to-maturity investment securities were \$2.6 million less at June 30, 2017 than at December 31, 2016. Investment securities in the available-for-sale category increased primarily due to purchases totaling \$27.0 million, partially offset by maturities and calls totaling \$8.3 million and sales of securities with a carrying value of \$12.1 million. Investment securities in the held-to-maturity category decreased primarily due to maturities and calls totaling \$7.9 million, partially offset by purchases totaling \$5.4 million.

Net loans at June 30, 2017 were \$7.3 million greater than at December 31, 2016. Commercial, secured by real estate loans increased \$18.0 million, partially offset by decreases in other lending categories. Residential real estate loans decreased \$7.1 million during the same period. This decrease does not include loans sold in the secondary market, which totaled \$4.4 million for the first half of 2017.

Net premises and equipment at June 30, 2017 was \$4.7 million greater than at December 31, 2016 primarily due to construction costs for the new Operations Center in Lebanon, Ohio.

Total deposits at June 30, 2017 were \$33.0 million greater than at December 31, 2016. Included in this increase was the \$31.8 million increase in public fund deposits by local government entities that was mentioned above.

The increase in total deposits contributed to the \$10.1 million increase in interest-bearing demand deposits mentioned above and to a \$10.3 million decrease in short-term borrowings between the same two dates.

Shareholders' equity at June 30, 2017 was \$5.0 million greater than at December 31, 2016, primarily due to earnings retained and an increase in accumulated other comprehensive income (loss), net of taxes, resulting from market driven increases in the market value of investments securities.

Regulatory Capital

LCNB (consolidated) and the Bank must meet certain minimum capital requirements set by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's and Bank's financial statements. LCNB's and the Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

A new rule requiring a Capital Conservation Buffer began phase-in on January 1, 2016 and will be fully implemented in 2019. 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.

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LCNB CORP. AND SUBSIDIARIES

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

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

| | Minimum Requirement | | Minimum Requirement with Capital Conservation Buffer for 2017 | | To Be Considered Well-Capitalized | |
|---|---------------------|---|---|---|-----------------------------------|---|
| Ratio of Common Equity Tier 1 Capital to risk-weighted assets | 4.5 | % | 5.75 | % | 6.5 | % |
| Ratio of Tier 1 Capital to risk-weighted assets | 6.0 | % | 7.25 | % | 8.0 | % |
| Ratio of Total Capital (Tier 1 Capital plus Tier 2 Capital) to risk-weighted assets | 8.0 | % | 9.25 | % | 10.0 | % |
| Leverage Ratio (Tier 1 Capital to adjusted quarterly average total assets) | 4.0 | % | N/A | | 5.0 | % |

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

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

| | June 30, 2017 | December 31, 2016 | | |
|--|------------------|----------------------|-------|---|
| Regulatory Capital: | | | | |
| Shareholders' equity | \$147,927 | \$142,944 | | |
| Goodwill and other intangibles | (33,208) | (32,676) | | |
| Accumulated other comprehensive (income) loss | 975 | 2,617 | | |
| Tier 1 risk-based capital | 115,694 | 112,885 | | |
| Eligible allowance for loan losses | 3,382 | 3,575 | | |
| Total risk-based capital | \$119,076 | \$116,460 | | |
| Capital ratios: | | | | |
| Common Equity Tier 1 Capital to risk-weighted assets | 13.03 | % | 13.00 | % |
| Tier 1 Capital to risk-weighted assets | 13.03 | % | 13.00 | % |
| Total Capital to risk-weighted assets | 13.41 | % | 13.41 | % |
| Leverage | 8.97 | % | 8.81 | % |

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 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 June 30, 2017, LCNB's liquid assets amounted to \$358.8 million or 26.9% of total assets. This compares to liquid assets totaling \$339.5 million, or 26.0% of total assets, at December 31, 2016.

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LCNB CORP. AND SUBSIDIARIES

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

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

Approximately 82.8% of total deposits at June 30, 2017 were "core" deposits, compared to 85.0% of deposits at December 31, 2016. 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 FHLB, purchase federal funds, issue repurchase agreements, or using lines of credit established with two other banks.

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 June 30, 2017 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 | \$45,669 | 2,408 | 5.57 % |
| Up 200 | 44,778 | 1,517 | 3.51 % |
| Up 100 | 43,994 | 733 | 1.69 % |
| Base | 43,261 | — | — % |

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 June 30, 2017 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 | \$145,310 | (11,410) | (7.28)% |
| Up 200 | 147,994 | (8,726) | (5.57)% |
| Up 100 | 150,411 | (6,309) | (4.03)% |
| Base | 156,720 | — | — % |

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 June 30, 2017, 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

Except for routine litigation incidental to its business, LCNB is not a party to any material pending legal proceedings and none of its property is the subject of any material proceedings.

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 |
|-------------|---|
| 3.1 | <u>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.</u> |
| 3.2 | <u>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).</u> |
| 10.1 | <u>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).</u> |
| 10.2 | <u>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)</u> |
| 10.3 | <u>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.</u> |
| 10.4 | <u>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.</u> |
| 10.5 | <u>Form of Restricted Share Grant Agreement under the LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2015, Exhibit 10.7</u> |
| 31.1 | <u>Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2 | <u>Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32 | <u>Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101 | The following financial information from LCNB Corp.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2017 is formatted in Extensible Business Reporting Language: (i) the Consolidated Condensed Balance Sheets, (ii) the Consolidated Condensed Statements of Income, (iii) the Consolidated Condensed Statements of Comprehensive Income, (iv) the Consolidated Condensed Statements of Shareholders' Equity, (v) the Consolidated Condensed Statements of Cash Flows, and (vi) the Notes to Consolidated Condensed Financial Statements. |

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LCNB CORP. AND SUBSIDIARIES
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.

August 8, 2017 /s/ Steve P. Foster
Steve P. Foster
Chief Executive Officer and President

August 8, 2017 /s/ Robert C. Haines, II
Robert C. Haines, II
Executive Vice President and Chief
Financial Officer