LCNB CORP
Form 10-K
February 26, 2013

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

FORM 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________________ to ________________________

Commission File Number 000-26121

LCNB Corp.
(Exact name of registrant as specified in its charter)

Ohio	31-1626393
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2 North Broadway, Lebanon, Ohio 45036
(Address of principal executive offices, including Zip Code)

(513) 932-1414
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of Each Class	Name of each exchange on which registered
None	None

Securities registered pursuant to 12(g) of the Exchange Act:

COMMON STOCK, NO PAR VALUE
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes x No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

The aggregate market value of the registrant’s outstanding voting common stock held by nonaffiliates on June 30, 2012, determined using a per share closing price on that date of $13.33 as quoted on the NASDAQ Capital Market, was $85,277,689.

As of February 25, 2013, 7,620,914 common shares were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement included in the Notice of Annual Meeting of Shareholders to be held April 23, 2013, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2012 are incorporated by reference into Part III.

LCNB CORP.

For the Year Ended December 31, 2012

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

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

DESCRIPTION OF LCNB CORP.'S BUSINESS

General Description

LCNB Corp., an Ohio corporation formed in December, 1998, is a financial holding company headquartered in Lebanon, Ohio. Substantially all of the assets, liabilities and operations of LCNB Corp. are attributable to its wholly-owned subsidiary, LCNB National Bank (the "Bank"). LCNB Corp. and its subsidiary are herein collectively referred to as “LCNB.”

The predecessor of LCNB Corp., the Bank, was formed as a national banking association in 1877. On May 19, 1999, the Bank became a wholly-owned subsidiary of LCNB Corp. The Bank's main office is located in Warren County, Ohio and 24 branch offices are located in Warren, Butler, Clinton, Clermont, Hamilton, and Montgomery Counties, Ohio. In addition, the Bank operates 31 automated teller machines ("ATMs") in its market area.

On January 11, 2013, LCNB consummated a merger with First Capital Bancshares, Inc. (“First Capital”) in a stock and cash transaction valued at approximately $20.2 million. Immediately following the merger of First Capital into LCNB, Citizens National Bank (“Citizens”), a wholly-owned subsidiary of First Capital, was merged into LCNB National Bank. At that time, Citizens’ six full–service offices became offices of LCNB. Three of these offices are located in Chillicothe, Ohio and one office is located in each of Frankfort, Ohio, Clarksburg, Ohio, and Washington Court House, Ohio.

The Bank is a full service community bank offering a wide range of commercial and personal banking services. Deposit services include checking accounts, NOW accounts, savings accounts, Christmas and vacation club accounts, money market deposit accounts, Classic 50 accounts (a senior citizen program), individual retirement accounts, and certificates of deposit. Deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation (the “FDIC”).

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Loan products offered include commercial and industrial loans, commercial and residential real estate loans, construction loans, various types of consumer loans, and Small Business Administration loans. The Bank's residential mortgage lending activities consist primarily of loans for purchasing or refinancing personal residences, home equity lines of credit, and loans for commercial or consumer purposes secured by residential mortgages. Most fixed-rate residential real estate loans are sold to the Federal Home Loan Mortgage Corporation with servicing retained. Consumer lending activities include automobile, boat, home improvement and personal loans. The Bank also offers indirect financing through various automotive, boat, and lawn and garden dealers.

The Trust and Investment Management Division of the Bank performs complete trust administrative functions and offers agency and trust services, retirement savings products, and mutual fund investment products to individuals, partnerships, corporations, institutions and municipalities.

Security brokerage services are offered by the Bank through arrangements with LPL Financial LLC, a registered broker/dealer. Licensed brokers offer a full range of investment services and products, including financial needs analysis, mutual funds, securities trading, annuities, and life insurance.

Other services offered include safe deposit boxes, night depositories, travelers' checks, money orders, cashier's checks, bank-by-mail, ATMs, cash and transaction services, debit cards, wire transfers, electronic funds transfer, utility bill collections, notary public service, personal computer based cash management services, 24 hour telephone banking, PC Internet banking, mobile banking, and other services tailored for both individuals and businesses.

The Bank is not dependent upon any one significant customer or specific industry. Business is not seasonal to any material degree.

The address of the main office of the Bank is 2 North Broadway, Lebanon, Ohio 45036; telephone (513) 932-1414.

Market Area

LCNB’s primary market area consists of Warren, Butler, and Clinton Counties and portions of Hamilton, Clermont, and Montgomery Counties in Southwestern Ohio. Certain demographic information for Warren, Butler, Clinton, Hamilton, and Montgomery Counties are as follows:

	Warren	Butler	Clinton	Hamilton	Montgomery
Population, 2000 census	158,383	332,807	40,543	845,303	559,062
Population, 2010 census	212,693	368,130	42,040	802,374	535,153
Percentage increase/decrease in population	34.3 %	10.6 %	3.0 %	-5.1 %	-4.3 %
Estimated percentage of persons below poverty level	5.9 %	12.8 %	14.0 %	15.4 %	15.7 %
Estimated median household income	$71,274	$54,788	$46,261	$48,234	$ 43,965
Median age	37.0	35.7	37.7	36.9	38.7
Unemployment rate:					
December 2012	5.6 %	6.0 %	9.7 %	6.2 %	7.0 %
December 2011	7.0 %	7.9 %	11.1 %	7.5 %	8.5 %
December 2010	8.4 %	8.8 %	15.0 %	8.5 %	10.1 %

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Once primarily a rural county (its population according to the 1950 census was only 38,505), Warren County experienced significant growth during the latter half of the twentieth century and into the twenty-first century. Many people who now live in Warren County are employed by companies located in the Cincinnati and Dayton metropolitan areas. People employed within Warren County usually work in the trade, transportation, and utilities sector, the manufacturing sector, the professional and businesses services sector, and the leisure and hospitality sector. A sizable tourist industry that includes King's Island and the Ohio Renaissance Festival provides a number of temporary summer jobs. Not including local government entities and school districts, which are significant sources of employment, the top five major employers in Warren County are Macy's Credit and Customer Service, Procter and Gamble's Mason Business Center, Atrium Medical Center (a hospital), WellPoint (health insurance), and Luxottica.

Butler County was historically a rural area with the exception of three urban centers. Hamilton and Middletown were both manufacturing centers. As is true with many manufacturing communities in the Midwest, many of the manufacturing companies in Hamilton and Middletown have either closed or greatly diminished their workforces and these jobs have been largely replaced with lower-paying service oriented jobs. Oxford is the home of Miami University and Oxford's businesses primarily serve the college students.

Most of the growth in Butler County has occurred in West Chester, Liberty, and Fairfield Townships. Many of the people living in these townships are employed by companies located in the Cincinnati metropolitan area. People employed within Butler County usually work in the trade, transportation, and utilities sectors, the manufacturing sector, the education and health services sectors, the professional and business services sectors, and the leisure and hospitality sector. Not including local government entities and school districts, the top five major employers in Butler County are Miami University, AK Steel, Cincinnati Financial Corp. (insurance), GE Aviation, and Fort Hamilton Hospital. In addition to Fort Hamilton Hospital, Mercy Hospital Fairfield, McCullough-Hyde Memorial Hospital, West Chester Hospital, and Bethesda Butler County TriHealth Hospital are located in Butler County and collectively are a significant source of health-related employment.

Clinton County remains mostly rural. Wilmington, with a 2010 census population of 12,520, is the largest city. The next largest is Blanchester, with a 2010 census population of 4,243. The unemployment rates at December 2010, 2011, and 2012 are unusually high, even for the current economy, because of the loss of a dominant employer. DHL, an overnight shipping company, owned the Wilmington Air Park, a decommissioned air force base, and maintained hub operations at this location. In 2008, Wilmington Air Park discontinued operations, resulting in the direct loss of approximately 8,000 jobs, not including job losses sustained by other businesses dependent on the air park operations. Certain services subcontracted to ABX Air and ASTAR Air Cargo continue, but with greatly diminished work forces.

Hamilton County's economics are dominated by Cincinnati. Fortune 500 companies with their headquarters in Hamilton County include American Financial Group, Federated Department Stores, Fifth Third Bank, The Kroger Company, The Procter & Gamble Company, and Western & Southern Financial Group. The five largest employers are The Kroger Company, The University of Cincinnati, The Procter & Gamble Company, Cincinnati Children's Hospital Medical Center, and the Health Alliance of Greater Cincinnati.

LCNB's two offices in Montgomery County are located in the communities of Oakwood and Centerville. Similar to Cincinnati and Hamilton County, Dayton is the largest city in Montgomery County and dominates the economic demographics of the county. The largest employer of Montgomery County residents is Wright Patterson Air Force Base, which is actually located in Greene County. Large employers located in Montgomery County include Premier Health Partners, Kettering Health Network, LexisNexis, and Honda of America.

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LCNB's market area includes a portion of Clermont County primarily because of a branch office located in Goshen, Ohio. Goshen is a suburb of Cincinnati and many of its residents work in Hamilton County. Goshen's economic demographics are similar to Hamilton County's demographics.

Competition

The Bank faces strong competition both in making loans and attracting deposits. The deregulation of the banking industry and the wide spread enactment of state laws that permit multi-bank holding companies as well as the availability of nationwide interstate banking has created a highly competitive environment for financial services providers. The Bank competes with other national and state banks, savings and loan associations, credit unions, finance companies, mortgage brokerage firms, realty companies with captive mortgage brokerage firms, mutual funds, insurance companies, brokerage and investment banking companies, and other financial intermediaries operating in its market and elsewhere, many of whom have substantially larger financial and managerial resources.

The Bank seeks to minimize the competitive effect of other financial institutions through a community banking approach that emphasizes direct customer access to the Bank's President and other officers in an environment conducive to friendly, informed, and courteous personal services. Management believes that the Bank is well positioned to compete successfully in its primary market area. Competition among financial institutions is based upon interest rates offered on deposit accounts, interest rates charged on loans and other credit and service charges, the quality and scope of the services rendered, the convenience of the banking facilities, and, in the case of loans to commercial borrowers, relative lending limits.

Management believes the commitment of the Bank to personal service, innovation, and involvement in the communities and primary market areas it serves, as well as its commitment to quality community banking service, are factors that contribute to its competitive advantage.

Supervision and Regulation

LCNB Corp., as a financial holding company, is regulated under the Bank Holding Company Act of 1956, as amended (the "Act"), and is subject to the supervision and examination of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). The Act requires the prior approval of the Federal Reserve Board for a bank or financial holding company to acquire or hold more than a 5% voting interest in any bank and restricts interstate banking activities.

On September 29, 1994, the Act was amended by the Interstate Banking and Branch Efficiency Act of 1994, which authorizes interstate bank acquisitions anywhere in the country, effective one year after the date of enactment, and interstate branching by acquisition and consolidation, effective June 1, 1997, in those states that have not opted out by that date.

The Bank is subject to the provisions of the National Bank Act. The Bank is subject to primary supervision, regulation and examination by the Office of the Comptroller of the Currency (the "OCC"). The Bank is also subject to the rules and regulations of the Board of Governors of the Federal Reserve System and the FDIC. Under the Bank Holding Company Act of 1956, as amended, and under Regulations of the Federal Reserve Board pursuant thereto, a bank or financial holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit.

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LCNB Corp. and the Bank are subject to an extensive array of banking laws and regulations that are intended primarily for the protection of the customers and depositors of LCNB's subsidiary. These laws and regulations govern such areas as permissible activities, loans and investments, and rates of interest that can be charged on loans and reserves. LCNB and the Bank also are subject to general U.S. federal laws and regulations and to the laws and regulations of the State of Ohio. Set forth below are brief descriptions of selected laws and regulations applicable to LCNB and the Bank.

The Financial Reform, Recovery and Enforcement Act of 1989 ("FIRREA") provides that a holding company and its controlled insured depository institutions are liable for any loss incurred by the FDIC in connection with the default of any FDIC assisted transaction involving an affiliated insured bank or savings association.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") substantially revised the bank regulatory and funding provisions of the Federal Deposit Insurance Act and several other federal banking statutes. Among its many reforms, FDICIA, as amended:

1. Required regulatory agencies to take "prompt corrective action" with financial institutions that do not meet minimum capital requirements;

2. Established five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized;

3. Imposed significant restrictions on the operations of a financial institution that is not rated well-capitalized or adequately capitalized;

4. Prohibited a depository institution from making any capital distributions, including payments of dividends or paying any management fee to its holding company, if the institution would be undercapitalized as a result;

5. Implemented a risk-based premium system;

6. Required an audit committee to be comprised of outside directors;

7. Required a financial institution with more than $1 billion in total assets to issue annual, audited financial statements prepared in conformity with U.S. generally accepted accounting principles; and

8. Required a financial institution with more than $1 billion in total assets to document, evaluate, and report on the effectiveness of the entity's internal control system and required an independent public accountant to attest to management's assertions concerning the bank's internal control system.

The members of an audit committee for banks with more than $1 billion in total assets must be independent of management. Only a majority, rather than all, of the members of an audit committee for banks with total assets between $500 million and $1 billion must be independent. Financial institutions that are public companies, such as LCNB, are not relieved from their SOX internal control reporting and attestation requirements or their audit committee independence requirements by the provisions of FDICIA.

At December 31, 2012, the Bank was well capitalized based on FDICIA's guidelines.

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The Gramm-Leach-Bliley Act, which amended the Bank Holding Company Act of 1956 and other banking related laws, was signed into law on November 12, 1999. The Gramm-Leach-Bliley Act repealed certain sections of the Glass-Steagall Act and substantially eliminated the barriers separating the banking, insurance, and securities industries. Effective March 11, 2000, qualifying bank holding companies could elect to become financial holding companies. Financial holding companies have expanded investment powers, including affiliating with securities and insurance firms and engaging in other activities that are "financial in nature or incidental to such financial activity" or "complementary to a financial activity." The Gramm-Leach-Bliley Act defines "financial in nature" to include:

1. securities underwriting, dealing, and market making;
2. sponsoring mutual funds and investment companies;
3. insurance underwriting and agency;
4. merchant banking activities; and
5. other activities that the Federal Reserve Board, in consultation with and subject to the approval of the U.S. Department of the Treasury (the "Treasury Department"), determines are financial in nature.

Financial holding companies may commence the activities listed above or acquire a company engaged in any of those activities without additional approval from the Federal Reserve. Notice of the commencement or acquisition must be provided to the Federal Reserve within thirty days of the start of the activity. Sixty days advance notice is required before the start of any activity that is "complementary to a financial activity."

The Sarbanes-Oxley Act of 2002 ("SOX") became effective on July 30, 2002. The purpose of SOX is to strengthen accounting oversight and corporate accountability by enhancing disclosure requirements, increasing accounting and auditor regulation, creating new federal crimes, and increasing penalties for existing federal crimes. SOX directly impacts publicly traded companies, certified public accounting firms auditing public companies, attorneys who work for public companies or have public companies as clients, brokerage firms, investment bankers, and financial analysts who work for brokerage firms or investment bankers. Key provisions affecting LCNB include:

1. Certification of financial reports by the chief executive officer ("CEO") and the chief financial officer ("CFO"), who are responsible for designing and monitoring internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to the certifying officers by others within the company;

2. Inclusion of an internal control report in annual reports that include management's assessment of the effectiveness of a company's internal control over financial reporting and a report by the company's independent registered public accounting firm attesting to the effectiveness of internal control over financial reporting;

3. Accelerated reporting of stock trades on Form 4 by directors and executive officers;

4. Disgorgement requirements of incentive pay or stock-based compensation profits received within twelve months of the release of financial statements if the company is later required to restate those financial statements due to material noncompliance with any financial reporting requirement that resulted from misconduct;

5. Disclosure in a company's periodic reports stating if it has adopted a code of ethics for its CFO and principal accounting officer or controller and, if such code of ethics has been implemented, immediate disclosure of any change in or waiver of the code of ethics;

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6. Disclosure in a company's periodic reports stating if at least one member of the audit committee is a "financial expert," as that term is defined by the Securities and Exchange Commission (the "SEC"); and

7. Implementation of new duties and responsibilities for a company's audit committee, including independence requirements, the direct responsibility to appoint the outside auditing firm and to provide oversight of the auditing firm's work, and a requirement to establish procedures for the receipt, retention, and treatment of complaints from a company's employees regarding questionable accounting, internal control, or auditing matters.

In addition, the SEC adopted final rules on September 5, 2002, which rules were amended in December, 2005, requiring accelerated filing of quarterly and annual reports. Under the amended rules, “large accelerated filers” includes companies with a market capitalization of $700 million or more and “accelerated filers” includes companies with a market capitalization between $75 million and $700 million. Large accelerated filers are required to file their annual reports within 60 days of year-end and quarterly reports within 40 days. Accelerated filers are required to file their annual and quarterly reports within 75 days and 40 days, respectively. These new accelerated filing deadlines were effective for fiscal years ending on or after December 15, 2005. Under the amended rules, LCNB is considered an accelerated filer.

The Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (collectively, the “Deposit Insurance Reform Acts”) were both signed into law during February, 2006. The provisions of the Deposit Insurance Reform Acts included:

1. Merging the Bank Insurance Fund and the Savings Association Insurance Fund into a new fund called the Deposit Insurance Fund, effective March 31, 2006;

2. Increasing insurance coverage for retirement accounts from $100,000 to $250,000, effective April 1, 2006;

3. Adjusting deposit insurance levels of $100,000 for non-retirement accounts and $250,000 for retirement accounts every five years based on an inflation index;

4. Eliminating a 1.25% hard target Designated Reserve Ratio, as defined, and giving the FDIC discretion to set the Designated Reserve Ratio within a range of 1.15% to 1.50% for any given year;

5. Eliminating certain restrictions on premium rates the FDIC charges covered institutions and establishing a risk-based premium system; and

6. Providing for a one-time credit for institutions that paid premiums to the Bank Insurance Fund or the Savings Association Insurance Fund prior to December 31, 1996.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) became effective on July 21, 2010. The Dodd-Frank Act includes provisions that specifically affect financial institutions and other entities providing financial services and other corporate governance and compensation provisions that will affect most public companies.

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The Dodd-Frank Act established a new independent regulatory body within the Federal Reserve System known as the Bureau of Consumer Financial Protection (the "Bureau"). The Bureau has assumed responsibility for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by banks and non-banks. The Bureau has authority to supervise, examine, and take enforcement actions with respect to depository institutions with more than $10 billion in assets, non-bank mortgage industry participants, and other Bureau-designated non-bank providers of consumer financial services. The primary regulator for depository institutions with $10 billion or less in assets will continue to have primary examination and enforcement authority for these institutions. The regulations enforced, however, will be the regulations written by the Bureau.

The Dodd-Frank Act directs federal bank regulators to develop new capital requirements for holding companies and depository institutions that address activities that pose risk to the financial system, such as significant activities in higher risk areas, or concentrations in assets whose reported values are based on models.

The Dodd-Frank Act permanently raised the FDIC maximum deposit insurance amount to $250,000. In addition, the Dodd-Frank Act places a floor on the FDIC's reserve ratio at 1.35% of estimated insured deposits or the comparable percentage of the assessment base.

The Dodd-Frank Act provided for temporary unlimited deposit insurance for non-interest bearing transaction accounts. With several important differences, the unlimited coverage was similar to coverage provided by the FDIC's Transaction Account Guarantee Program (the "TAGP"), which expired December 31, 2010, as extended. The Dodd-Frank Act coverage was in effect from January 1, 2011 to December 31, 2012. All insured institutions had unlimited coverage for non-interest bearing transactions under Dodd-Frank; financial institutions could opt-out of the TAGP. Only non-interest bearing transaction accounts and accounts commonly known as Interest on Lawyers Trust Accounts ("IOLTAs") were covered under the Dodd-Frank provisions. Under TAGP, low-interest NOW accounts were included.

On November 9, 2010, the FDIC issued a final rule implementing Section 343 of the Dodd-Frank Act providing for unlimited insurance coverage of noninterest-bearing transaction accounts and Interest on Lawyers Trust Accounts beginning on December 31, 2010 and ending on December 31, 2012. The extended coverage was available to all depositors including consumer, businesses, and government entities. Money market deposit accounts and NOW accounts were not eligible for the unlimited coverage, even if no interest was paid on the accounts.

General corporate governance provisions included in the Dodd-Frank Act include expanding executive compensation disclosures to be included in the annual proxy statement, requiring non-binding shareholder advisory votes on executive compensation at annual meetings, enhancing independence requirements for compensation committee members and any advisors used by the compensation committee, and requiring the adoption of certain compensation policies including the recovery of executive compensation in the event of a financial statement restatement.

LCNB and the Bank are also subject to the state banking laws of Ohio. Ohio adopted nationwide reciprocal interstate banking effective October, 1988.

Noncompliance with laws and regulations by bank holding companies and banks can lead to monetary penalties and/or an increased level of supervision or a combination of these two items. Management is not aware of any current significant instances of noncompliance with laws and regulations and does not anticipate any problems maintaining compliance on a prospective basis. Recent regulatory inspections and examinations of LCNB and the Bank have not disclosed any significant instances of noncompliance.

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The earnings and growth of LCNB are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government and its agencies, particularly the Federal Reserve Board. Its policies influence the amount of bank loans and deposits and the interest rates charged and paid thereon and thus have an effect on earnings. The nature of future monetary policies and the effect of such policies on the future business and earnings of LCNB and the Bank cannot be predicted.

A substantial portion of LCNB's cash revenues is derived from dividends paid by the Bank. These dividends are subject to various legal and regulatory restrictions. Generally, dividends are limited to the aggregate of current year retained net income, as defined, plus the retained net income of the two prior years. In addition, dividend payments may not reduce capital levels below minimum regulatory guidelines.

Employees

As of December 31, 2012, LCNB employed 217 full-time equivalent employees. LCNB is not a party to any collective bargaining agreement. Management considers its relationship with its employees to be very good. Employee benefit programs are considered by management to be competitive with benefit programs provided by other financial institutions and major employers within LCNB's market area.

Divestitures

In March 2011, LCNB Corp. sold Dakin Insurance Agency Inc. ("Dakin") to an independent insurance agency and therefore its financial results are reported in the income statements as income from discontinued operations, net of tax.

Availability of Financial Information

LCNB files unaudited quarterly financial reports on Form 10-Q, annual financial reports on Form 10-K, current reports on Form 8-K, and amendments to these reports are filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 with the SEC. Copies of these reports are available free of charge in the shareholder information section of the Bank's website, www.lcnb.com, as soon as reasonably practicable after they are electronically filed or furnished to the SEC, or by writing to:

Robert C. Haines II
Executive Vice President, CFO
LCNB Corp.
2 N. Broadway
P.O. Box 59
Lebanon, Ohio 45036

Financial reports and other materials filed by LCNB with the SEC may also be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained from the SEC by calling 1-800-SEC-0330. The SEC also maintains an internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that file reports electronically, as LCNB does.

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FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

LCNB and its subsidiary do not have any offices located in foreign countries and have no foreign assets, liabilities or related income and expense for the years presented.

STATISTICAL INFORMATION

The following tables and certain tables appearing in Item 7, Management's Discussion and Analysis present additional statistical information about LCNB Corp. and its operations and financial condition. They should be read in conjunction with the consolidated financial statements and related notes and the discussion included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 7A, Quantitative and Qualitative Disclosures about Market Risk.

Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential

The table presenting an average balance sheet, interest income and expense, and the resultant average yield for average interest-earning assets and average interest-bearing liabilities is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

The table analyzing changes in interest income and expense by volume and rate is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Investment Portfolio

The following table presents the carrying values of securities for the years indicated:

	At December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Securities available-for-sale:			
U.S. Treasury notes	$ 18,686	17,550	19,585
U.S. Agency notes	90,606	82,927	82,862
U.S. Agency mortgage-backed securities	52,541	52,287	33,094
Corporate securities	3,067	6,365	2,025
Municipal securities	89,723	91,610	96,396
Mutual funds	2,168	2,125	1,053
Trust preferred securities	245	564	604
Equity securities	1,470	578	263
Total securities available-for-sale	258,506	254,006	235,882
Securities held-to-maturity:			
Municipal securities	15,424	10,734	12,141
Federal Reserve Bank stock	949	940	939
Federal Home Loan Bank stock	2,091	2,091	2,091
Total securities	$ 276,970	267,771	251,053

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Contractual maturities of securities at December 31, 2012, were as follows. 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	Yield		Amortized Cost	Fair Value	Yield	
	(Dollars in thousands)							
U.S. Treasury notes:								
Five to ten years	$18,462	18,686	1.10	%	-	-	-	%
Total U.S. Treasury notes	18,462	18,686	1.10	%	-	-	-	%
U.S. Agency notes:								
One to five years	31,264	32,239	1.58	%	-	-	-	%
Five to ten years	58,108	58,367	1.39	%	-	-	-	%
Total U.S. Agency notes	89,372	90,606	1.46	%	-	-	-	%
Corporate securities:								
Within one year	1,000	1,000	2.21	%	-	-	-	%
One to five years	2,032	2,067	1.23	%	-	-	-	%
Total corporate securities	3,032	3,067	1.56	%	-	-	-	%
Municipal securities (1):								
Within one year	7,023	7,091	2.35	%	6,701	6,701	1.67	%
One to five years	38,204	40,325	3.80	%	985	985	3.90	%
Five to ten years	30,206	32,167	4.04	%	3,928	3,928	6.56	%
After ten years	9,922	10,140	3.94	%	3,810	3,810	8.62	%
Total Municipal securities	85,355	89,723	3.78	%	15,424	15,424	4.77	%
U.S. Agency mortgage-backed securities	51,121	52,541	2.41	%	-	-	-	%
Mutual Funds	2,138	2,168	2.48	%	-	-	-	%
Trust preferred securities	250	245	8.13	%	-	-	-	%
Equity securities	1,390	1,470	3.96	%	-	-	-	%
Totals	$251,120	258,506	2.50	%	15,424	15,424	4.77	%

(1) Yields on tax-exempt obligations are computed on a taxable-equivalent basis based upon a 34% statutory Federal income tax rate.

Excluding holdings in U.S. Treasury securities and U.S. Government Agencies, there were no investments in securities of any issuer that exceeded 10% of LCNB's consolidated shareholders' equity at December 31, 2012.

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Loan Portfolio

Administration of the lending function is the responsibility of the Chief Lending Officer and certain senior lenders. Such lenders perform their lending duties subject to oversight and policy direction from the Board of Directors and the Loan Committee. The Loan Committee consists of LCNB's Chief Executive Officer, President, Chief Financial Officer, Cashier, Chief Lending Officer, Chief Credit Officer, Loan Operations Officer, Loan Review Officer, Credit Analysis Officer, and the officers in charge of commercial, consumer, and real estate loans.

Employees authorized to accept loan applications have various, designated lending limits for the approval of loans. A loan application for an amount outside a particular employee's lending limit needs to be approved by an employee with a lending limit sufficient for that loan. Residential and commercial real estate loans of any amount require the approval of two of the following designated officers: Chief Executive Officer, President, Chief Lending Officer, Chief Credit Officer, and the officers in charge of commercial and consumer lending. Any loan in excess of $2.0 million needs the approval of the Board of Directors.

Interest rates charged by LCNB vary with degree of risk, type of loan, amount, complexity, repricing frequency and other relevant factors associated with the loan.

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The following table summarizes the distribution of the loan portfolio for the years indicated:

	At December 31,									
	2012		2011		2010		2009		2008	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Commercial and industrial	$26,236	5.8 %	30,990	6.7 %	36,122	7.9 %	42,807	9.3 %	38,724	8.6 %
Commercial, secured by real estate	230,256	50.7 %	219,188	47.6 %	196,136	43.1 %	185,024	40.2 %	174,493	38.5 %
Residential real estate	183,132	40.4 %	186,904	40.5 %	190,277	41.9 %	193,293	42.0 %	194,039	42.8 %
Consumer	10,554	2.3 %	14,562	3.2 %	19,691	4.3 %	26,185	5.7 %	33,369	7.4 %
Agricultural	1,668	0.4 %	2,835	0.6 %	2,966	0.7 %	3,125	0.7 %	3,216	0.7 %
Other loans, including deposit overdrafts	1,875	0.4 %	6,554	1.4 %	9,413	2.1 %	9,422	2.1 %	9,203	2.0 %
	453,721	100.0 %	461,033	100.0 %	454,605	100.0 %	459,856	100.0 %	453,044	100.0 %
Deferred origination costs, net	62		229		386		560		767	
Total loans	453,783		461,262		454,991		460,416		453,811	
Less allowance for loan losses	3,437		2,931		2,641		2,998		2,468	
Loans, net	$450,346		458,331		452,350		457,418		451,343	

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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 line of credit. Most commercial and industrial loans have a variable rate, with adjustments occurring monthly, annually, every three years, or every five years. Adjustments are generally based on a publicly available index rate plus a margin. The margin varies based on the terms and collateral securing the loan. Commercial and industrial loans are offered to businesses and professionals for short and medium terms on both a collateralized and uncollateralized basis. Commercial and industrial loans typically are underwritten on the basis of the borrower's ability to make repayment from the cash flow of the business. Collateral, when obtained, may include liens on furniture, fixtures, equipment, inventory, receivables, or other assets. As a result, such loans involve complexities, variables, and risks that require thorough underwriting and more robust servicing than other types of loans.

Commercial, Secured by Real Estate Loans. Commercial real estate loans include loans secured by a variety of commercial, retail, and office buildings, religious facilities, multifamily (more than two-family) residential properties, construction and land development loans, and other land loans. Commercial real estate loan products generally amortize over five to twenty-five years and are payable in monthly principal and interest installments. Some have balloon payments due within one to ten years after the origination date. Many have adjustable interest rates with adjustment periods ranging from one to ten years, some of which are subject to established "floor" and "ceiling" 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 collateral value, financial ability of any guarantors, and other factors. Commercial real estate loans are generally originated with a 75 percent 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 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 requires private mortgage insurance for first mortgage loans that have a loan to appraised value ratio of greater than 80%.

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

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

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

As of December 31, 2012, there were no concentrations of loans exceeding 10% of total loans that are not already disclosed as a category of loans in the above table.

The following table summarizes the commercial and agricultural loan maturities and sensitivities to interest rate change at December 31, 2012:

	(Dollars in thousands)	
Maturing in one year or less	$	18,150
Maturing after one year, but within five years		35,077
Maturing beyond five years		204,933
Total commercial and agricultural loans	$	258,160
Loans maturing beyond one year:		
Fixed rate	$	68,152
Variable rate		171,858
Total	$	240,010

Risk Elements

The following table summarizes non-accrual, past-due, and accruing restructured loans for the dates indicated:

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Non-accrual loans	$2,283	3,668	3,761	2,939	2,281
Past-due 90 days or more and still accruing	128	39	300	924	806
Accruing restructured loans	13,343	14,739	9,088	7,173	332
Total	$15,754	18,446	13,149	11,036	3,419
Percent to total loans	3.47 %	4.00 %	2.89 %	2.40 %	0.75 %

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LCNB is not committed to lend additional funds to debtors whose loans have been modified to provide a reduction or deferral of principal or interest because of deterioration in the financial position of the borrower.

At December 31, 2012, there were no material additional loans not already disclosed as non-accrual, accruing restructured, or accruing past due 90 days or more where known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with present loan repayment terms.

Summary of Loan Loss Experience

The table summarizing the activity related to the allowance for loan losses is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

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Allocation of the Allowance for Loan Losses

The following table presents the allocation of the allowance for loan loss:

	At December 31,									
	2012		2011		2010		2009		2008	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
	(Dollars in thousands)									
Commercial and industrial	$320	5.8 %	162	6.7 %	305	7.9 %	546	9.3 %	369	8.6 %
Commercial, secured by real estate	2,296	50.7 %	1,941	47.6 %	1,625	43.1 %	1,628	40.2 %	1,182	38.5 %
Residential real estate	712	40.4 %	656	40.5 %	459	41.9 %	491	42.0 %	471	42.8 %
Consumer	108	2.3 %	166	3.2 %	246	4.3 %	313	5.7 %	429	7.4 %
Agricultural	-	0.4 %	-	0.6 %	-	0.7 %	-	0.7 %	-	0.7 %
Other loans, including deposit overdrafts	1	0.4 %	6	1.4 %	6	2.1 %	9	2.1 %	13	2.0 %
Unallocated	-	- %	-	- %	-	- %	11	- %	4	- %
Total	$3,437	100.0 %	2,931	100.0 %	2,641	100.0 %	2,998	100.0 %	2,468	100.0 %

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Deposits

The statistical information regarding average amounts and average rates paid for the deposit categories is included in the "Distribution of Assets, Liabilities and Shareholders' Equity" table included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following table presents the contractual maturity of time deposits of $100,000 or more at December 31, 2012:

	(Dollars in thousands)	
Maturity within 3 months	$	5,480
After 3 but within 6 months		9,549
After 6 but within 12 months		12,295
After 12 months		37,157
	$	64,481

Return on Equity and Assets

The statistical information regarding the return on assets, return on equity, dividend payout ratio, and equity to assets ratio is presented in Item 6, Selected Financial Data.

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Item 1A. Risk Factors

There are risks inherent in LCNB's operations, many beyond management's control, which may adversely affect its financial condition and results from operations and should be considered in evaluating the company. Credit, market, operational, liquidity, interest rate and other risks are described elsewhere in this report. Other risk factors may include the items described below.

New capital requirements could adversely affect LCNB's capital ratios

The Dodd-Frank Act directs federal bank regulators to develop new capital requirements for holding companies and depository institutions that address activities that pose risk to the financial system, such as significant activities in higher-risk areas, or concentrations in assets whose reported values are based on models.

During June 2012, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation issued three proposed rules that would significantly revise current regulatory capital requirements for financial institutions. Among other items, the proposals, if adopted, would:

- Introduce a new requirement that common equity Tier 1 capital be at least 4.5% of risk-weighted assets;
- Increase the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6%;
- Introduce a new requirement to maintain a capital conservation buffer in excess of other minimum risk-based capital ratios of at least 2.5% of risk-weighted assets;
- Revise capital definitions and risk-weighting categories for various assets; and
- Revise the prompt corrective action framework by increasing category thresholds to reflect the new requirements.

Financial institutions not meeting the 2.5% capital conservation buffer would be subject to limits on capital distributions, including dividend payments to shareholders and treasury share purchases, and would also be limited in awarding certain discretionary bonus payments to executive officers.

If issued as proposed, the new requirements would have phased in starting in 2013 with full implementation in 2019. During November 2012, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation announced that, in light of the volume of comments received and the wide range of views expressed during the comment period, the three agencies did not expect that any of the proposed rules would become effective on January 1, 2013. The exact nature of the final requirements, the timing of implementation, or their impact on LCNB cannot be predicted at this time.

LCNB's financial results may be adversely affected by current economic conditions and resulting government legislation.

The United States economy was in an economic recession during much of 2008 and 2009, which reduced business activity across a wide range of industries and regions. Economic conditions have slowly improved since then, but many government entities and businesses are still experiencing financial difficulties and unemployment remains at historically elevated levels. A direct consequence has been increased loan delinquencies and charge-offs.

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In response, the United States government has established and may continue to establish a variety of new programs and policies designed to mitigate the effects of the recession, stimulate the economy, and reduce the likelihood of future downturns. The nature of future laws and regulations and their effect on LCNB's operations cannot be predicted.

LCNB's earnings are significantly affected by market interest rates.
Fluctuations in interest rates may negatively impact LCNB's profitability. A primary source of income from operations is net interest income, which is equal to the difference between interest income earned on loans and investment securities and the interest paid for deposits and other borrowings. These rates are highly sensitive to many factors beyond LCNB's control, including general economic conditions, the slope of the yield curve (that is, the relationship between short and long-term interest rates), and the monetary and fiscal policies of the United States Federal government. LCNB expects the current level of interest rates and the current slope of the yield curve will cause further downward pressure on its net interest margin.

Increases in general interest rates could have a negative impact on LCNB's results of operations by reducing the ability of borrowers to repay their current loan obligations. Some residential real estate mortgage loans, most home equity line of credit loans, and many of LCNB's commercial loans have adjustable rates. Borrower inability to make scheduled loan payments due to a higher loan cost could result in increased loan defaults, foreclosures, and write-offs and may necessitate additions to the allowance for loan losses. In addition, increases in the general level of interest rates may decrease the demand for new consumer and commercial loans, thus limiting LCNB's growth and profitability. A general increase in interest rates may also result in deposit disintermediation, which is the flow of deposits away from banks and other depository institutions into direct investments that have the potential for higher rates of return, such as stocks, bonds, and mutual funds. If this occurs, LCNB may have to rely more heavily on borrowings as a source of funds in the future, which could negatively impact its net interest margin.

Gains from sales of mortgage loans may experience significant volatility.
Gains from sales of mortgage loans are highly influenced by the level and direction of mortgage interest rates, real estate activity, and refinancing activity. Current historically low market interest rates created a refinancing demand for residential fixed-rate mortgage loans. The increased volume of refinancing activity increased gains from sales of mortgage loans as LCNB sold most of these loans to the Federal Home Loan Mortgage Corporation. An increase in market interest rates may decrease the demand for refinanced loans and decrease the gains from sales of mortgage loans recognized in LCNB's consolidated statements of income. Gains from sales of mortgage loans may also be impacted by changes in LCNB's strategy to manage its residential mortgage portfolio. For example, LCNB may occasionally change the proportion of loan originations that are sold in the secondary market and instead add a greater proportion to its loan portfolio.

Increasing regulation of interchange reimbursement fees may affect LCNB's earnings.
The Federal Reserve enacted a rule, effective October 1, 2011, setting the maximum interchange fee an electronic debit card issuer with more than $10 billion in assets may receive at the sum of 21 cents per transaction plus five basis points multiplied by the value of the transaction. The Federal Reserve also issued a rule that allows for an upward adjustment of at most one cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures to achieve the fraud prevention standards detailed in the interim final rule. Although institutions with less than $10 billion in assets, including LCNB, are exempt from the new rules, many within the financial institutions industry believe that smaller institutions will need to match the pricing of those institutions with assets greater than $10 billion or lose business to the larger institutions.

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Banking competition in Southwestern Ohio is intense.
LCNB faces strong competition for deposits, loans, trust accounts, and other services from other banks, savings banks, credit unions, mortgage brokers, and other financial institutions. Many of LCNB's competitors include major financial institutions that have been in business for many years and have established customer bases, numerous branches, and substantially higher regulatory lending limits. Competitors in the Southwestern Ohio area include U.S. Bank, PNC Bank, Fifth Third Bank, Chase, KeyBank, Park National Bank, Huntington National Bank, and First Financial Bank. In addition, credit unions are growing larger due to more flexible membership requirement regulations and are offering more financial services than they legally could in the past.

LCNB also competes with numerous real estate brokerage firms, some owned by realty companies, for residential real estate mortgage loans. Incentives offered by captive finance companies owned by the major automobile companies, primarily Ally Bank (formerly General Motors Acceptance Corporation) and Ford Motor Credit Company, have limited the banking industry's opportunities for growth in the new automobile loan market. The banking industry now competes with brokerage firms and mutual fund companies for funds that would have historically been held as bank deposits. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of these competitors have fewer regulatory constraints and may have lower cost structures.

If LCNB is unable to attract and retain loan, deposit, brokerage, and trust customers, its growth and profitability levels may be negatively impacted.

Economic conditions in Southwestern Ohio could adversely affect LCNB's financial condition and results of operations.
LCNB has 31 offices located in Warren, Butler, Clinton, Clermont, Hamilton, Fayette, Ross, and Montgomery Counties in Southern Ohio. As a result of this geographic concentration, LCNB's results are heavily influenced by economic conditions in this area. A further deterioration in economic conditions or a natural or manmade disaster in Southwestern Ohio or Ohio in general could have a material adverse impact on the ability of borrowers to make scheduled loan payments, the fair value of underlying loan collateral, the ability of depositors to maintain or add to deposit balances, the demand for trust and brokerage services, and the demand for other products and services offered by LCNB.

The allowance for loan losses may be inadequate.
The provision for loan losses is determined by management based upon its evaluation of the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated 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, the fair value of any underlying collateral, borrowers' cash flows, and current economic conditions that may affect borrowers' ability to make payments. Increases in the allowance result in an expense for the period. By its nature, the evaluation is imprecise and requires significant judgment. Actual results may vary significantly from management's assumptions. If, as a result of general economic conditions or a decrease in asset quality, management determines that additional increases in the allowance for loan losses are necessary, LCNB will incur additional expenses.

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LCNB's loan portfolio includes a substantial amount of commercial and industrial loans and commercial real estate loans, which may have more risks than residential or consumer loans.
LCNB's commercial and industrial and commercial real estate loans comprise a substantial portion of its total loan portfolio. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity, residential mortgage, or consumer loans. The increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans, the size of loan balances, the effects of general economic conditions on income-producing properties, and the increased difficulty of evaluating and monitoring these types of loans.

The repayment of loans secured by commercial real estate is often dependent upon the successful operation, development, or sale of the related real estate or commercial business and may, therefore, be subject to adverse conditions in the real estate market or economy. If the cash flow from operations is reduced, the borrower's ability to repay the loan may be impaired. In such cases, LCNB may take one or more actions to protect its financial interest in the loan. Such actions may include foreclosure on the real estate securing the loan, taking possession of other collateral that may have been pledged as security for the loan, or modifying the terms of the loan. If foreclosed on, commercial real estate is often unique and may not be as salable as a residential home.

The fair value of LCNB's investments could decline.
Most of LCNB's investment securities portfolio is designated as available-for-sale. Accordingly, unrealized gains and losses, net of tax, in the estimated fair value of the available-for-sale portfolio is recorded as other comprehensive income, a separate component of shareholders' equity. The fair value of LCNB's investment portfolio may decline, causing a corresponding decline in shareholders' equity. Management believes that several factors will affect the fair values of the investment portfolio including, but not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation, and the slope of the interest rate yield curve. These and other factors may impact specific categories of the portfolio differently and the effect any of these factors may have on any specific category of the portfolio cannot be predicted.

Approximately 38% of LCNB's investment securities portfolio at December 31, 2012 was composed of municipal securities. Many state and local governmental authorities have experienced deterioration of financial condition in recent years due to declining tax revenues, increased demand for services, and various other factors. To the extent LCNB has any municipal securities in its portfolio from issuers who are experiencing deterioration of financial condition or who may experience future deterioration of financial condition, the value of such securities may decline and could result in other-than-temporary impairment charges, which could have an adverse effect on LCNB's financial condition and results of operations. Additionally, a general, industry-wide decline in the fair value of municipal securities could significantly affect LCNB's financial condition and results of operations.

Changes in income tax laws or interpretations or in accounting standards could materially affect LCNB's financial condition or results of operations.
Changes in income tax laws could be enacted, or interpretations of existing income tax laws could change, causing an adverse effect to LCNB's financial condition or results of operations. Similarly, new accounting standards may be issued by the Financial Accounting Standards Board (the "FASB") or existing standards revised, changing the methods for preparing financial statements. These changes are not within LCNB's control and may significantly impact its reported financial condition and results of operations. FASB is currently working on various projects, including accounting for impaired financial instruments and accounting for leases.

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LCNB is subject to environmental liability risk associated with lending activities.
A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Bank to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Bank's exposure to environmental liability. Although the Bank has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on LCNB's financial condition and results of operations.

The banking industry is highly regulated.
LCNB is subject to regulation, supervision, and examination by the Federal Reserve Board and the Bank is subject to regulation, supervision, and examination by the OCC. LCNB and the Bank are also subject to regulation and examination by the FDIC as the deposit insurer. The Bureau of Consumer Financial Protection is responsible for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by banks. Federal and state laws and regulations govern numerous matters including, but not limited to, changes in the ownership or control of banks, maintenance of adequate capital, permissible business operations, maintenance of deposit insurance, protection of customer financial privacy, the level of reserves held against deposits, restrictions on dividend payments, the making of loans, and the acceptance of deposits. See the previous section titled "Supervision and Regulation" for more information on this subject.

Federal regulators may initiate various enforcement actions against a financial institution that violates laws or regulations or that operates in an unsafe or unsound manner. These enforcement actions may include, but are not limited to, the assessment of civil money penalties, the issuance of cease-and-desist or removal orders, and the imposition of written agreements.

Proposals to change the laws governing financial institutions are periodically introduced in Congress and proposals to change regulations are periodically considered by the regulatory bodies. Such future legislation and/or changes in regulations could increase or decrease the cost of doing business, limit or expand permissible activities, or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The likelihood of any major changes in the future and their effects are impossible to determine.

FDIC deposit insurance assessments may materially increase in the future.
Bank and thrift failures during 2009 and 2008 coupled with deteriorating economic conditions significantly decreased the deposit insurance fund's reserve ratio. The FDIC developed and implemented a restoration plan that included a special assessment on all member financial institutions in early 2009, followed by a required prepayment in December 2009 of premiums relating to the period for 2010 through 2012. The FDIC implemented a new assessment base during 2011 that uses total assets and tier one capital as opposed to deposits. LCNB's premiums decreased under the new assessment base, but the likelihood of future rate increases and the imposition of additional special assessments are indeterminable.

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The FDIC may borrow up to $100 billion from the U.S. Treasury. Although no borrowings were outstanding at December 31, 2012, LCNB cannot predict if the FDIC will borrow funds in the future. The source for repaying any future borrowings will be the premiums paid by financial institutions, which may necessitate additional rate increases or special assessments.

Future growth and expansion opportunities may contain risks.
From time to time LCNB may seek to acquire other financial institutions or parts of those institutions or may engage in de novo branch expansion. It may also consider and enter into new lines of business or offer new products or services. Such activities involve a number of risks, which may include potential inaccuracies in estimates and judgments used to evaluate the expansion opportunity, diversion of management and employee attention, lack of experience in a new market or product or service, and difficulties in integrating a future acquisition or introducing a new product or service. There is no assurance that such growth or expansion activities will be successful or that they will achieve desired profitability levels.

LCNB’s controls and procedures may fail or be circumvented.
Management regularly reviews and updates LCNB’s internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of LCNB’s controls and procedures or failure to comply with regulations related to its controls and procedures could have a material adverse effect on LCNB’s business, results of operations, and financial condition.

LCNB’s information systems may experience an interruption or breach in security.
LCNB relies heavily on communications and information systems to conduct its business. Any failure, interruption, or breach in security of these systems could result in failures or disruptions in LCNB’s customer relationship management, general ledger, deposit, loan, and other systems. While LCNB has policies and procedures designed to prevent or limit the effect of the failure, interruption, or security breach of its information systems, there can be no assurance that any such occurrences will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions, or security breaches of LCNB’s information systems could damage LCNB’s reputation, result in a loss of customer business, subject LCNB to additional regulatory scrutiny, or expose LCNB to civil litigation and possible financial liability, any of which could have a material adverse effect on its financial condition and results of operations.

Risk factors related to LCNB’s trust business.
Competition for trust business is intense. Competitors include other commercial bank and trust companies, brokerage firms, investment advisory firms, mutual fund companies, accountants, and attorneys.

LCNB’s trust business is directly affected by conditions in the debt and equity securities markets. The debt and equity securities markets are affected by, among other factors, domestic and foreign economic conditions and the monetary and fiscal policies of the United States Federal government, all of which are beyond LCNB’s control. Changes in economic conditions may directly affect the economic performance of the trust accounts in which clients’ assets are invested. A decline in the fair value of the trust accounts caused by a decline in general economic conditions directly affects LCNB’s trust fee income because such fees are primarily based on the fair value of the trust accounts. In addition, a sustained decrease in the performance of the trust accounts or a lack of sustained growth may encourage clients to seek alternative investment options.

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The management of trust accounts is subject to the risk of mistaken distributions, poor investment choices, and miscellaneous other incorrect decisions. Such mistakes may give rise to surcharge actions by beneficiaries, with damages substantially in excess of the fees earned from management of the accounts.

LCNB's ability to pay cash dividends is limited.
LCNB is dependent upon the earnings of the Bank for funds to pay dividends on its common shares. The payment of dividends by LCNB and the Bank is subject to certain regulatory restrictions. As a result, any payment of dividends in the future will be dependent, in large part, on the ability of LCNB and the Bank to satisfy these regulatory restrictions and on the Bank's earnings, capital levels, financial condition, and other factors. Although LCNB's financial earnings and financial condition have allowed it to declare and pay periodic cash dividends to shareholders, there can be no assurance that the current dividend policy or the amount of dividend distributions will continue in the future.

Item 1B. Unresolved Staff Comments

Not applicable

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Item 2. Properties

The Bank conducts its business from the following offices:

	Name of Office	Address	
1.	Main Office	2 North Broadway Lebanon, Ohio 45036	Owned
2.	Auto Bank	Silver and Mechanic Streets Lebanon, Ohio 45036	Owned
3.	Centerville Office	9605 Dayton-Lebanon Pike Centerville, Ohio 45458	Owned
4.	Colerain Township Office	3209 West Galbraith Road Cincinnati, Ohio 45239	Owned
5.	Columbus Avenue Office	730 Columbus Avenue Lebanon, Ohio 45036	Owned
6.	Fairfield Office	765 Nilles Road Fairfield, Ohio 45014	Leased
7.	Goshen Office	6726 Dick Flynn Blvd. Goshen, Ohio 45122	Owned
8.	Hamilton Office	794 NW Washington Blvd. Hamilton, Ohio 45013	Owned
9.	Hunter Office	3878 State Route 122 Franklin, Ohio 45005	Owned
10.	Loveland Office	500 Loveland-Madeira Road Loveland, OH 45140	Owned
11.	Maineville Office	7795 South State Route 48 Maineville, Ohio 45039	Owned
12.	Mason/West Chester Office	1050 Reading Road Mason, Ohio 45040	Owned
13.	Mason Christian Village Office	Mason Christian Village 411 Western Row Road Mason, Ohio 45040	Leased
14.	Middletown Office	4441 Marie Drive Middletown, Ohio 45044	Owned

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	Name of Office	Address	
15.	Monroe Office	101 Clarence F. Warner Drive Monroe, Ohio 45050	Owned
16.	Oakwood Office	2705 Far Hills Avenue Oakwood, Ohio 45419	(2)
17.	Okeana Office	6225 Cincinnati-Brookville Road Okeana, Ohio 45053	Owned
18.	Otterbein Office	Otterbein Retirement Community State Route 741 Lebanon, Ohio 45036	Leased
19.	Oxford Office (1)	30 West Park Place Oxford, Ohio 45056	(2)
20.	Rochester/Morrow Office	Route 22-3 at 123 Morrow, Ohio 45152	Owned
21.	South Lebanon Office	603 Corwin Nixon Blvd. South Lebanon, Ohio 45065	Owned
22.	Springboro/Franklin Office	525 West Central Avenue Springboro, Ohio 45066	Owned
23.	Warrior Office	Lebanon High School 1916 Drake Road Lebanon, Ohio 45036	Leased
24.	Waynesville Office	9 North Main Street Waynesville, Ohio 45068	Owned
25.	Wilmington Office	1243 Rombach Avenue Wilmington, Ohio 45177	Owned

(1) Excess space in this office is leased to third parties.
(2) The Bank owns the Oakwood and Oxford office buildings and leases the land.

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On January 11, 2013, First Capital merged into LCNB Corp. and First Capital's wholly owned subsidiary, Citizens National Bank, merged into LCNB National Bank. At that time, the following locations became offices of LCNB:

	Name of Office	Address	
1.	Chillicothe Office	33 West Main Street Chillicothe, Ohio 45601	Owned
2.	Frankfort Office	Springfield and Main Streets Frankfort, Ohio 45628	Owned
3.	Western Avenue Office	1006 Western Avenue Chillicothe, Ohio 45601	Owned
4.	Bridge Street Office	1240 North Bridge Street Chillicothe, Ohio 45601	Owned
5.	Washington Court House Office	100 Crossings Drive Washington Court House, Ohio 43160	(1)
6.	Clarksburg Office	10820 Main Street Clarksburg, Ohio 43115	Owned

(1) The Bank owns the Washington Court House office building and leases the land.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not Applicable

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.

LCNB had approximately 654 registered holders of its common stock as of December 31, 2012. The number of shareholders includes banks and brokers who act as nominees, each of whom may represent more than one shareholder. On September 8, 2011, LCNB's stock began trading on the NASDAQ Capital Market exchange under the symbol "LCNB." Before that date, it traded on the NASDAQ Over-The-Counter Bulletin Board, also under the symbol "LCNB." Trade prices for shares of LCNB Common Stock are set forth below. Prior to its listing on the NASDAQ Capital Market exchange, trade prices for shares of LCNB common stock were reported through registered securities dealers and trades could have occurred during those periods without the knowledge of LCNB. The trade prices shown below are interdealer without retail markups, markdowns, or commissions.

	2012		2011	
	High	Low	High	Low
First Quarter	$ 13.44	12.34	12.25	11.56
Second Quarter	14.49	12.80	13.00	11.70
Third Quarter	13.75	12.84	14.22	11.85
Fourth Quarter	14.49	13.10	13.70	12.22

The following table presents cash dividends per share declared and paid in the periods shown.

	2012	2011
First Quarter	$ 0.16	0.16
Second Quarter	0.16	0.16
Third Quarter	0.16	0.16
Fourth Quarter	0.16	0.16
Total	$ 0.64	0.64

It is expected that LCNB will continue to pay dividends on a similar schedule, to the extent permitted by business and other factors beyond management's control.

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, as defined, for the current year plus retained net income for the previous two years. Prior approval from the OCC, the Bank's primary regulator, would be 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 ordinary dividends to LCNB without needing to request approval.

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

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On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two of which continue to be in effect – the "Market Repurchase Program and the "Private Sale Repurchase Program." Any shares purchased will be held for future corporate purposes.

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares. Through December 31, 2012, 290,444 shares have been purchased under this program. No shares were purchased under the Market Repurchase Program during 2012.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. There is no limit to the number of shares that may be purchased under this program. A total of 466,018 shares have been purchased under this program since its inception through December 31, 2012. No shares were purchased under the Private Sale Repurchase Program during 2012.

LCNB established an Ownership Incentive Plan during 2002 that allows for the issuance of up to 200,000 shares of stock-based awards to eligible employees, as determined by the Board of Directors. The awards may be in the form of stock options, share awards, and/or appreciation rights. The following table shows information relating to stock options outstanding at December 31, 2012:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance
Equity compensation plans approved by security holders	110,586	$ 12.42	87,270
Equity compensation plans not approved by security holders	-	-	-
Total	110,586	$ 12.42	87,270

A total of 2,511 restricted shares were granted to an executive officer in February 2010 and vested in November 2010. Until they vested, they were restricted from sale, transfer, or assignment in accordance with the terms of the agreement under which they were issued. At the date of vesting, the shares were issued from treasury stock and, therefore, did not affect the number of securities remaining available for future issuance in the table above. No restricted shares were granted prior to February 2010 or during 2011 or 2012.

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The graph below provides an indicator of cumulative total shareholder returns for LCNB as compared with the NASDAQ Composite, the SNL Midwest OTC-BB and Pink Sheet Banks, and the SNL Midwest Bank indexes. This graph covers the period from December 31, 2007 through December 31, 2012. The cumulative total shareholder returns included in the graph reflect the returns for the shares of common stock of LCNB. The information provided in the graph assumes that $100 was invested on December 31, 2007 in LCNB common stock, the NASDAQ Composite, the SNL Midwest OTC-BB and Pink Sheet Banks, and the SNL Midwest Bank Index and that all dividends were reinvested.

LCNB Corp.

	Period Ending					
Index	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12
LCNB Corp.	100.00	83.09	103.45	124.18	141.76	157.27
NASDAQ Composite	100.00	60.02	87.24	103.08	102.26	120.42
SNL Midwest OTC-BB and Pink Banks Index	100.00	74.53	63.59	67.50	66.87	77.21
SNL Midwest Bank	100.00	65.79	55.75	69.23	65.39	78.71

Source : SNL Financial LC, Charlottesville, VA

www.snl.com

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Item 6. Selected Financial Data

The following represents selected consolidated financial data of LCNB for the years ended December 31, 2008 through 2012 and are derived from LCNB's consolidated financial statements. Certain prior year data presented in this table have been reclassified to conform with the current year presentation. This data should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 8 of this Form 10-K and Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures about Market Risk included in Items 7 and 7A, respectively, of this Form 10-K, and are qualified in their entirety thereby and by other detailed information elsewhere in this Form 10-K.

	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands, except ratios and per share data)				
Income Statement:					
Interest income	$29,938	32,093	34,031	34,898	34,398
Interest expense	4,889	6,387	8,334	10,060	13,421
Net interest income	25,049	25,706	25,697	24,838	20,977
Provision for loan losses	1,351	2,089	1,680	1,400	620
Net interest income after provision for loan losses	23,698	23,617	24,017	23,438	20,357
Non-interest income	9,049	7,764	8,887	7,180	6,759
Non-interest expenses	21,682	21,849	21,277	20,686	18,555
Income before income taxes	11,065	9,532	11,627	9,932	8,561
Provision for income taxes	2,795	2,210	2,494	2,245	2,134
Net income from continuing operations	8,270	7,322	9,133	7,687	6,427
Income from discontinued operations, net of tax	-	793	240	79	176
Net income	8,270	8,115	9,373	7,766	6,603
Preferred stock dividends and discount accretion	-	-	-	1,108	-
Net income available to common shareholders	8,270	8,115	9,373	6,658	6,603
Dividends per common share	$0.64	0.64	0.64	0.64	0.64
Basic earnings per common share:					
Continuing operations	1.23	1.09	1.37	0.99	0.96
Discontinued operations	-	0.12	0.03	0.01	0.03
Diluted earnings per common share:					
Continuing operations	1.22	1.08	1.36	0.98	0.96
Discontinued operations	-	0.12	0.03	0.01	0.03
Balance Sheet:					
Securities	$276,970	267,771	251,053	217,639	139,272
Loans, net	450,346	458,331	452,350	457,418	451,343
Total assets	788,637	791,570	760,134	734,409	649,731
Total deposits	671,471	663,562	638,539	624,179	577,622
Short-term borrowings	13,756	21,596	21,691	14,265	2,206
Long-term debt	13,705	21,373	23,120	24,960	5,000
Total shareholders' equity	82,006	77,960	70,707	65,615	58,116

Selected Financial Ratios and Other Data:										
Return on average assets	1.02	%	1.02	%	1.22	%	1.07	%	1.03	%
Return on average equity	10.22	%	10.89	%	13.36	%	10.43	%	11.35	%
Equity-to-assets ratio	10.40	%	9.85	%	9.30	%	8.93	%	8.94	%
Dividend payout ratio	52.03	%	52.89	%	45.71	%	64.39	%	64.65	%
Net interest margin, fully taxable equivalent	3.52	%	3.70	%	3.89	%	3.96	%	3.74	%

Dakin was sold during the first quarter 2011 and therefore the net gain on the sale and Dakin’s financial operating results are reported in the income statements as income from discontinued operations, net of tax.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following is management's discussion and analysis of the consolidated financial condition and consolidated results of operations of LCNB. It is intended to amplify certain financial information regarding LCNB and should be read in conjunction with the Consolidated Financial Statements and related Notes and the Financial Highlights contained in the 2012 Annual Report to Shareholders.

Forward-Looking Statements

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

Overview

Net income for 2012 was $8,270,000, compared to $8,115,000 in 2011 and $9,373,000 in 2010. Total basic earnings per common share for 2012, 2011, and 2010 were $1.23, $1.21, and $1.40, respectively. Total diluted earnings per common share for 2012, 2011, and 2010 were $1.22, $1.20, and $1.39, respectively.

The following items significantly affected earnings for the years indicated:

- Gains from sales of securities were significantly greater in 2012 when compared to 2011 and 2010.
- Gains from sales of mortgage loans were greater in 2012 and 2010 as compared to 2011 due to higher volumes of residential mortgage loan refinancings.
- Bank owned life insurance income was greater during 2010 due to death benefits received. No death benefits were received during 2012 or 2011.
- FDIC premiums for 2012 and 2011 were less than for 2010 due to a change in the assessment base.
- Other real estate owned expense was greater during 2012 and 2010 as compared to 2011 because of valuation write-downs and related increases in holding costs. Other real estate owned expense for 2011 included a loss recognized on the sale of commercial property.
- Income from discontinued operations, net of tax, for 2011 includes a gain from the sale of Dakin Insurance Agency.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Net Interest Income

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 years indicated, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resulting average yields earned or rates paid.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

	Years ended December 31,								
	2012			2011			2010		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Averag Yield/ Rate
	(Dollars in thousands)								
Loans (1)	$457,519	23,585	5.15%	$458,049	$25,502	5.57%	$458,708	$27,020	5.89
Interest-bearing demand deposits	11,031	25	0.23%	13,296	32	0.24%	20,876	51	0.24
Federal Reserve Bank Stock	947	57	6.02%	940	56	5.96%	940	56	5.96
Federal Home Loan Bank Stock	2,091	93	4.45%	2,091	89	4.26%	2,091	92	4.40
Investment securities:									
Taxable	192,284	3,737	1.94%	176,922	3,843	2.17%	133,556	3,686	2.76
Nontaxable (2)	83,342	3,698	4.44%	78,917	3,895	4.94%	85,718	4,736	5.53
Total earning assets	747,214	31,195	4.17%	730,215	33,417	4.58%	701,889	35,641	5.08
Non-earning assets	63,760			64,735			66,489		
Allowance for loan losses	(2,877)			(2,936)			(2,815)		
Total assets	$808,097			$792,014			$765,563		
Savings deposits	$138,656	265	0.19%	$122,987	452	0.37%	$108,734	653	0.60
NOW and money fund	244,225	347	0.14%	232,418	667	0.29%	221,926	1,282	0.58
IRA and time certificates	191,129	3,705	1.94%	219,174	4,583	2.09%	231,971	5,678	2.45
Short-term borrowings	12,648	16	0.13%	12,415	28	0.23%	7,606	27	0.35
Long-term debt	18,219	556	3.05%	22,733	657	2.89%	23,826	694	2.91
Total interest-bearing liabilities	604,877	4,889	0.81%	609,727	6,387	1.05%	594,063	8,334	1.40
Demand deposits	115,087			101,781			95,273		
Other liabilities	7,188			5,964			6,059		
Capital	80,945			74,542			70,168		
Total liabilities and capital	$808,097			$792,014			$765,563		
Net interest rate spread (3)			3.37%			3.53%			3.68
Net interest income and net interest margin on a tax equivalent basis (4)		26,306	3.52%		$27,030	3.70%		$27,307	3.89
Ratio of interest-earning assets to interest-bearing liabilities	123.53 %			119.76 %			118.15 %		

(1) Includes non-accrual loans if any.

(2)

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

(3) The net interest spread is the difference between the average rate on total interest-earning assets and interest-bearing liabilities.

(4) The net interest margin is the taxable-equivalent net interest income divided by average interest-earning assets.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table presents the changes in 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 years indicated. 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.

	For the years ended December 31,					
	2012 vs. 2011			2011 vs. 2010		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income attributable to:						
Loans (1)	$(29)	(1,888)	(1,917)	(39)	(1,479)	(1,518)
Interest-bearing demand deposits	(5)	(2)	(7)	(18)	(1)	(19)
Federal Reserve Bank stock	-	1	1	-	-	-
Federal Home Loan Bank stock	-	4	4	-	(3)	(3)
Investment securities:						
Taxable	318	(424)	(106)	1,043	(886)	157
Nontaxable (2)	211	(408)	(197)	(359)	(482)	(841)
Total interest income	495	(2,717)	(2,222)	627	(2,851)	(2,224)
Interest expense attributable to:						
Savings deposits	52	(239)	(187)	77	(278)	(201)
NOW and money fund	32	(352)	(320)	58	(673)	(615)
IRA and time certificates	(559)	(319)	(878)	(301)	(794)	(1,095)
Short-term borrowings	1	(13)	(12)	13	(12)	1
Long-term debt	(136)	35	(101)	(32)	(5)	(37)
Total interest expense	(610)	(888)	(1,498)	(185)	(1,762)	(1,947)
Net interest income	$1,105	(1,829)	(724)	812	(1,089)	(277)

(1) Non-accrual loans, if any, are included in average loan balances.

(2) Change in interest income from nontaxable investment securities is computed based on interest income determined on a taxable-equivalent yield basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34%.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

2012 vs. 2011. Net interest income on a fully tax-equivalent basis for 2012 totaled $26,306,000, a decrease of $724,000 from 2011. The decrease resulted from a decrease in total taxable-equivalent interest income of $2,222,000, partially offset by a decrease in total interest expense of $1,498,000.

The decrease in taxable-equivalent interest income was due to a 41 basis point (a basis point equals 0.01%) decrease in the average rate earned on interest-earning assets, partially offset by a $17.0 million increase in total average interest-earning assets. The decrease in average rates earned was primarily due to general decreases in market rates. The increase in average interest-earning assets occurred primarily in the investment securities portfolio, which grew $19.8 million on an average basis.

Interest expense decreased primarily due to a 24 basis point decrease in the average rate paid on interest-bearing liabilities and to a $4.9 million decrease in total average interest-bearing liabilities. Savings deposits and NOW and money fund deposits grew a combined total of $27.5 million on an average basis, while average IRA and time certificates decreased $28.0 million. Average long-term debt decreased $4.5 million due to the payment in full of a $6.0 Federal Home Loan Bank advance in August 2012. The decrease in average rates paid was primarily due to general decreases in market rates.

The net interest margin, on a taxable-equivalent basis, decreased from 3.70% for 2011 to 3.52% for 2012 primarily due to the limited loan growth during 2012 and low market interest rates. With weak demand for loans and the sale of most residential real estate mortgage loans originated to the Federal Home Loan Mortgage Corporation, deposit growth was largely invested in the investment securities portfolio, which usually pays lower interest rates than the loan portfolio.

2011 vs. 2010. Net interest income on a fully tax-equivalent basis for 2011 totaled $27,030,000, a decrease of $277,000 from 2010. The decrease resulted from a decrease in total taxable-equivalent interest income of $2,224,000, largely offset by a decrease in total interest expense of $1,947,000.

The decrease in taxable-equivalent interest income was due to a 50 basis point decrease in the average rate earned on interest-earning assets, partially offset by a $28.3 million increase in total average interest-earning assets. The decrease in average rates earned was primarily due to general decreases in market rates. The increase in average interest-earning assets occurred primarily in the taxable investment securities portfolio, which grew $43.4 million on an average basis.

Interest expense decreased primarily due to a 35 basis point decrease in the average rate paid on interest-bearing liabilities. A secondary factor was a $12.8 million decrease in average IRA and time certificate balances, partially offset by increases in average balances of other deposit account categories and average short-term borrowings. The decrease in average rates paid was primarily due to general decreases in market rates.

The net interest margin, on a taxable-equivalent basis, decreased from 3.89% for 2010 to 3.70% for 2011 primarily due to the limited loan growth during 2011 and low market interest rates. With weak demand for loans and the sale of most residential real estate mortgage loans originated to the Federal Home Loan Mortgage Corporation, deposit growth was largely invested in the investment securities portfolio, which usually pays lower interest rates than the loan portfolio.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Provisions and Allowance for Loan Losses

The following table presents the total loan loss provision and the other changes in the allowance for loan losses for the years 2008 through 2012:

	2012	2011	2010	2009	2008
			(Dollars in thousands)		
Balance – Beginning of year	2,931	2,641	2,998	2,468	2,468
Loans charged off:					
Commercial and industrial	159	581	289	36	73
Commercial, secured by real estate	234	598	1,105	352	-
Residential real estate	486	512	331	152	129
Consumer	134	252	422	490	617
Agricultural	-	-	-	-	-
Other loans, including deposit overdrafts	85	127	144	178	228
Total loans charged off	1,098	2,070	2,291	1,208	1,047
Recoveries:					
Commercial and industrial	-	-	35	2	40
Commercial, secured by real estate	71	30	-	-	-
Residential real estate	7	31	2	3	20
Consumer, excluding credit card	123	122	120	203	201
Agricultural	-	-	-	-	-
Credit Card	-	-	-	-	1
Other loans, including deposit overdrafts	52	88	97	130	165
Total recoveries	253	271	254	338	427
Net charge offs	845	1,799	2,037	870	620
Provision charged to operations	1,351	2,089	1,680	1,400	620
Balance - End of year	$3,437	2,931	2,641	2,998	2,468
Ratio of net charge-offs during the period to average loans outstanding	0.18 %	0.39 %	0.44 %	0.19 %	0.14 %
Ratio of allowance for loan losses to total loans at year-end	0.76 %	0.64 %	0.58 %	0.65 %	0.54 %

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The $581,000 of charge-offs in the commercial and industrial loan category for 2011 is comprised of a $251,000 charge-off connected to a retail business that ceased operations during that year and the remaining $330,000 is due to one borrower. Commercial real estate charge-offs for 2011 consisted of loans to five different borrowers.

Of the $1,105,000 in commercial real estate loan charge-offs during 2010, $421,000 was due to four loans while $684,000 was due to two loans made to the same borrower. Commercial and industrial loan charge-offs of $289,000 during 2010 included one charge-off of $281,000 relating to a business that ceased operations during that year.

Charge-offs and recoveries classified as “Other” represent charge-offs and recoveries on checking and NOW account overdrafts. LCNB charges off such overdrafts when considered uncollectible, but no later than 60 days from the date first overdrawn.

LCNB continuously reviews the loan portfolio for credit risk through the use of its lending and loan review functions. Independent loan reviews analyze specific loans, providing validation that credit risks are appropriately identified and reported to the Loan Committee and Board of Directors. In addition, the Board of Directors’ Audit Committee receives loan review reports multiple times throughout each year. Specific new credits are analyzed prior to origination and are reviewed by the Loan Committee and Board of Directors.

Inputs from all of the Bank’s credit risk identification processes are used by management to analyze and validate the adequacy and methodology of the allowance quarterly. The analysis includes two basic components: specific allocations for individual loans and general loss allocations for pools of loans based on average historic loss ratios for the thirty-six preceding months adjusted for identified economic and other risk factors. Due to the number, size, and complexity of loans within the loan portfolio, there is always a possibility of inherent undetected losses. The possible imprecision of management’s assumptions in the evaluation of loans can result in the allowance also having an unallocated component.

The following table presents the components of the allowance for loan losses on the dates specified:

	At December 31,					
	2012		2011		2010	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Specific allocations	$904	26.3 %	399	13.6 %	296	11.2 %
General allocations:						
Historical loss	1,399	40.7 %	1,381	47.3 %	975	36.9 %
Adjustments to historical loss	1,134	33.0 %	1,151	39.1 %	1,370	51.9 %
Total	$3,437	100.0 %	2,931	100.0 %	2,641	100.0 %

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The increase in the specific allocation from December 31, 2011 to December 31, 2012 is primarily due to one commercial real estate loan where the borrower is continuing to experience financial difficulty, although the loan is current under the terms of a troubled debt restructuring modification. The increase in the general historical loss allocation from December 31, 2010 to December 31, 2011 is primarily due to increases in net charge-offs during the historic look-back period.

Non-Interest Income

2012 vs. 2011. Total non-interest income for 2012 was $1,285,000 greater than for 2011. Net gains on sales of securities increased $905,000 due to a greater volume of sales during 2012. LCNB sold about $88.7 million of securities during 2012, compared to $35.8 million of securities sold during 2011. Gains from sales of mortgage loans during 2012 were $329,000 more than in 2011 primarily due to an increase in the volume of loans sold. Loans sold during 2012 totaled $28.1 million, compared to $9.4 million in sales during 2011. Trust income increased $218,000 primarily due to executor fees recognized during the first quarter 2012 and to an increase in brokerage income due to an increase in the volume of new accounts. These favorable items were partially offset by a $134,000 decrease in service charges and fees on deposit accounts primarily due to a downward trend in overdraft fees, partially offset by an increase in check card fee income.

2011 vs. 2010. Total non-interest income for 2011 was $1,123,000 less than for 2010. Bank owned life insurance income decreased in 2011 by $793,000 primarily due to the absence during 2011 of death benefits received in 2010. Gains from sales of mortgage loans were $319,000 less primarily due to a decrease in the volume of loans sold. Loans sold during 2011 totaled $9.4 million, compared to $24.2 million in sales during 2010. Lower interest rates fueled a demand for loan refinancings during 2010. Service charges and fees on deposit accounts decreased $165,000 primarily due to a downward trend in overdraft fees, partially offset by an increase in check card fee income. These unfavorable items were partially offset by a $202,000 increase in trust income that was primarily due to executor fees received and a change in the mix of trust assets.

Non-Interest Expense

2012 vs. 2011. Total non-interest expense was $167,000 less in 2012 as compared to 2011 primarily due to a $129,000 decrease in salaries and employee benefits, a $140,000 decrease in FDIC premiums, and a $187,000 decrease in other non-interest expenses.

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Salaries and employee benefits decreased primarily due to decreased expense for LCNB’s qualified noncontributory defined benefit retirement plan. LCNB’s minimum funding requirements for its qualified noncontributory defined benefit retirement plan for the plan year July 1, 2012 through June 30, 2013 was significantly less than the previous fiscal year due to an interest rate stabilization provision included in the “Moving Ahead for Progress in the 21st Century Act.” Although LCNB management elected to contribute an amount that would have been required absent the stabilization provision, accounting guidance allows expensing only the required contribution. Consequently, LCNB charged a $694,000 difference to a prepaid account, which is included with other assets in the Consolidated Balance Sheets at December 31, 2012.

FDIC premiums decreased primarily due to implementation of a new assessment base, effective April 1, 2011, that uses total assets and tier one capital as opposed to deposits. The decrease in other non-interest expenses is primarily due to the absence during the 2012 period of the following costs paid during 2011: a $56,000 loss recognized on a standby letter of credit, $59,000 in environmental remediation costs for the lot on which LCNB’s new Lebanon Drive-Up facility is located, and $50,000 in NASDAQ application fees.

These favorable items were partially offset by a $140,000 increase in other real estate owned expenses primarily due to the recognition of impairment charges on property currently held for sale.

2011 vs. 2010. Total non-interest expense was $572,000 greater in 2011 as compared to 2010 primarily due to a $472,000 increase in salaries and employee benefits, a $149,000 increase in equipment expenses, a $109,000 increase in computer maintenance and supplies, and a $399,000 increase in other non-interest expenses. While salaries were held to a less than 4% increase, health care costs and pension costs contributed to the balance of the increase in salaries and employee benefits. Equipment expenses increased primarily due to increased depreciation caused by ATM and computer hardware replacements. The increase in other non-interest expenses resulted from the one-time costs detailed in the 2012 vs. 2011 other non-interest expense comparison above and other smaller miscellaneous costs. Partially offsetting these increases were a $413,000 decrease in FDIC premiums, a $156,000 decrease in other real estate owned expense, and a $114,000 decrease in occupancy expense. FDIC premiums decreased primarily due to implementation of a new assessment base that uses total assets and tier one capital as opposed to deposits. Other real estate owned expense decreased due to a decrease in valuation write-downs.

Income Taxes

LCNB's effective tax rates for the years ended December 31, 2012, 2011, and 2010 were 25.3%, 23.2%, and 21.4%, respectively. The difference between the statutory rate of 34.0% and the effective tax rate is primarily due to tax-exempt interest income and tax-exempt earnings from bank owned life insurance.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Assets

Net loans decreased $8.0 million during 2012. The commercial real estate loan portfolio, which increased $11.1 million, was the only category that experienced growth during 2012. Commercial and industrial loans decreased $4.8 million and consumer loans decreased $4.0 million, reflecting lower demand due to economic conditions during 2012. Residential real estate loans decreased $3.8 million, which does not reflect $28.1 million of residential real estate loans that were originated and sold to the Federal Home Loan Mortgage Corporation during 2012.

Investment securities available-for-sale increased $4.5 million during 2012. U.S. Agency notes increased $7.7 million, non-taxable municipal securities increased $4.2 million, and U.S. Treasury notes increased $1.1 million. These increases were partially offset by a $6.1 million decrease in taxable municipal securities.

Investment securities held-to-maturity increased $4.7 million primarily due to the purchase of non-taxable municipal securities. Securities placed in the held-to-maturity category are securities purchased from local municipalities.

Bank owned life insurance increased $2.1 million due to the purchase of $1.5 million in new policies and earnings on existing policies.

Deposits

Total deposits at December 31, 2012 were $7.9 million greater than at December 31, 2011. The growth was in the liquid deposit products – checking, NOW, and savings accounts. These types of instruments increased a total of $44.6 million, while IRA and time certificate accounts decreased $30.2 million and money fund deposit accounts decreased $6.5 million. Of the $30.2 million decrease in IRA and time certificate accounts, $13.6 million of the decrease was due to public fund time deposit accounts. Approximately $12.2 million of the decrease in public fund time deposit accounts was reinvested in other financial institutions through LCNB's membership in the Certificate of Deposit Account Registry Service (CDARS). CDARS is a program that allows customers to spread large time deposits among various financial institutions, usually to stay below FDIC insurance limits at any given bank.

Long-Term Debt

Long-term debt decreased $7.7 million primarily because of the payment in full of a $6.0 million advance from the Federal Home Loan Bank of Cincinnati in August 2012.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Liquidity

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. These commitments may include paying dividends to shareholders, funding new loans for borrowers, funding withdrawals by depositors, paying general and administrative expenses, and funding capital expenditures. Sources of liquidity include growth in deposits, principal payments received on loans, proceeds from the sale of loans, the sale or maturation of investment securities, cash generated by operating activities, and the ability to borrow funds. Management closely monitors the level of liquid assets available to meet ongoing funding requirements. 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 during the past year as a result of current liquidity levels.

The liquidity of LCNB is enhanced by the fact that 83.6% of total deposits at December 31, 2012 were "core" deposits. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than $100,000.

Liquid assets include cash, federal funds sold and securities available-for-sale. Except for investments in the stock of the Federal Reserve Bank and the Federal Home Loan Bank of Cincinnati (“FHLB”) and certain local municipal securities, all of LCNB's investment portfolio is classified as "available-for-sale" and can be readily sold to meet liquidity needs, subject to certain pledging commitments for public funds, repurchase agreements, and other requirements. At December 31, 2012, LCNB's liquid assets amounted to $272.0 million or 34.5% of total assets, a slight decrease from $273.5 million or 34.6% of total assets at December 31, 2011.

An additional source of funding is borrowings from the FHLB. Long-term advances totaling $13.7 million were outstanding at December 31, 2012. LCNB is approved to borrow up to $39.4 million in short-term advances through the FHLB’s Cash Management Advance program. Total remaining available borrowing capacity, including short-term advances, with the FHLB at December 31, 2012 was approximately $31.8 million. One of the factors limiting availability of FHLB borrowings is a bank’s ownership of FHLB stock. LCNB could increase its available borrowing capacity by purchasing more FHLB stock.

Besides the short-term FHLB advances, short-term borrowings may include repurchase agreements, federal funds purchased, and advances from a line of credit with another financial institution. At December 31, 2012, LCNB could borrow up to $20 million through the line of credit and up to $17 million under federal funds arrangements with two other financial institutions. Short-term borrowings at December 31, 2012 included $2.7 million from the line of credit and $11.1 million in repurchase agreements.

Commitments to extend credit at December 31, 2012 totaled $77.7 million and standby letters of credit totaled $5.1 million and are more fully described in Note 11 to LCNB's Financial Statements. Since many commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table provides information concerning LCNB's contractual obligations at December 31, 2012:

	Total	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years
			Payments due by period (In thousands)		
Short-term borrowings	$13,756	13,756	-	-	-
Long-term debt obligations	13,705	1,603	6,155	5,644	303
Operating lease obligations	5,485	349	601	475	4,060
Commitments to purchase municipal securities to be issued in January 2013	2,729	2,729	-	-	-
Estimated pension plan contribution for 2013	125	125	-	-	-
Certificates of deposit:					
$100,000 and over	64,481	27,324	22,431	4,083	10,643
Other time certificates	114,299	53,545	44,990	9,768	5,996
Total	$214,580	97,828	74,330	19,326	23,096

The following table provides information concerning LCNB's commitments at December 31, 2012:

	Total Amounts Committed	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years
			Amount of Commitment Expiration Per Period (In thousands)		
Commitments to extend credit	$19,465	19,465	-	-	-
Unused lines of credit	58,232	25,804	11,059	10,807	10,562
Standby letters of credit	5,109	346	4,763	-	-
Total	$82,806	45,615	15,822	10,807	10,562

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Capital Resources

LCNB and the Bank are required by banking regulators to meet certain minimum levels of capital adequacy. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on LCNB's and the Bank's financial statements. These minimum levels are expressed in the form of certain ratios. Capital is separated into Tier 1 capital (essentially shareholders' equity less goodwill and other intangibles) and Tier 2 capital (essentially the allowance for loan losses limited to 1.25% of risk-weighted assets). The first two ratios, which are based on the degree of credit risk in the Bank's assets, provide for weighting assets based on assigned risk factors and include off-balance sheet items such as loan commitments and stand-by letters of credit. The ratio of Tier 1 capital to risk-weighted assets must be at least 4.00% and the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8.00%. The capital leverage ratio supplements the risk-based capital guidelines. Banks are required to maintain a minimum ratio of Tier 1 capital to adjusted quarterly average total assets of 3.00%. A table summarizing the regulatory capital of LCNB and the Bank at December 31, 2012 and 2011 is included in Note 12, "Regulatory Matters", of the 2012 Annual Report to Shareholders.

The FDIC, the insurer of deposits in financial institutions, has adopted a risk-based insurance premium system based in part on an institution's capital adequacy. Under this system, a depository institution is required to pay successively higher premiums depending on its capital levels and its supervisory rating by its primary regulator. It is management's intention to maintain sufficient capital to permit the Bank to maintain a "well capitalized" designation (the FDIC's highest rating).

On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two of which continue to be in effect – the “Market Repurchase Program” and the “Private Sale Repurchase Program.” Any shares purchased will be held for future corporate purposes.

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock, as restated for a 100% stock dividend issued in May, 2007, through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares, as restated for the stock dividend. Through December 31, 2012, 290,444 shares, as restated for the stock dividend, had been purchased under this program. No shares were purchased under this program during 2012.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. A total of 466,018 shares, as restated for the stock dividend, had been purchased under this program at December 31, 2012. No shares were purchased under this program during 2012.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

LCNB established an Ownership Incentive Plan during 2002 that allows for stock-based awards to eligible employees. The awards may be in the form of stock options, share awards, and/or appreciation rights. The plan provides for the issuance of up to 200,000 shares, as restated for the stock dividend. The following table provides the stock options granted to key executive officers of LCNB for the years indicated:

Year	Options Granted
2008	13,918
2009	29,110
2010	20,798
2011	25,083
2012	14,491

The exercise price for stock options granted shall not be less than the fair market value of the stock on the date of grant. Options vest ratably over a five-year period and the maximum term for each grant will be specified by the Board of Directors, but cannot be greater than ten years from the date of grant. In the event of an optionee's death or incapacity, all outstanding options held by that optionee shall immediately vest and be exercisable.

On January 9, 2009, LCNB issued 13,400 shares of Fixed Rate Cumulative Preferred Stock, Series A and a warrant for the purchase of 217,063 common shares of LCNB stock at an exercise price of $9.26 per share to the U.S. Treasury Department. LCNB allocated $583,000 of the proceeds from the preferred stock issuance to the warrant. The warrant carries a ten year term and was 100% vested at grant. On October 21, 2009, LCNB redeemed the preferred stock that had been issued under the Capital Purchase Program agreement, but did not redeem the warrant. The Treasury Department sold the warrant to an investor during the fourth quarter 2011.

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

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

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

Accounting for Intangibles. LCNB’s intangible assets at December 31, 2012 are composed primarily of goodwill and a core deposit intangible related to the acquisition of Sycamore during the fourth quarter 2007 and mortgage servicing rights recorded from sales of mortgage loans to the Federal Home Loan Mortgage Corporation. Goodwill is not subject to amortization, but is reviewed annually for impairment. The core deposit intangible is being amortized on a straight line basis over six years. 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.

Fair Value Accounting for Investment Securities. Securities classified as available-for-sale are carried at estimated fair value. Unrealized gains and losses, net of taxes, are reported as accumulated other comprehensive income or loss in shareholders’ equity. Fair value is estimated using market quotations for U.S. Treasury and corporate securities and equity investments. Fair value for the majority of the remaining available-for-sale securities is estimated using the discounted cash flow method for each security with discount rates based on rates observed in the market.

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LCNB CORP. AND SUBSIDIARIES
QUARTERLY FINANCIAL DATA (UNAUDITED)
(Dollars in thousands, except per share data)

	Three Months Ended			
	March 31	June 30	Sep. 30	Dec. 31
2012				
Interest income	$7,731	7,571	7,404	7,232
Interest expense	1,322	1,272	1,190	1,105
Net interest income	6,409	6,299	6,214	6,127
Provision for loan losses	215	91	436	609
Net interest income after provision	6,194	6,208	5,778	5,518
Total non-interest income	2,336	1,755	2,205	2,753
Total non-interest expenses	5,448	5,330	5,564	5,340
Income before income taxes	3,082	2,633	2,419	2,931
Provision for income taxes	805	646	572	772
Net income from continuing operations	2,277	1,987	1,847	2,159
Income (loss) from discontinued operations, net of tax	-	-	-	-
Net income	$2,277	1,987	1,847	2,159
Basic earnings per common share:				
Continuing operations	$0.34	0.30	0.27	0.32
Discontinued operations	-	-	-	-
Diluted earnings per common share:				
Continuing operations	0.34	0.29	0.27	0.32
Discontinued operations	-	-	-	-
2011				
Interest income	$8,130	8,099	7,976	7,888
Interest expense	1,772	1,667	1,537	1,411
Net interest income	6,358	6,432	6,439	6,477
Provision for loan losses	664	224	588	613
Net interest income after provision	5,694	6,208	5,851	5,864
Total non-interest income	1,915	1,835	2,033	1,981
Total non-interest expenses	5,785	5,307	5,436	5,321
Income before income taxes	1,824	2,736	2,448	2,524
Provision for income taxes	346	713	581	570
Net income from continuing operations	1,478	2,023	1,867	1,954
Income (loss) from discontinued operations, net of tax	824	(31)	-	-
Net income	$2,302	1,992	1,867	1,954
Basic earnings per common share:				
Continuing operations	$0.22	0.30	0.28	0.29
Discontinued operations	0.12	-	-	-
Diluted earnings per common share:				
Continuing operations	0.22	0.30	0.28	0.28

Discontinued operations	0.12	-	-	-

LCNB CORP. AND SUBSIDIARIES

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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. The IRSA model is used to estimate the effect on net interest income during a one-year period of instantaneous and sustained movements in interest rates, also called interest rate shocks, of 100, 200, and 300 basis points. Management considers the results of any significant downward scenarios to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the December 31, 2012 IRSA indicates that an increase in interest rates at all shock levels will have a positive effect on net interest income. The changes in net interest income for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in Net Interest Income	% Change in Net Interest Income
Up 300	$ 25,904	1,634	6.73 %
Up 200	25,359	1,089	4.49 %
Up 100	24,807	537	2.21 %
Base	24,270	-	- %

IRSA shows the effect on net interest income 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 December 31, 2012 EVE analysis indicates that an increase in interest rates would have a negative effect on the EVE. The changes in the EVE for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in EVE	% Change in EVE
Up 300	$ 80,130	(1,374)	(1.69)%
Up 200	81,217	(287)	(0.35)%
Up 100	81,449	(55)	(0.07)%
Base	81,504	-	- %

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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Item 8. Financial Statements and Supplementary Data

REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

LCNB Corp. ("LCNB") is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. Management of LCNB and its subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15f. LCNB's internal control over financial reporting is a process designed under the supervision of LCNB's Chief Executive Officer and the Chief Financial Officer. The purpose is to provide reasonable assurance to the Board of Directors regarding the reliability of financial reporting and the preparation of LCNB's financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Management maintains internal controls over financial reporting. The internal controls contain control processes and actions are taken to correct deficiencies as they are identified. The internal controls are evaluated on an ongoing basis by LCNB's Management and Audit Committee. Even effective internal controls, no matter how well designed, have inherent limitations – including the possibility of circumvention or overriding of controls – and therefore can provide only reasonable assurance with respect to financial statement preparation. Also, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed LCNB's internal controls as of December 31, 2012, in relation to criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2012, LCNB's internal control over financial reporting met the criteria.

J.D. Cloud & Co. L.L.P., an independent registered public accounting firm, has issued an attestation report on the effectiveness of LCNB's internal control over financial reporting as of December 31, 2012.

Submitted by:

LCNB Corp.

/s/ Stephen P. Wilson
Stephen P. Wilson
Chief Executive Officer &
Chairman of the Board of Directors
February 25, 2013

/s/ Robert C. Haines II
Robert C. Haines II
Executive Vice President &
Chief Financial Officer
February 25, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited LCNB Corp. and subsidiaries' (LCNB) internal control over financial reporting as of December 31, 2012, based on criteria established in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). LCNB's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Report of Management's Assessment of Internal Control over Financial Reporting." Our responsibility is to express an opinion on LCNB's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, LCNB maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2012 and 2011 and the related consolidated statements of income, comprehensive income, shareholders’ equity and cash flows for each of the three years in the period ended December 31, 2012 of LCNB, and our report dated February 25, 2013 expressed an unqualified opinion.

/s/ J.D. Cloud & Co. L.L.P.
Certified Public Accountant

Cincinnati, Ohio
February 25, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of LCNB Corp. and subsidiaries (LCNB) as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. LCNB's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of LCNB as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), LCNB's internal control over financial reporting as of December 31, 2012, based on criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 25, 2013 expressed an unqualified opinion.

/s/ J.D. Cloud & Co. L.L.P.
Certified Public Accountants

Cincinnati, Ohio
February 25, 2013

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FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
At December 31,
(Dollars in thousands)

		2012	2011
ASSETS:			
Cash and due from banks	$	11,260	12,449
Interest-bearing demand deposits		2,215	7,086
Total cash and cash equivalents		13,475	19,535
Investment securities:			
Available-for-sale, at fair value		258,506	254,006
Held-to-maturity, at cost		15,424	10,734
Federal Reserve Bank stock, at cost		949	940
Federal Home Loan Bank stock, at cost		2,091	2,091
Loans, net		450,346	458,331
Premises and equipment, net		16,564	17,346
Goodwill		5,915	5,915
Bank owned life insurance		16,915	14,837
Other assets		8,452	7,835
TOTAL ASSETS	$	788,637	791,570
LIABILITIES:			
Deposits:			
Noninterest-bearing	$	133,848	106,793
Interest-bearing		537,623	556,769
Total deposits		671,471	663,562
Short-term borrowings		13,756	21,596
Long-term debt		13,705	21,373
Accrued interest and other liabilities		7,699	7,079
TOTAL LIABILITIES		706,631	713,610
SHAREHOLDERS' EQUITY:			
Preferred shares - no par value, authorized 1,000,000 shares, none outstanding		-	-
Common shares - no par value, authorized 12,000,000 shares, issued 7,485,527 and 7,460,494 shares at December 31, 2012 and 2011, respectively		27,107	26,753
Retained earnings		61,843	57,877
Treasury shares at cost, 753,627 and 755,771 shares at December 31, 2012 and 2011, respectively		(11,665)	(11,698)
Accumulated other comprehensive income, net of taxes		4,721	5,028
TOTAL SHAREHOLDERS' EQUITY		82,006	77,960
TOTAL LIABILITES AND SHAREHOLDERS' EQUITY	$	788,637	791,570

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

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the years ended December 31,
(Dollars in thousands, except per share data)

	2012	2011	2010
INTEREST INCOME:			
Interest and fees on loans	$23,585	25,502	27,020
Interest on investment securities:			
Taxable	3,737	3,843	3,686
Non-taxable	2,441	2,571	3,126
Other investments	175	177	199
TOTAL INTEREST INCOME	29,938	32,093	34,031
INTEREST EXPENSE:			
Interest on deposits	4,317	5,702	7,613
Interest on short-term borrowings	16	28	27
Interest on long-term debt	556	657	694
TOTAL INTEREST EXPENSE	4,889	6,387	8,334
NET INTEREST INCOME	25,049	25,706	25,697
PROVISION FOR LOAN LOSSES	1,351	2,089	1,680
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	23,698	23,617	24,017
NON-INTEREST INCOME:			
Trust income	2,317	2,099	1,897
Service charges and fees on deposit accounts	3,605	3,739	3,904
Net gain on sales of securities	1,853	948	948
Bank owned life insurance income	578	596	1,389
Gains from sales of mortgage loans	506	177	496
Other operating income	190	205	253
TOTAL NON-INTEREST INCOME	9,049	7,764	8,887
NON-INTEREST EXPENSE:			
Salaries and employee benefits	11,614	11,743	11,271
Equipment expenses	1,100	1,038	889
Occupancy expense, net	1,671	1,761	1,875
State franchise tax	790	764	703
Marketing	526	480	448
FDIC premiums	405	545	958
ATM expense	620	553	513
Computer maintenance and supplies	524	565	456
Telephone expense	465	407	414
Contracted services	441	420	370
Other real estate owned	490	350	506
Other non-interest expense	3,036	3,223	2,874
TOTAL NON-INTEREST EXPENSE	21,682	21,849	21,277
INCOME BEFORE INCOME TAXES	11,065	9,532	11,627

PROVISION FOR INCOME TAXES	2,795	2,210	2,494
NET INCOME FROM CONTINUING OPERATIONS	8,270	7,322	9,133
INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX	-	793	240
NET INCOME	$8,270	8,115	9,373
Basic earnings per common share:			
Continuing Operations	$1.23	1.09	1.37
Discontinued Operations	-	0.12	0.03
Diluted earnings per common share:			
Continuing operations	1.22	1.08	1.36
Discontinued operations	-	0.12	0.03
Weighted average shares outstanding:			
Basic	6,717,357	6,692,385	6,687,500
Diluted	6,802,475	6,751,599	6,736,622

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

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the years ended December 31,
(Dollars in thousands)

	2012	2011	2010
Net income	$8,270	8,115	9,373
Other comprehensive income (loss):			
Net unrealized gain on available-for-sale securities (net of taxes of $473, $1,994, and $231 for 2012, 2011, and 2010, respectively)	918	3,852	448
Change in nonqualified pension plan unrecognized net gain (loss) and unrecognized prior service cost (net of taxes of $1, $102, and $55 for 2012, 2011, and 2010, respectively)	(2)	(199)	107
Nonqualified pension plan curtailment (net of taxes of $80)	-	155	-
Reclassification adjustment for:			
Net realized gain on sale of available-for-sale securities included in net income (net of taxes of $630, $323, and $323 for 2012, 2011 and 2010, respectively)	(1,223)	(625)	(625)
TOTAL COMPREHENSIVE INCOME	$7,963	11,298	9,303
SUPPLEMENTAL INFORMATION:			
COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX, AS OF YEAR-END:			
Net unrealized gain on securities available-for-sale	$4,875	5,180	1,953
Net unfunded liability for nonqualified pension plan	(154)	(152)	(108)
Balance at year-end	$4,721	5,028	1,845

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the years ended December 31,
(Dollars in thousands)

	Common Shares Outstanding	Common Shares	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2009	6,687,232	$ 26,475	48,962	(11,737)	1,915	65,615
Net income			9,373			9,373
Net unrealized gain on available-for-sale securities, net of tax					448	448
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income, net of taxes						