LCNB CORP
Form 10-Q
August 09, 2018

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

FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 001-35292
LCNB Corp.
(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes No
The number of shares outstanding of the issuer's common stock, without par value, as of August 8, 2018 was 13,300,046 shares.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

TABLE OF CONTENTS

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS
(Dollars in thousands, except per share data)

	June 30, 2018 (Unaudited)	December 31, 2017
ASSETS:		
Cash and due from banks	$23,123	$ 21,159
Interest-bearing demand deposits	1,778	4,227
Total cash and cash equivalents	24,901	25,386
Interest-bearing time deposits	9,852	—
Investment securities:		
Equity securities with a readily determinable fair value, at fair value	2,188	2,160
Equity securities without a readily determinable fair value, at cost	2,099	1,099
Debt securities, available-for-sale, at fair value	257,721	275,213
Debt securities, held-to-maturity, at cost	31,610	32,571
Federal Reserve Bank stock, at cost	2,732	2,732
Federal Home Loan Bank stock, at cost	4,845	3,638
Loans, net	1,155,495	845,657
Premises and equipment, net	33,257	34,927
Premises held for sale, net	512	—
Goodwill	59,160	30,183
Core deposit and other intangibles	5,501	3,799
Bank owned life insurance	28,354	27,985
Other assets	13,215	10,288
TOTAL ASSETS	$1,631,442	$ 1,295,638
LIABILITIES:		
Deposits:		
Noninterest-bearing	$343,172	$ 283,212
Interest-bearing	1,037,712	802,609
Total deposits	1,380,884	1,085,821
Short-term borrowings	—	47,000
Long-term debt	27,085	303
Accrued interest and other liabilities	11,107	12,243
TOTAL LIABILITIES	1,419,076	1,145,367
COMMITMENTS AND CONTINGENT LIABILITIES	—	—
SHAREHOLDERS' EQUITY:		
Preferred shares – no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares – no par value; authorized 19,000,000 shares; issued 14,052,862 and 10,776,686 shares at June 30, 2018 and December 31, 2017, respectively	140,870	76,977

Retained earnings	89,544	87,301
Treasury shares at cost, 753,627 shares at June 30, 2018 and December 31, 2017	(11,665)	(11,665)
Accumulated other comprehensive loss, net of taxes	(6,383)	(2,342)
TOTAL SHAREHOLDERS' EQUITY	212,366	150,271
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,631,442	$ 1,295,638

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

The consolidated condensed balance sheet as of December 31, 2017 has been derived from the audited consolidated balance sheet as of that day.

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
INTEREST INCOME:				
Interest and fees on loans	$10,703	$ 8,823	$20,116	$ 17,738
Dividends on equity securities:				
With a readily determinable fair value	16	16	31	31
Without a readily determinable fair value	8	5	15	11
Interest on debt securities:				
Taxable	934	1,128	1,865	2,200
Non-taxable	680	795	1,384	1,594
Other investments	197	167	269	224
TOTAL INTEREST INCOME	12,538	10,934	23,680	21,798
INTEREST EXPENSE:				
Interest on deposits	1,096	846	1,967	1,689
Interest on short-term borrowings	7	12	76	42
Interest on long-term debt	67	3	81	7
TOTAL INTEREST EXPENSE	1,170	861	2,124	1,738
NET INTEREST INCOME	11,368	10,073	21,556	20,060
PROVISION FOR LOAN LOSSES	224	222	303	237
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,144	9,851	21,253	19,823
NON-INTEREST INCOME:				
Fiduciary income	942	881	1,906	1,733
Service charges and fees on deposit accounts	1,426	1,312	2,731	2,534
Net gain (loss) from sales of debt securities, available-for-sale	(1)	140	(1)	140
Bank owned life insurance income	182	297	368	486
Gains from sales of loans	97	63	119	102
Other operating income	145	97	304	225
TOTAL NON-INTEREST INCOME	2,791	2,790	5,427	5,220
NON-INTEREST EXPENSE:				
Salaries and employee benefits	5,128	4,703	10,105	9,229
Equipment expenses	268	264	521	475
Occupancy expense, net	658	636	1,385	1,204
State franchise tax	296	286	599	570
Marketing	284	216	416	359
Amortization of intangibles	188	188	373	373
FDIC insurance premiums	99	108	198	212
Contracted services	391	375	706	623
Other real estate owned	1	—	3	5
Merger-related expenses	855	—	1,613	—

Other non-interest expense	2,543	1,835	4,341	3,529
TOTAL NON-INTEREST EXPENSE	10,711	8,611	20,260	16,579
INCOME BEFORE INCOME TAXES	3,224	4,030	6,420	8,464
PROVISION FOR INCOME TAXES	486	1,027	969	2,215
NET INCOME	$2,738	$ 3,003	$5,451	$ 6,249
Dividends declared per common share	$0.16	$ 0.16	$0.32	$ 0.32
Earnings per common share:				
Basic	$0.25	$ 0.30	$0.52	$ 0.62
Diluted	0.25	0.30	0.52	0.62
Weighted average common shares outstanding:				
Basic	11,099,485	10,004,422	10,563,030	9,999,765
Diluted	11,105,014	10,011,312	10,568,792	10,007,192

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

3

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$2,738	$3,003	$5,451	$6,249
Other comprehensive income (loss):				
Net unrealized gain (loss) on available-for-sale securities (net of taxes of $(145) and $638 for the three months ended June 30, 2018 and 2017, respectively, and $(937) and $894 for the six months ended June 30, 2018 and 2017, respectively)	(544)	1,206	(3,523)	1,734
Reclassification adjustment for net realized (gain) loss on sale of available-for-sale securities included in net income (net of taxes of $0 and $48 for the three months ended June 30, 2018 and 2017, respectively, and $0 and $ 48 for the six months ended June 30, 2018 and 2017, respectively)	1	(92)	1	(92)
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of $1 and $0 for the three months ended June 30, 2018 and 2017, respectively, and $2 and $0 for the six months ended June 30, 2018 and 2017, respectively)	3	—	6	—
Other comprehensive income (loss), net of tax	(540)	1,114	(3,516)	1,642
TOTAL COMPREHENSIVE INCOME	$2,198	$4,117	$1,935	$7,891

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

Table of Contents

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

	Common Shares Outstanding	Common Stock	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2016	9,998,025	$76,490	$80,736	$(11,665)	$ (2,617)	$ 142,944
Net income			6,249			6,249
Other comprehensive income, net of taxes					1,642	1,642
Dividend Reinvestment and Stock Purchase Plan	8,554	180				180
Exercise of stock options	3,398	51				51
Compensation expense relating to stock options		1				1
Compensation expense relating to restricted stock	4,027	63				63
Common stock dividends, $0.32 per share			(3,203)			(3,203)
Balance at June 30, 2017	10,014,004	$76,785	$83,782	$(11,665)	$ (975)	$ 147,927
Balance at December 31, 2017	10,023,059	$76,977	$87,301	$(11,665)	$ (2,342)	$ 150,271
Cumulative effect of changes in accounting principles (1)			525		(525)	—
Balance at December 31, 2017, as adjusted	10,023,059	76,977	87,826	(11,665)	(2,867)	150,271
Net income			5,451			5,451
Other comprehensive loss, net of taxes					(3,516)	(3,516)
Dividend Reinvestment and Stock Purchase Plan	9,851	191				191
Stock issued for acquisition of Columbus First Bancorp, Inc.	3,253,060	63,598				63,598
Exercise of stock options	2,631	33				33
Compensation expense relating to restricted stock	10,634	71				71
Common stock dividends, $0.32 per share			(3,733)			(3,733)
Balance at June 30, 2018	13,299,235	$140,870	$89,544	$(11,665)	$ (6,383)	$ 212,366

(1) Represents the impact of adopting Accounting Standards Update No. 2018-02 and No. 2016-01. See Note 1 of the consolidated condensed financial statements for more information.

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

Table of Contents

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

	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$5,451	$6,249
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization, and accretion	2,019	1,668
Provision for loan losses	303	237
Deferred income tax provision (benefit)	63	928
Increase in cash surrender value of bank owned life insurance	(368)	(379)
Bank owned life insurance mortality benefits in excess of cash surrender value	—	(107)
Realized gain from equity securities	(11)	—
Realized (gain) loss from sales of debt securities available-for-sale	1	(140)
Realized (gain) loss from sales of premises and equipment	42	(23)
Impairment charge recognized on premises and equipment	645	—
Realized loss from sales and impairment of other real estate owned and repossessed assets	—	3
Origination of mortgage loans for sale	(3,554)	(4,416)
Realized gains from sales of loans	(119)	(102)
Proceeds from sales of mortgage loans	3,628	4,464
Compensation expense related to stock options	—	1
Compensation expense related to restricted stock	71	63
Changes in:		
Accrued income receivable	97	63
Other assets	(541)	(1,967)
Other liabilities	(1,374)	1,297
TOTAL ADJUSTMENTS	902	1,590
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	6,353	7,839
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of equity securities	65	—
Proceeds from sales of debt securities available-for-sale	3,343	12,243
Proceeds from maturities and calls of debt securities, available-for-sale	8,876	8,288
Proceeds from maturities and calls of debt securities, held-to-maturity	3,271	7,941
Purchases of equity securities	(1,081)	—
Purchases of debt securities, available-for-sale	—	(26,950)
Purchases of debt securities, held-to-maturity	(2,310)	(5,375)
Proceeds from maturities of interest-bearing time deposits	498	—
Net increase (decrease) in loans	(25,504)	(8,222)
Proceeds from bank owned life insurance mortality benefits	—	189
Proceeds from sale of other real estate owned and repossessed assets	—	971
Purchases of premises and equipment	(288)	(5,561)
Proceeds from sale of premises and equipment	16	220
Net cash received from acquisition of Columbus First Bancorp, Inc.	12,896	—
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(218)	(16,256)

CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	50,027	33,015
Net decrease in short-term borrowings	(57,000)	(10,328)
Proceeds from long-term debt	6,000	—
Principal payments on long-term debt	(2,138)	(196)
Proceeds from issuance of common stock	23	21
Proceeds from exercise of stock options	33	51
Cash dividends paid on common stock	(3,565)	(3,044)
NET CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES	(6,620)	19,519
NET CHANGE IN CASH AND CASH EQUIVALENTS	(485)	11,102
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	25,386	18,865
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$24,901	$29,967
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$2,314	$1,768
Income taxes paid	500	1,400
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Transfer from loans to other real estate owned and repossessed assets	—	974

Table of Contents

LCNB purchased all of the common stock of Columbus First Bancorp, Inc on May 31, 2018, In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	343,028
Less common stock issued	63,598
Less cash paid for the common stock	783
Liabilities assumed	278,647

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

Table of Contents

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

Note 1 - Basis of Presentation

Basis of Presentation
The accompanying unaudited interim consolidated condensed financial statements include LCNB Corp. ("LCNB") and its wholly-owned subsidiaries: LCNB National Bank (the "Bank") and LCNB Risk Management, Inc., its captive insurance company. All material intercompany transactions and balances are eliminated in consolidation.

The unaudited interim consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation of financial position, results of operations, and cash flows for the interim periods, as required by Regulation S-X, Rule 10-01.

The consolidated condensed balance sheet as of December 31, 2017 has been derived from the audited consolidated balance sheet as of that day.

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

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

Results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results to be expected for the full year ending December 31, 2018. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, accounting policies, and financial notes thereto included in LCNB's 2017 Annual Report on Form 10-K filed with the SEC.

Accounting Changes
ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"
ASU No. 2014-09 was issued in May 2014 and was adopted by LCNB as of January 1, 2018. It supersedes most current revenue recognition guidance for contracts to transfer goods or services or other nonfinancial assets. Lease contracts, insurance contracts, and most financial instruments are not included in the scope of this update. ASU No. 2014-09 provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance enumerates five steps that entities should follow in achieving this core principle. Additional disclosures providing information about contracts with customers are required. Adoption did not have a material impact on LCNB's results of operations or financial position.

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

ASU No. 2016-01 was issued in January 2016 and was adopted by LCNB as of January 1, 2018. It applies to all entities that hold financial assets or owe financial liabilities. It makes targeted changes to generally accepted accounting principles for public companies as follows:

1. Requires most equity investments to be measured at fair value with changes in fair value recognized in net income.
2. Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.
3. Eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.
4. Requires use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 1 - Basis of Presentation (continued)

5. Requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
6. Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
7. Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets.

Adoption of ASU No. 2016-01 did not have a material impact on LCNB's results of operations or financial position. Upon adoption on January 1, 2018, LCNB reclassified net unrealized gain on equity securities, net of taxes, of $33,000 from accumulated other comprehensive income into retained earnings. Before adoption, equity securities were included with investment securities, available for sale in the consolidated condensed balance sheets and dividends received were included in interest on investment securities, taxable in the consolidated condensed statements of income. After adoption, equity securities are separate line items in the consolidated condensed balance sheets and the consolidated condensed statements of income. Changes in the fair value of equity securities are included in other operating income in the consolidated condensed statements of income.

ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost"
ASU No. 2017-07 was issued in March 2017 and was adopted by LCNB as of January 1, 2018. It applies to all employers that offer to their employees defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715. The amendments in this update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost, as defined, are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in this update are to be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement. Adoption of ASU No. 2017-07 did not have a material impact on LCNB's results of operations or financial position.

ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting"
ASU No. 2017-09 was issued in May 2017 and was adopted by LCNB on January 1, 2018. It applies to any entity that changes the terms or conditions of a share-based payment award. The amendments in this update provide that an entity would not apply modification accounting under the guidance in Topic 718 if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments are to be applied prospectively and are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of ASU No. 2017-09 did not have a material impact on LCNB's results of operations or financial position.

.

9

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 1 - Basis of Presentation (continued)

ASU No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income"
ASU No. 2018-02 was issued in February 2018 and is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted and LCNB early adopted the ASU as of January 1, 2018. ASU No. 2018-02 addresses a narrow-scope financial reporting issue that arose as a consequence of the passage of H.R. 1, known as the "Tax Cuts and Jobs Act." Generally Accepted Accounting Principles requires adjustment of deferred tax assets and liabilities for the effect of a change in tax laws or rates with the effect to be included in income from continuing operations in the reporting period that includes the enactment date. This guidance is applicable even in situations in which the related income tax effects of items in accumulated other comprehensive income were originally recognized in other comprehensive income rather than in income from continuing operations. As a consequence, the tax effects of items within accumulated other comprehensive income, referred to as stranded tax effects in the update, do not reflect the appropriate tax rate. The amendments in ASU No. 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings for the stranded tax effects resulting from the Tax Cuts and Jobs Act. Because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. Upon adoption, LCNB reclassified stranded tax effects of $492,000 into retained earnings as of January 1, 2018.

Revenue Recognition
Accounting Standards Codification 606, "Revenue from Contracts with Customers" ("ASC 606") provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance enumerates five steps that entities should follow in achieving this core principle. Revenue generated from financial instruments, including loans and investment securities, are not included in the scope of ASC 606. The adoption of ASC 606 did not result in a change to the accounting for any of LCNB's revenue streams that are within the scope of the amendments. Revenue-generating activities that are within the scope of ASC 606 and that are presented as non-interest income in LCNB's consolidated statements of income include:

- Fiduciary income - this includes periodic fees due from trust and investment services customers for managing the customers' financial assets. Fees are generally charged on a quarterly or annual basis and are recognized ratably throughout the period, as the services are provided on an ongoing basis.
- Service charges and fees on deposit accounts - these include general service fees charged for deposit account maintenance and activity and transaction-based fees charged for certain services, such as debit card, wire transfer, or overdraft activities. Revenue is recognized when the performance obligation is completed, which is generally after a transaction is completed or monthly for account maintenance services.

Note 2 – Acquisition

On December 20, 2017, LCNB and Columbus First Bancorp, Inc. ("CFB") entered into an Agreement and Plan of Merger ("Merger Agreement") pursuant to which CFB merged with and into LCNB on May 31, 2018. LCNB entered into this transaction with the expectation that it would be accretive to income and expand its presence in the desirable

Franklin County, Ohio market area. Immediately following the merger of CFB into LCNB, Columbus First Bank, a wholly-owned subsidiary of CFB, merged into the Bank. Columbus First Bank operated from one full-service office located in Worthington, Ohio. That office became a branch of the Bank after the merger.

Under the terms of the Merger Agreement, the shareholders of CFB received two shares of LCNB common stock for each outstanding CFB common share. Unexercised stock options of CFB were canceled in exchange for a cash payment.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 2 – Acquisition (continued)

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

Consideration Paid:	
Common shares issued (3,253,060 shares issued at $19.55 per share)	$63,598
Cash paid to cancel share based payment awards	783
	64,381
Identifiable Assets Acquired:	
Cash and cash equivalents	13,679
Interest-bearing time deposits	10,350
Federal Home Loan Bank stock	1,207
Loans, net	282,748
Loans held for sale, net	1,819
Premises and equipment	102
Core deposit intangible	2,089
Other real estate owned	35
Other assets	2,022
Total identifiable assets acquired	314,051
Liabilities Assumed:	
Deposits	245,036
Short-term borrowings	10,000
Long-term debt	22,920
Deferred income taxes	200
Other liabilities	491
Total liabilities assumed	278,647
Total Identifiable Net Assets Acquired	35,404
Goodwill resulting from merger	$28,977

LCNB has recorded provisional amounts at June 30, 2018 for fair values related to loans, deposits, mortgage servicing rights, long-term debt, core deposit intangible, and corresponding current and deferred taxes as the initial accounting for the business combination is incomplete. As permitted by ASC 805-10-25, Business Combinations, these provisional amounts may be adjusted to reflect any new information obtained about facts and circumstances existing at the acquisition date.

The amount of goodwill recorded reflects LCNB's expansion in the Columbus market and related synergies that are expected to result from the acquisition and represents the excess purchase price over the estimated fair value of the net assets acquired. The goodwill will not be amortizable on LCNB's financial records and will not be deductible for tax purposes. Goodwill will be subject to an annual test for impairment and the amount impaired, if any, will be charged to expense at the time of impairment. The core deposit intangible will be amortized over the estimated weighted average economic life of the various core deposit types.

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

CFB's results of operations are included in the consolidated condensed statements of income from the date of the merger.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 2 – Acquisition (continued)

The amount of CFB's revenue (net interest income plus non-interest income) and net income, excluding merger-related expenses, included in LCNB's consolidated condensed statement of income for the three and six months ended June 30, 2018 were as follows (in thousands):

Total revenue	$906
Net income	469

The following table presents unaudited pro forma information as if the merger with CFB had occurred on January 1, 2017 (in thousands). This pro forma information gives effect to certain adjustments, including purchase accounting fair value adjustments, amortization of the core deposit intangible, and related income tax effects. It does not include merger and data conversion costs. The pro forma information does not necessarily reflect the results of operations that would have occurred had the merger with CFB occurred in 2017. In particular, expected operational cost savings are not reflected in the pro forma amounts.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Total revenue	$16,116	16,173	31,704	31,159
Net income	3,721	4,129	7,734	7,917
Basic earnings per common share	0.28	0.31	0.58	0.60
Diluted earnings per common share	0.28	0.31	0.58	0.60

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 3 - Investment Securities

The amortized cost and estimated fair value of equity and debt securities at June 30, 2018 and December 31, 2017 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2018				
Debt Securities, Available-for-Sale:				
U.S. Treasury notes	$ 2,280	$ —	$ 78	$ 2,202
U.S. Agency notes	83,774	—	3,226	80,548
U.S. Agency mortgage-backed securities	62,752	17	2,571	60,198
Municipal securities:				
Non-taxable	96,853	112	1,933	95,032
Taxable	19,935	104	298	19,741
	$ 265,594	$ 233	$ 8,106	$ 257,721
Debt Securities, Held-to-Maturity:				
Municipal securities:				
Non-taxable	$ 27,910	$ 51	$ 715	$ 27,246
Taxable	3,700	—	150	3,550
	$ 31,610	$ 51	$ 865	$ 30,796
December 31, 2017				
Equity Securities with a Readily Determinable Fair Value:				
Mutual funds	$ 1,586	2	46	1,542
Trust preferred securities	49	1	—	50
Equity securities	$ 475	97	4	568
	2,110	$ 100	$ 50	$ 2,160
Debt Securities, Available-for-Sale:				
U.S. Treasury notes	$ 2,283	$ —	$ 24	$ 2,259
U.S. Agency notes	84,837	57	1,633	83,261
U.S. Agency mortgage-backed securities	68,347	33	1,227	67,153
Municipal securities:				
Non-taxable	102,849	343	1,018	102,174
Taxable	20,313	175	122	20,366
	$ 278,629	$ 608	$ 4,024	$ 275,213
Debt Securities, Held-to-Maturity:				
Municipal securities:				
Non-taxable	$ 28,871	$ 101	$ 227	$ 28,745
Taxable	3,700	—	95	3,605

$ 32,571	$ 101	$ 322	$ 32,350

13

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 3 - Investment Securities (continued)

Information concerning debt securities with gross unrealized losses at June 30, 2018 and December 31, 2017, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (dollars in thousands):

	Less than Twelve Months		Twelve Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2018				
Available-for-Sale:				
U.S. Treasury notes	$2,202	$ 78	$—	$ —
U.S. Agency notes	31,616	867	48,932	2,359
U.S. Agency mortgage-backed securities	19,555	483	39,827	2,088
Municipal securities:				
Non-taxable	54,493	691	23,525	1,242
Taxable	13,898	215	3,214	83
	$121,764	$ 2,334	$115,498	$ 5,772
Held-to-Maturity:				
Municipal securities:				
Non-taxable	$17,229	618	3,539	97
Taxable	399	1	3,151	149
	$17,628	$ 619	$6,690	$ 246
December 31, 2017				
Available-for-Sale:				
U.S. Treasury notes	$2,259	$ 24	$—	$ —
U.S. Agency notes	33,651	344	44,560	1,289
U.S. Agency mortgage-backed securities	24,433	142	41,080	1,085
Municipal securities:				
Non-taxable	36,348	315	24,197	703
Taxable	11,068	114	1,032	8
	$107,759	$ 939	$110,869	$ 3,085
Held-to-Maturity:				
Municipal securities:				
Non-taxable	$9,824	$ 133	$3,542	$ 94
Taxable	—	—	3,205	95
	$9,824	$ 133	$6,747	$ 189

Management has determined that the unrealized losses at June 30, 2018 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because LCNB does not have the intent to sell the investments and it is more likely than not that LCNB will not be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, LCNB does not consider these investments to be other-than-temporarily impaired.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 3 - Investment Securities (continued)

Contractual maturities of debt securities at June 30, 2018 were as follows (in thousands). Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$15,287	$15,278	$3,240	$3,245
Due from one to five years	102,178	100,308	4,084	3,996
Due from five to ten years	83,168	79,860	8,474	8,232
Due after ten years	2,209	2,077	15,812	15,323
	202,842	197,523	31,610	30,796
U.S. Agency mortgage-backed securities	62,752	60,198	—	—
	$265,594	$257,721	$31,610	$30,796

Debt securities with a market value of $134,626,000 and $108,751,000 at June 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes required or as permitted by law.

Certain information concerning the sale of debt securities available for sale for the three and six months ended June 30, 2018 and 2017 was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Proceeds from sales	$3,343	$12,243	$3,343	$12,243
Gross realized gains	7	140	7	140
Gross realized losses	8	—	8	—

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

Beginning January 1, 2018, equity securities with a readily determinable fair value are carried at fair value, with changes in fair value recognized in other operating income in the consolidated condensed statements of income. Equity securities without a readily determinable fair value are measured at cost minus impairment, if any, plus or minus any changes resulting from observable price changes in orderly transactions, as defined, for identical or similar investments of the same issuer. LCNB was not aware of any impairment or observable price change adjustments that needed to be made at June 30, 2018 on its investments in equity securities without a readily determinable fair value.

The amortized cost and estimated fair value of equity securities with a readily determinable fair value at June 30, 2018 are summarized as follows (in thousands):

	Amortized Cost	Fair Value
Mutual funds	$ 1,623	$1,545
Trust preferred securities	49	50
Equity securities	478	593

Total equity securities with a readily determinable fair value	$ 2,150	$2,188

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 3 - Investment Securities (continued)

Certain information concerning changes in fair value of equity securities with a readily determinable fair value for the six months ended June 30, 2018 was as follows (in thousands):

Net gains recognized	$11
Less net gains recognized on equity securities sold	23
Unrealized losses recognized and still held at period end	$(12)

Note 4 - Loans

Major classifications of loans at June 30, 2018 and December 31, 2017 are as follows (in thousands):

	June 30, 2018	December 31, 2017
Commercial and industrial	$81,778	$ 36,057
Commercial, secured by real estate	705,978	527,947
Residential real estate	339,435	251,582
Consumer	17,705	17,450
Agricultural	13,390	15,194
Other loans, including deposit overdrafts	583	539
	1,158,869	848,769
Deferred origination costs, net	229	291
	1,159,098	849,060
Less allowance for loan losses	3,603	3,403
Loans, net	$1,155,495	$ 845,657

Non-accrual, past-due, and accruing restructured loans as of June 30, 2018 and December 31, 2017 are as follows (in thousands):

	June 30, 2018	December 31, 2017
Non-accrual loans:		
Commercial and industrial	$—	$ —
Commercial, secured by real estate	3,050	2,183
Residential real estate	838	604
Consumer	—	—
Agricultural	177	178
Total non-accrual loans	4,065	2,965
Past-due 90 days or more and still accruing	5	—
Total non-accrual and past-due 90 days or more and still accruing	4,070	2,965
Accruing restructured loans	10,228	10,469
Total	$14,298	$ 13,434

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 4 – Loans (continued)

The allowance for loan losses for the three and six months ended June 30, 2018 and 2017 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
Three Months Ended June 30, 2018							
Balance, beginning of period	$ 393	$ 2,143	$ 869	$ 78	$ 44	$ 2	$3,529
Provision charged to expenses	14	189	—	(1)	8	14	224
Losses charged off	—	—	(192)	(10)	—	(30)	(232)
Recoveries	—	51	13	3	—	15	82
Balance, end of period	$ 407	$ 2,383	$ 690	$ 70	$ 52	$ 1	$3,603
Six Months Ended June 30, 2018							
Balance, beginning of year	$ 378	$ 2,178	$ 717	$ 76	$ 53	$ 1	$3,403
Provision charged to expenses	29	58	186	7	(1)	24	303
Losses charged off	—	(29)	(227)	(21)	—	(61)	(338)
Recoveries	—	176	14	8	—	37	235
Balance, end of period	$ 407	$ 2,383	$ 690	$ 70	$ 52	$ 1	$3,603
Three Months Ended June 30, 2017							
Balance, beginning of period	$ 353	$ 2,007	$ 809	$ 91	$ 66	$ 2	$3,328
Provision charged to expenses	(90)	206	109	(20)	(5)	22	222
Losses charged off	—	(82)	(118)	(9)	—	(31)	(240)
Recoveries	10	5	22	24	—	11	72
Balance, end of period	$ 273	$ 2,136	$ 822	$ 86	$ 61	$ 4	$3,382
Six Months Ended June 30, 2017							
Balance, beginning of year	$ 350	$ 2,179	$ 885	$ 96	$ 60	$ 5	3,575
Provision charged to expenses	(92)	296	2	3	1	27	237
Losses charged off	—	(344)	(135)	(54)	—	(61)	(594)
Recoveries	15	5	70	41	—	33	164
Balance, end of period	$ 273	$ 2,136	$ 822	$ 86	$ 61	$ 4	$3,382

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 4 – Loans (continued)

A breakdown of the allowance for loan losses and the loan portfolio by loan segment at June 30, 2018 and December 31, 2017 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
June 30, 2018							
Allowance for loan losses:							
Individually evaluated for impairment	$ 10	$ 3	$ 26	$ —	$ —	$ —	$ 39
Collectively evaluated for impairment	397	2,380	664	70	52	1	3,564
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of period	$ 407	$ 2,383	$ 690	$ 70	$ 52	$ 1	$ 3,603
Loans:							
Individually evaluated for impairment	$ 285	$ 11,748	$ 1,366	$ 44	$ 178	$ —	$ 13,621
Collectively evaluated for impairment	80,154	688,669	335,934	17,771	13,232	213	1,135,973
Acquired credit impaired loans	1,378	5,171	2,585	—	—	370	9,504
Balance, end of period	$ 81,817	$ 705,588	$ 339,885	$ 17,815	$ 13,410	$ 583	$ 1,159,098
December 31, 2017							
Allowance for loan losses:							
Individually evaluated for impairment	$ 8	$ 146	$ 29	$ 8	$ —	$ —	$ 191
Collectively evaluated for impairment	370	2,032	688	68	53	1	3,212
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of period	$ 378	$ 2,178	$ 717	$ 76	$ 53	$ 1	$ 3,403
Loans:							
Individually evaluated for impairment	$ 303	$ 11,289	$ 1,351	$ 47	$ 177	$ —	$ 13,167
Collectively evaluated for impairment	34,792	512,259	248,674	17,516	15,033	137	828,411
Acquired credit impaired loans	1,008	4,048	2,024	—	—	402	7,482
Balance, end of period	$ 36,103	$ 527,596	$ 252,049	$ 17,563	$ 15,210	$ 539	$ 849,060

Note 4 – Loans (continued)

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

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

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

Commercial real estate loans are underwritten based on the ability of the property, in the case of income producing property, or the borrower’s business to generate sufficient cash flow to amortize the debt. Secondary emphasis is placed upon global debt service, collateral value, financial strength of any guarantors, and other factors. Commercial real estate loans are generally originated with a 75% to 80% maximum loan to appraised value ratio, depending upon borrower occupancy.

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

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

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

a loan to appraised value ratio of greater than 80%.
Consumer Loans. LCNB's portfolio of consumer loans generally includes secured and unsecured loans to individuals for household, family and other personal expenditures. Secured loans include loans to fund the purchase of automobiles, recreational vehicles, boats, and similar acquisitions. Consumer loans made by LCNB generally have fixed rates and terms ranging up to 72 months, depending upon the nature of the collateral, size of the loan, and other relevant factors.

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

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

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 4 – Loans (continued)

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

- Pass – loans categorized in this category are higher quality loans that do not fit any of the other categories described below.
- Other Assets Especially Mentioned ("OAEM") – loans in this category are currently protected but are potentially weak. These loans constitute a risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an undue risk in light of the circumstances surrounding a specific asset.
- Substandard – loans in this category are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that LCNB will sustain some loss if the deficiencies are not corrected.
- Doubtful – loans classified in this category have all the weaknesses inherent in loans classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

A breakdown of the loan portfolio by credit quality indicators at June 30, 2018 and December 31, 2017 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
June 30, 2018					
Commercial & industrial	$81,341	$134	$ 342	$ —	$81,817
Commercial, secured by real estate	685,745	790	18,838	215	705,588
Residential real estate	336,980	—	2,905	—	339,885
Consumer	17,788	—	27	—	17,815
Agricultural	13,233	—	177	—	13,410
Other	583	—	—	—	583
Total	$1,135,670	$924	$ 22,289	$ 215	$1,159,098
December 31, 2017					
Commercial & industrial	$35,683	$176	$ 244	$ —	$36,103
Commercial, secured by real estate	506,833	2,180	18,583	—	527,596
Residential real estate	250,039	—	2,010	—	252,049
Consumer	17,522	—	41	—	17,563
Agricultural	14,233	—	977	—	15,210
Other	539	—	—	—	539
Total	$824,849	$2,356	$ 21,855	$ —	$849,060

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 4 – Loans (continued)

A loan portfolio aging analysis at June 30, 2018 and December 31, 2017 is as follows (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans Greater Than 90 Days and Accruing
June 30, 2018							
Commercial & industrial	$3	$24	$—	$27	$81,790	$81,817	$ —
Commercial, secured by real estate	35	—	1,531	1,566	704,022	705,588	—
Residential real estate	846	96	753	1,695	338,190	339,885	—
Consumer	23	20	5	48	17,767	17,815	5
Agricultural	—	—	177	177	13,233	13,410	—
Other	161	—	—	161	422	583	—
Total	$1,068	$140	$2,466	$3,674	$1,155,424	$1,159,098	$ 5
December 31, 2017							
Commercial & industrial	$—	$—	$—	$—	$36,103	$36,103	$ —
Commercial, secured by real estate	124	—	598	722	526,874	527,596	—
Residential real estate	362	135	496	993	251,056	252,049	—
Consumer	29	2	—	31	17,532	17,563	—
Agricultural	—	—	177	177	15,033	15,210	—
Other	82	—	—	82	457	539	—
Total	$597	$137	$1,271	$2,005	$847,055	$849,060	$ —

Impaired loans, including acquired credit impaired loans, at June 30, 2018 and December 31, 2017 are as follows (in thousands):

	June 30, 2018			December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial & industrial	$1,383	$2,619	$ —	$1,015	$1,100	$ —
Commercial, secured by real estate	16,766	18,550	—	12,677	13,608	—
Residential real estate	3,396	4,277	—	2,822	3,516	—
Consumer	21	21	—	6	6	—
Agricultural	178	178	—	177	177	—
Other	370	515	—	402	554	—
Total	$22,114	$26,160	$ —	$17,099	$18,961	$ —

With an allowance recorded:

Commercial & industrial	$280	$ 285	$ 10	$296	$ 301	$ 8
Commercial, secured by real estate	153	153	3	2,660	2,660	146
Residential real estate	555	581	26	553	572	29
Consumer	23	23	—	41	41	8
Agricultural	—	—	—	—	—	—
Other	—	—	—	—	—	—
Total	$1,011	$ 1,042	$ 39	$3,550	$ 3,574	$ 191
Total:						
Commercial & industrial	$1,663	$ 2,904	$ 10	$1,311	$ 1,401	$ 8
Commercial, secured by real estate	16,919	18,703	3	15,337	16,268	146
Residential real estate	3,951	4,858	26	3,375	4,088	29
Consumer	44	44	—	47	47	8
Agricultural	178	178	—	177	177	—
Other	370	515	—	402	554	—
Total	$23,125	$ 27,202	$ 39	$20,649	$ 22,535	$ 191

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 4 – Loans (continued)

The following presents information related to the average recorded investment and interest income recognized on impaired loans, including acquired credit impaired loans, for the three and six months ended June 30, 2018 and 2017 (in thousands):

	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Three Months Ended June 30,				
With no related allowance recorded:				
Commercial & industrial	$741	$ 15	$261	$ 10
Commercial, secured by real estate	15,281	193	16,488	269
Residential real estate	2,934	49	3,351	47
Consumer	10	—	30	1
Agricultural	178	—	217	—
Other	391	11	463	14
Total	$19,535	$ 268	$20,810	$ 341
With an allowance recorded:				
Commercial & industrial	$283	$ 4	$314	$ 4
Commercial, secured by real estate	154	3	1,087	25
Residential real estate	566	7	603	8
Consumer	23	—	44	1
Agricultural	—	—	—	—
Other	—	—	—	—
Total	$1,026	$ 14	$2,048	$ 38
Total:				
Commercial & industrial	$1,024	$ 19	$575	$ 14
Commercial, secured by real estate	15,435	196	17,575	294
Residential real estate	3,500	56	3,954	55
Consumer	33	—	74	2
Agricultural	178	—	217	—
Other	391	11	463	14
Total	$20,561	$ 282	$22,858	$ 379
Six Months Ended June 30,				
With no related allowance recorded:				
Commercial & industrial	$805	$ 25	$261	$ 36
Commercial, secured by real estate	15,166	389	16,736	468
Residential real estate	2,950	97	3,332	136
Consumer	15	1	31	1
Agricultural	178	—	267	—

Other	394	22	463	32
Total	$19,508	$ 534	$21,090	$ 673
With an allowance recorded:				
Commercial & industrial	$288	$ 9	$318	$ 9
Commercial, secured by real estate	155	6	970	33
Residential real estate	571	15	612	16
Consumer	24	—	43	2
Agricultural	—	—	—	—
Other	—	—	—	—
Total	$1,038	$ 30	$1,943	$ 60
Total:				
Commercial & industrial	$1,093	$ 34	$579	$ 45
Commercial, secured by real estate	15,321	395	17,706	501
Residential real estate	3,521	112	3,944	152
Consumer	39	1	74	3
Agricultural	178	—	267	—
Other	394	22	463	32
Total	$20,546	564	$23,033	$ 733

Note 4 – Loans (continued)

Of the interest income recognized on impaired loans during the six months ended June 30, 2018 and 2017, approximately $20,000 and $3,000, respectively, were recognized on a cash basis.

From time to time, the terms of certain loans are modified as troubled debt restructurings ("TDRs") where concessions are granted to borrowers experiencing financial difficulties. The modification of the terms of such loans may have included one or a combination of the following: a reduction of the stated interest rate of the loan, and increase in the stated rate of interest lower than the current market rate for new debt with similar risk, an extension of the maturity date, or a change in the payment terms. During the three and six months ended June 30, 2018, there were no loans modified as a TDR.

Two commercial, secured by real estate loans to the same borrower totaling $1,236,000 that were modified during the fourth quarter 2016 subsequently defaulted in February 2017. There were no troubled debt restructurings that subsequently defaulted within twelve months of the restructuring date for the six months ended June 30, 2018 and that remained in default at period end.

No impaired loans without a valuation allowance and no impaired loans with a valuation allowance at June 30, 2018 consisted of loans that were modified during the six months ended June 30, 2018 and were determined to be troubled debt restructurings. Approximately $0 of impaired loans without a valuation allowance and $23,000 of impaired loans with a valuation allowance at June 30, 2017 consisted of loans that were modified during the six months ended June 30, 2017 and were determined to be troubled debt restructurings.

Mortgage loans sold to and serviced for the Federal Home Loan Mortgage Corporation and other investors or participants are not included in the accompanying consolidated condensed balance sheets. The unpaid principal balances of those loans at June 30, 2018 and December 31, 2017 were approximately $114,536,000 and $92,818,000, respectively.

The total recorded investment in residential consumer mortgage loans secured by residential real estate that were in the process of foreclosure at June 30, 2018 was $488,000.

Note 5 - Acquired Credit Impaired Loans

Loans acquired through mergers are recorded at fair value with no carryover of the acquired entity's previously established allowance for loan losses. The excess of expected cash flows over the estimated fair value of acquired loans is recognized as interest income over the remaining contractual lives of the loans using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows result in the recognition of additional interest income over the then-remaining contractual lives of the loans. The calculation of the excess of expected cash flows over the estimated fair value of loans acquired from the CFB acquisition has not been finalized.

Impaired loans acquired are accounted for under FASB Accounting Standards Codification ("ASC") 310-30. Factors considered in evaluating whether an acquired loan was impaired include delinquency status and history, updated borrower credit status, collateral information, and updated loan-to-value information. The difference between contractually required payments at the time of acquisition and the cash flows expected to be collected is referred to as the nonaccretable difference. The interest component of the cash flows expected to be collected is referred to as the accretable yield and is recognized as interest income over the remaining contractual life of the loan using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows will result in a reclassification from the nonaccretable difference to the accretable yield. The calculation of the nonaccretable difference and interest component of cash flows expected to be collected from loans obtained from the CFB acquisition has not been finalized.

The final fair values of CFB's loans and the classification of loans as acquired credit impaired have not yet been finalized and the following tables contain provisional amounts that are subject to change as more information becomes available.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 5 – Acquired Credit Impaired Loans (continued)

The following table provides at June 30, 2018 and December 31, 2017 the major classifications of acquired credit impaired loans that are accounted for in accordance with FASB ASC 310-30 (in thousands):

	June 30, 2018	December 31, 2017
Acquired from First Capital Bancshares, Inc.		
Commercial & industrial	$ 16	$ 20
Commercial, secured by real estate	834	848
Residential real estate	929	947
Other loans, including deposit overdrafts	—	—
Total	$ 1,779	$ 1,815
Acquired from Eaton National Bank & Trust Co.		
Commercial & industrial	$ 867	$ 988
Commercial, secured by real estate	1,628	1,699
Residential real estate	825	892
Other loans, including deposit overdrafts	370	402
Total	$ 3,690	$ 3,981
Acquired from BNB Bancorp, Inc.		
Commercial & industrial	$ —	$ —
Commercial, secured by real estate	1,452	1,501
Residential real estate	169	185
Other loans, including deposit overdrafts	—	—
Total	$ 1,621	$ 1,686
Acquired from Columbus First Bancorp, Inc.		
Commercial & industrial	$ 495	
Commercial, secured by real estate	1,257	
Residential real estate	662	
Other loans, including deposit overdrafts	—	
Total	$ 2,414	
Total		
Commercial & industrial	$ 1,378	$ 1,008
Commercial, secured by real estate	5,171	4,048
Residential real estate	2,585	2,024
Other loans, including deposit overdrafts	370	402
Total	$ 9,504	$ 7,482

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

	June 30, 2018	December 31, 2017
Outstanding balance	$13,500	$ 9,065
Carrying amount	9,504	7,482

24

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

Note 5 – Acquired Credit Impaired Loans (continued)

Activity during the six months ended June 30, 2018 and 2017 for the accretable discount related to acquired credit impaired loans is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Accretable discount at beginning of period	$635	$896	$669	$1,080
Reclassification from nonaccretable discount to accretable discount	—	59	—	158
Less disposals	—	—	—	(170)
Less accretion	(2)	(104)	(36)	(217)
Accretable discount at end of period	$633	$851	$633	$851

Provisional amounts for the accretable discount related to acquired credit impaired loans obtained from the acquisition of CFB have not been finalized and are not included in the above table.

Note 6 - Affordable Housing Tax Credit Limited Partnership

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

The following table presents the balances of LCNB's affordable housing tax credit investments and related unfunded commitments at June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Affordable housing tax credit investment	$ 3,000	$ 3,000
Less amortization	343	231
Net affordable housing tax credit investment	$ 2,657	$ 2,769
Unfunded commitment	$ 1,804	$ 2,257

The net affordable housing tax credit investment is included in other assets and the unfunded commitment is included in accrued interest and other liabilities in the consolidated condensed balance sheets.

LCNB expects to fund the unfunded commitment over 10.0 years.

The following table presents other information relating to LCNB's affordable housing tax credit investments for the six months ended June 30, 2018 and 2017 (in thousands):

	2018	2017
Tax credits and other tax benefits recognized	$112	$ 79
Tax credit amortization expense included in provision for income taxes	112	82

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 7 - Premises Held for Sale, Net

During the second quarter 2018, LCNB entered into a contract to sell a branch building. Finalization of the sale agreement is anticipated to occur in the third quarter of 2018. The sale price of the building was approximately $645,000 less than the carrying value, resulting in an impairment charge of the aforementioned amount. The new fair value of the premises held for sale at June 30, 2018 is $512,000.

Note 8 - Goodwill

On May 31, 2018, the Columbus First acquisition resulted in a provisional amount of goodwill totaling $28,977,000. The following table shows the changes in the carrying amount of goodwill for the six months ended June 30, 2018 and 2017 (in thousands):

	2018	2017
Balance, January 1	$30,183	$30,183
Goodwill acquired	28,977	—
Balance, June 30	$59,160	$30,183

Note 9 – Borrowings

Borrowings at June 30, 2018 and December 31, 2017 are as follows (dollars in thousands):

	June 30, 2018		December 31, 2017	
	Amount	Rate	Amount	Rate
FHLB short-term advances	$—	— %	$47,000	1.43%
FHLB long-term advances	27,085	1.82%	303	2.82%
	$27,085	1.82%	$47,303	1.44%

All advances from the Federal Home Loan Bank ("FHLB") of Cincinnati, both long-term and short-term, are secured by a blanket pledge of LCNB's 1-4 family first lien mortgage loans in the amount of approximately $294 million and $217 million at June 30, 2018 and December 31, 2017, respectively. Additionally, LCNB is required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 10 – Income Taxes

The Tax Cuts and Jobs Act ("Tax Act") was enacted on December 22, 2017. Among other changes, the Tax Act reduced the maximum U.S. Federal corporate tax rate from 35% to 21%.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Statutory tax rate	21.0 %	35.0 %	21.0 %	35.0 %
Increase (decrease) resulting from:				
Tax exempt interest	(4.4)%	(6.7)%	(4.3)%	(6.4)%
Tax exempt income on bank owned life insurance	(1.2)%	(2.6)%	(1.2)%	(2.0)%
Captive insurance premium income	(1.0)%	— %	(1.3)%	— %
Other, net	0.7 %	(0.2)%	0.9 %	(0.4)%
Effective tax rate	15.1 %	25.5 %	15.1 %	26.2 %

Note 11 - Commitments and Contingent Liabilities

LCNB is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. Exposure to credit loss in the event of nonperformance by the other parties to financial instruments for commitments to extend credit is represented by the contract amount of those instruments.

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

LCNB uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Financial instruments whose contract amounts represent off-balance-sheet credit risk at June 30, 2018 and December 31, 2017 are as follows (in thousands):

	June 30, 2018	December 31, 2017
Commitments to extend credit:		
Commercial loans	$20,757	$18,964
Other loans		
Fixed rate	5,261	2,747

Adjustable rate	1,015	1,150
Unused lines of credit:		
Fixed rate	52,302	20,984
Adjustable rate	161,103	90,147
Unused overdraft protection amounts on demand and NOW accounts	16,309	16,441
Standby letters of credit	1,080	294
Total commitments	$257,827	$150,727

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 11 – Commitments and Contingent Liabilities (continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Unused lines of credit include amounts not drawn on line of credit loans. Commitments to extend credit and unused lines of credit generally have fixed expiration dates or other termination clauses.

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

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

Capital expenditures include the construction or acquisition of new office buildings, improvements to LCNB's offices, purchases of furniture and equipment, and additions or improvements to LCNB's information technology system. Commitments outstanding for capital expenditures as of June 30, 2018 totaled approximately $260,000.

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

LCNB and its subsidiaries are parties to various claims and proceedings arising in the normal course of business. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such proceedings and claims will not be material to the consolidated financial position or results of operations.

Note 12 – Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) for the six months ended June 30, 2018 and the year ended December 31, 2017 are as follows (in thousands):

	Unrealized Gains and Losses on Available-for-Sale Securities	Changes in Pension Plan Assets and Benefit Obligations	Total
Six Months Ended June 30, 2018:			
Balance at beginning of period	$ (2,200)	$ (142)	$(2,342)
Cumulative effect of changes in accounting principles	(498)	(27)	(525)
Balance at beginning of period, as adjusted	(2,698)	(169)	(2,867)
Before reclassifications	(3,523)	6	(3,517)
Reclassifications	1	—	1
Balance at end of period	$ (6,220)	$ (163)	$(6,383)
Year Ended December 31, 2017:			
Balance at beginning of period	$ (2,633)	$ 16	$(2,617)

Before reclassifications	585	(158)	427
Reclassifications	(152)	—	(152)
Balance at end of period	$ (2,200)	$ (142)	$(2,342)

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

Note 12 – Accumulated Other Comprehensive Income (Loss) (continued)

Reclassifications out of accumulated other comprehensive income (loss) during the three and six months ended June 30, 2018 and 2017 and the affected line items in the consolidated condensed statements of income are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,		Affected Line Item in the Consolidated Condensed Statements of Income
	2018	2017	2018	2017	
Realized gain (loss) on sale of debt securities	$(1)	$140	$(1)	$140	Net gain (loss) from sales of debt securities, available-for-sale
Less provision for income taxes	—	48	—	48	Provision for income taxes
Reclassification adjustment, net of taxes	$(1)	92	(1)	92	

Note 13 – Retirement Plans

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

Employees hired on or after January 1, 2009 receive a 50% employer match on their contributions into the 401(k) plan, up to a maximum LCNB contribution of 3% of each individual employee's annual compensation.

Funding and administrative costs of the qualified noncontributory defined benefit retirement plan and 401(k) plan charged to pension and other employee benefits in the consolidated condensed statements of income for the three and six-month periods ended June 30, 2018 and 2017 are as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Qualified noncontributory defined benefit retirement plan	$264	262	$525	$522
401(k) plan	107	94	217	196

Certain highly compensated employees participate in a nonqualified defined benefit retirement plan. The nonqualified plan ensures that participants receive the full amount of benefits to which they would have been entitled under the noncontributory defined benefit retirement plan in the absence of limits on benefit levels imposed by certain sections of the Internal Revenue Code. This plan is limited to the original participants and no new participants have been added.

The components of net periodic pension cost of the nonqualified defined benefit retirement plan for the three and six months ended June 30, 2018 and 2017 are summarized as follows (in thousands):

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Service cost	$—	—	$—	$—
Interest cost	17	17	34	34
Amortization of unrecognized net loss	4	—	8	—
Net periodic pension cost	$21	17	$42	$34

29

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

Note 13 – Retirement Plans (continued)

Amounts recognized in accumulated other comprehensive income (loss), net of tax, at June 30, 2018 and December 31, 2017 for the nonqualified defined benefit retirement plan consists of (in thousands):

	June 30, 2018	December 31, 2017
Net actuarial (gain) loss	$ 162	$ 141
Past service cost	—	—
Total recognized, net of tax	$ 162	$ 141

Note 14 – Stock Based Compensation

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

The 2015 Ownership Incentive Plan (the "2015 Plan") was ratified by LCNB's shareholders at the annual meeting on April 28, 2015 and allows for stock-based awards to eligible employees, as determined by the Compensation Committee of the Board of Directors. Awards may be made in the form of stock options, appreciation rights, restricted shares, and/or restricted share units. The 2015 Plan provides for the issuance of up to 450,000 shares of common stock. The 2015 Plan will terminate on April 28, 2025 and is subject to earlier termination by the Compensation Committee.

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

LCNB has not granted stock option awards since 2012. Options granted to date under the 2002 Plan vest ratably over a five-year period and expire ten years after the date of grant. Stock options outstanding at June 30, 2018 were as follows:

	Outstanding Stock Options			Exercisable Stock Options		
Exercise Price Range	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
$9.00 - $10.99	4,356	$ 9.00	0.6	4,356	$ 9.00	0.6
$11.00 - $12.99	13,278	11.98	2.6	13,278	11.98	2.6
	17,634	11.25	2.1	17,634	11.25	2.1

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

	Six Months Ended June 30,	
	2018	2017

	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, January 1,	20,265	$ 11.42	24,669	$ 12.17
Granted	—	—	—	—
Exercised	(2,631)	12.55	(3,398)	14.94
Expired	—	—	(1,006)	17.88
Outstanding, June 30,	17,634	11.25	20,265	11.42
Exercisable, June 30,	17,634	11.25	20,265	11.42

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 14 – Stock Based Compensation (continued)

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

	Six Months Ended June 30, 2018	2017
Intrinsic value of options exercised	$ 17	$ 25
Cash received from options exercised	33	51
Tax benefit realized from options exercised	2	5

The aggregate intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) for options outstanding and exercisable at June 30, 2018 that were "in the money" (market price greater than exercise price) was $149,000. The aggregate intrinsic value for options outstanding and exercisable at June 30, 2017 that were in the money was $174,000. The intrinsic value changes based upon fluctuations in the market value of LCNB's common stock.

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

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

	2018		2017	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding, January 1,	8,817	$ 16.44	8,624	$ 15.47
Granted	10,634	19.20	4,027	22.60
Vested	(669)	22.60	—	—
Forfeited	—	—	—	—
Outstanding, June 30,	18,782	$ 17.78	12,651	$ 17.74

Total expense related to restricted stock awards included in salaries and wages in the consolidated condensed statements of income for the three and six months ended June 30, 2018 was $15,000 and $71,000, respectively, and the related tax benefit was $3,000 and $15,000, respectively. Unrecognized compensation expense for restricted stock awards was $217,000 at June 30, 2018 and is expected to be recognized over a period of 4.0 years. Total expense related to restricted stock awards included in salaries and wages in the consolidated condensed statements of income for the three and six months ended June 30, 2017 was $7,000 and $63,000, respectively, and the related tax benefit was $3,000 and $22,000, respectively.

Note 15 – Earnings per Common Share

LCNB has granted restricted stock awards with non-forfeitable dividend rights, which are considered participating securities. Accordingly, earnings per share is computed using the two-class method as required by FASB ASC 260-10-45. Basic earnings per common share is calculated by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding during the period, which excludes the participating securities. Diluted earnings per common share is adjusted for the dilutive effects of stock options, warrants, and restricted stock. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock options and warrants with proceeds used to purchase treasury shares at the average market price for the period.

Earnings per share for the three and six months ended June 30, 2018 and 2017 were calculated as follows (dollars in thousands, except share and per share data):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$2,738	$ 3,003	$5,451	$ 6,249
Less allocation of earnings and dividends to participating securities	3	2	7	4
Net income allocated to common shareholders	$2,735	$ 3,001	$5,444	$ 6,245
Weighted average common shares outstanding, gross	11,114,745	10,010,455	10,578,290	10,005,798
Less average participating securities	15,260	6,033	15,260	6,033
Weighted average number of shares outstanding used in the calculation of basic earnings per common share	11,099,485	10,004,422	10,563,030	9,999,765
Add dilutive effect of:				
Stock options	5,529	6,890	5,762	7,427
Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share	11,105,014	10,011,312	10,568,792	10,007,192
Earnings per common share:				
Basic	$0.25	$ 0.30	$0.52	$ 0.62
Diluted	0.25	0.30	0.52	0.62

There were no anti-dilutive stock options outstanding at June 30, 2018 or 2017.

Note 16 - Fair Value Measurements

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

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

Note 16 - Fair Value Measurements (continued)

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

- Level 1 – quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs may include quoted prices for similar assets in active markets, quoted prices for identical assets or liabilities in markets that are not active, inputs other than quoted prices (such as interest rates or yield curves) that are observable for the asset or liability, and inputs that are derived from or corroborated by observable market data.
- Level 3 – inputs that are unobservable for the asset or liability.

Equity Securities With a Readily Determinable Fair Value
Equity securities with a readily determinable fair value are reported at fair value with changes in fair value reported in other operating income in the consolidated statements of income. Fair values for trust preferred and equity securities are determined based on market quotations (level 1). LCNB has invested in two mutual funds that are traded in active markets and their fair values are based on market quotations (level 1). Investments in another two mutual funds are measured at fair value using net asset values ("NAV") and are considered level 1 because the NAVs are determined and published and are the basis for current transactions.

Debt Securities, Available-for-Sale
The majority of LCNB's financial debt securities are classified as available-for-sale. The securities are reported at fair value with unrealized holding gains and losses reported net of income taxes in accumulated other comprehensive income (loss). LCNB utilizes a pricing service for determining the fair values of its debt securities. Methods and significant assumptions used to estimate fair value are as follows:

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

- Fair values for the other debt securities are calculated using the discounted cash flow method for each security. The discount rates for these cash flows are estimated by the pricing service using rates observed in the market (level 2). Cash flow streams are dependent on estimated prepayment speeds and the overall structure of the securities given existing market conditions.

Assets Recorded at Fair Value on a Nonrecurring Basis
Assets that may be recorded at fair value on a nonrecurring basis include impaired loans, other real estate owned, and other repossessed assets.

A loan is considered impaired when management believes it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate or the fair value of collateral if the loan is collateral dependent, if this value is less than the loan balance. These inputs are considered to be level 3.

Other real estate owned is adjusted to fair value, less costs to sell, upon transfer of the loan to foreclosed assets, usually based on an appraisal of the property. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Other repossessed assets are valued at estimated sales prices, less costs to sell. The inputs for real estate owned and other repossessed assets are considered to be level 3.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 16 - Fair Value Measurements (continued)

The following table summarizes the valuation of LCNB's assets recorded at fair value by input levels as of June 30, 2018 and December 31, 2017 (in thousands):

		Fair Value Measurements at the End of the Reporting Period Using		
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2018				
Recurring fair value measurements:				
Equity securities with a readily determinable fair value:				
Trust preferred securities	$ 50	$50	$ —	$ —
Equity securities	593	593	—	—
Mutual funds	36	36	—	—
Mutual funds measured at net asset value	1,509	1,509	—	—
Debt securities available-for-sale:				
U.S. Treasury notes	2,202	2,202	—	—
U.S. Agency notes	80,548	4,689	75,859	—
U.S. Agency mortgage-backed securities	60,198	—	60,198	—
Municipal securities:				
Non-taxable	95,032	—	95,032	—
Taxable	19,741	—	19,741	—
Total recurring fair value measurements	$ 259,909	$9,079	$ 250,830	$ —
Nonrecurring fair value measurements:				
Impaired loans	$ 972	$—	$ —	$ 972
Other real estate owned and repossessed assets	35	—	—	35
Total nonrecurring fair value measurements	$ 1,007	$—	$ —	$ 1,007
December 31, 2017				
Recurring fair value measurements:				
Equity securities with a readily determinable fair value:				
Trust preferred securities	$ 50	$50	$ —	$ —
Equity securities	568	568	—	—
Mutual funds	23	23	—	—

Mutual funds measured at net asset value	1,519	1,519	—	—
Debt securities available-for-sale:				
U.S. Treasury notes	2,259	2,259	—	—
U.S. Agency notes	83,261	—	83,261	—
U.S. Agency mortgage-backed securities	67,153	—	67,153	—
Municipal securities:				
Non-taxable	102,174	—	102,174	—
Taxable	20,366	—	20,366	—
Total recurring fair value measurements	$ 277,373	$4,419	$ 272,954	$ —
Nonrecurring fair value measurements:				
Impaired loans	$ 3,359	$—	$ —	$ 3,359

33

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 16 - Fair Value Measurements (continued)

The following table presents quantitative information about unobservable inputs used in nonrecurring level 3 fair value measurements at June 30, 2018 and December 31, 2017 (dollars in thousands):

	Fair Value	Valuation Technique	Unobservable Inputs	Range High	Range Low	Weighted Average
June 30, 2018						
Impaired loans	$59	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
	913	Discounted cash flows	Discount rate	8.25%	4.50%	6.93 %
Other real estate owned	35	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
December 31, 2017						
Impaired loans	$1,753	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
	1,606	Discounted cash flows	Discount rate	8.25%	3.25%	6.27 %
Other real estate owned	—	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 16 - Fair Value Measurements (continued)

Carrying amounts and estimated fair values of financial instruments as of June 30, 2018 and December 31, 2017 are as follows (in thousands):

			Fair Value Measurements at the End of the Reporting Period Using		
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2018					
FINANCIAL ASSETS:					
Cash and cash equivalents	$24,901	$ 24,901	$ 24,901	$ —	$ —
Equity securities without a readily determinable fair value:					
Equity security	99	99	—	—	99
Mutual fund	2,000	2,000	—	—	2,000
Investment securities, held-to-maturity	31,610	30,796	—	—	30,796
Federal Reserve Bank stock	2,732	2,732	2,732	—	—
Federal Home Loan Bank stock	4,845	4,845	4,845	—	—
Loans, net	1,155,495	1,110,582	—	—	1,110,582
Accrued interest receivable	4,344	4,344	—	4,344	—
FINANCIAL LIABILITIES:					
Deposits	1,380,884	1,381,561	1,077,990	303,571	—
Short-term borrowings	—	—	—	—	—
Long-term debt	27,085	27,415	—	27,415	—
Accrued interest payable	344	344	—	344	—
December 31, 2017					
FINANCIAL ASSETS:					
Cash and cash equivalents	$25,386	$ 25,386	$ 25,386	$ —	$ —
Equity securities without a readily determinable fair value:					
Equity security	99	99	—	—	99
Mutual fund	1,000	1,000	—	—	1,000
Investment securities, held-to-maturity	32,571	32,350	—	—	32,350
Federal Reserve Bank stock	2,732	2,732	2,732	—	—
Federal Home Loan Bank stock	3,638	3,638	3,638	—	—
Loans, net	845,657	813,368	—	—	813,368
Accrued interest receivable	3,511	3,511	—	3,511	—

FINANCIAL LIABILITIES:					
Deposits	1,085,821	1,087,086	894,046	193,040	—
Short-term borrowings	47,000	47,000	47,000	—	—
Long-term debt	303	307	—	307	—
Accrued interest payable	329	329	—	329	—

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 16 - Fair Value Measurements (continued)

The fair values of off-balance-sheet financial instruments such as loan commitments and letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements. The fair values of such instruments were not material at June 30, 2018 and December 31, 2017.

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

Cash and cash equivalents
The carrying amounts presented are deemed to approximate fair value.

Equity securities without a readily determinable fair value
Equity securities without a readily determinable fair value are measured at cost, less impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

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

Federal Home Loan Bank stock and Federal Reserve Bank stock
The carrying value of Federal Home Loan Bank and Federal Reserve Bank stock approximates fair value based on the respective redemptive provisions.

Loans
The estimated fair value of loans as of June 30, 2018 follows the guidance in ASU 2016-01, which prescribes an “exit price” approach in estimating and disclosing fair value of financial instruments. The fair value calculation at that date discounted estimated future cash flows using rates that incorporated discounts for credit, liquidity, and marketability factors. The fair value estimate shown as of December 31, 2017 used an “entry price” approach. The fair value calculation for that date discounted estimated future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Consequently, the fair value disclosures for June 30, 2018 and December 31, 2017 are not directly comparable.

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

Borrowings
The carrying amounts of federal funds purchased, repurchase agreements, and U.S. Treasury demand note borrowings are deemed to approximate fair value of short-term borrowings. For long-term debt, fair values are estimated based on

the discounted value of expected net cash flows using current interest rates.

Accrued interest receivable and Accrued interest payable
Carrying amount approximates fair value.

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 17 – Recent Accounting Pronouncements

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

ASU No. 2016-02, "Leases (Topic 842)"
ASU No. 2016-02 was issued in February 2016 and requires a lessee to recognize in the statement of financial position a liability to make lease payments ("the lease liability") and a right-of-use asset representing its right to use the underlying asset for the lease term, initially measured at the present value of the lease payments. When measuring assets and liabilities arising from a lease, the lessee should include payments to be made in optional periods only if the lessee is reasonably certain, as defined, to exercise an option to the lease or not to exercise an option to terminate the lease. Optional payments to purchase the underlying asset should be included if the lessee is reasonably certain it will exercise the purchase option. Most variable lease payments should be excluded except for those that depend on an index or a rate or are in substance fixed payments.

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

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

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

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

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

Table of Contents
LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(Continued)

Note 17 – Recent Accounting Pronouncements (continued)

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

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

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

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

ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities"
ASU No. 2017-12 was issued in August 2017 and applies to any entity that elects to apply hedge accounting in accordance with current generally accepted accounting principles. The amendments in this update better align an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both nonfinancial and financial risk

components. The amendments are effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early application is permitted. LCNB does not currently own any instruments within the scope of ASU No. 2017-12 and its adoption is not expected to have a material impact on its results of operations or financial position.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

Forward Looking Statements

Certain statements made in this document regarding LCNB's financial condition, results of operations, plans, objectives, future performance and business, are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. These forward-looking statements are identified by the fact they are not historical facts and include words such as "anticipate", "could", "may", "feel", "expect", "believe", "plan", and similar express Please refer to LCNB's Annual Report on Form 10-K for the year ended December 31, 2017, as well as its other filings with the SEC, for a more detailed discussion of risks, uncertainties and factors that could cause actual results to differ from those discussed in the forward-looking statements.

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

1. the success, impact, and timing of the implementation of LCNB's business strategies;
2. LCNB's ability to integrate recent and future acquisitions, including the merger with Columbus First Bancorp, Inc., may be unsuccessful or may be more difficult, time-consuming, or costly than expected;
3. LCNB may incur increased charge-offs in the future;
4. LCNB may face competitive loss of customers;
5. changes in the interest rate environment may have results on LCNB's operations materially different from those anticipated by LCNB's market risk management functions;
6. changes in general economic conditions and increased competition could adversely affect LCNB's operating results;
7. changes in regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact LCNB's operating results;
8. LCNB may experience difficulties growing loan and deposit balances;
9. the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations;
10. deterioration in the financial condition of the U.S. banking system may impact the valuations of investments LCNB has made in the securities of other financial institutions resulting in either actual losses or other-than-temporary impairments on such investments;
11. difficulties with technology or data security breaches, including cyberattacks, that could negatively affect LCNB's ability to conduct business and its relationships with customers, vendors, and others; and
12. government intervention in the U.S. financial system, including the effects of recent legislative, tax, accounting, and regulatory actions and reforms, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Jumpstart Our Business Startups Act, the Consumer Financial Protection Bureau, the capital ratios of Basel III as adopted by the federal banking authorities, and the Tax Cuts and Jobs Act.

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

Critical Accounting Policies

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

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

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

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

Accounting for Intangibles. LCNB’s intangible assets at June 30, 2018 are composed primarily of goodwill and core deposit intangibles related to acquisitions of other financial institutions. It also includes mortgage servicing rights recorded from sales of mortgage loans to the Federal Home Loan Mortgage Corporation and mortgage servicing rights acquired through the acquisition of Eaton National Bank & Trust Co. Goodwill is not subject to amortization, but is reviewed annually for impairment. Core deposit intangibles are being amortized on a straight line basis over their respective estimated weighted average lives. Mortgage servicing rights are capitalized by allocating the total cost of loans between mortgage servicing rights and the loans based on their estimated fair values. Capitalized mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income, subject to periodic review for impairment.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

Results of Operations

Net income for the three and six months ended June 30, 2018 was $2,738,000 (total basic and diluted earnings per share of $0.25) and $5,451,000 (total basic and diluted earnings per share of $0.52), respectively. This compares to net income of $3,003,000 (total basic and diluted earnings per share of $0.30) and $6,249,000 (total basic and diluted earnings per share of $0.62) for the same three and six month periods in 2017. Items significantly affecting net income during the 2018 periods were:

- expenses relating to the merger with Columbus First Bancorp, Inc. ("CFB") totaled $855,000 and $1,613,000 for the three and six month periods, respectively,
- results of operations from CFB are included in the consolidated condensed statements of income from the date of the merger, which was May 31, 2018.
- a $645,000 premises impairment charge recognized during the second quarter, and
- a reduction in LCNB's federal tax rate from 34% to 21% as a result of the Tax Cuts and Jobs Act that was signed into law on December 22, 2017.

Net interest income for the three and six months ended June 30, 2018 was, respectively, $1,295,000 and $1,496,000 greater than the comparable periods in 2017, primarily due to growth in LCNB's loan portfolio, partially offset by a decrease in average investment securities and a market-driven increase in average rates paid on deposits. Loans obtained through the merger with CFB were a significant component of LCNB's loan portfolio growth.

The provision for loan losses for the three and six months ended June 30, 2018 was, respectively, $2,000 and $66,000 greater than the comparable periods in 2017. Non-accrual loans and loans past due 90 days or more and still accruing interest increased $1,173,000, from $2,965,000 or 0.35% of total loans at December 31, 2017, to $4,138,000 or 0.36% of total loans at June 30, 2018. Most of the increase was due to one borrower.

Non-interest income for the three and six months ended June 30, 2018 was, respectively, $1,000 and $207,000 greater than the comparable periods in 2017 primarily due to increases in fiduciary income and service charges and fees on deposit accounts, partially offset by a decrease in net gains (losses) from sales of securities.

Non-interest expense for the three and six months ended June 30, 2018 was, respectively, $2,100,000 and $3,681,000 greater than the comparable periods in 2017 primarily due to increases in salaries and employee benefits, merger-related expenses, and an impairment charge recognized on one of LCNB's office buildings. Merger-related expenses increased due to costs connected to the acquisition of CFB.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

Net Interest Income

Three Months Ended June 30, 2018 vs. 2017

LCNB's primary source of earnings is net interest income, which is the difference between earnings from loans and other investments and interest paid on deposits and other liabilities. The following table presents, for the three months ended June 30, 2018 and 2017, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resulting average yields earned or rates paid.

	Three Months Ended June 30,					
	2018			2017		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
			(Dollars in thousands)			
Loans (1)	$961,726	$10,703	4.46 %	$811,186	$8,823	4.36 %
Federal funds sold	—	—	— %	—	—	— %
Interest-bearing demand deposits	8,084	52	2.58 %	17,648	42	0.95 %
Interest-bearing time deposits	3,462	2	0.23 %	—	—	— %
Federal Reserve Bank stock	2,732	82	12.04 %	2,732	82	12.04 %
Federal Home Loan Bank stock	4,036	61	6.06 %	3,638	43	4.74 %
Investment securities:						
Equity securities	3,291	24	2.93 %	3,258	21	2.59 %
Debt securities, taxable	168,245	934	2.23 %	218,223	1,128	2.07 %
Debt securities, non-taxable (2)	124,600	861	2.77 %	145,444	1,223	3.37 %
Total earnings assets	1,276,176	12,719	4.00 %	1,202,129	11,362	3.79 %
Non-earning assets	137,765			122,647		
Allowance for loan losses	(4,245)			(3,334)		
Total assets	$1,409,696			$1,321,442		
Savings deposits	$676,504	242	0.14 %	$666,318	153	0.09 %
IRA and time certificates	226,451	854	1.51 %	210,327	693	1.32 %
Short-term borrowings	3,491	7	0.80 %	15,030	12	0.32 %
Long-term debt	13,252	67	2.03 %	441	3	2.73 %
Total interest-bearing liabilities	919,698	1,170	0.51 %	892,116	861	0.39 %
Demand deposits	309,149			271,561		
Other liabilities	10,772			9,939		
Capital	170,077			147,826		
Total liabilities and capital	$1,409,696			$1,321,442		
Net interest rate spread (3)			3.49 %			3.40 %
Net interest income and net interest margin on a taxable-equivalent basis (4)		$11,549	3.63 %		$10,501	3.50 %
Ratio of interest-earning assets to interest-bearing liabilities	138.76 %			134.75 %		

(1)Includes non-accrual loans.
(2)Income from tax-exempt securities is included in interest income on a taxable-equivalent basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 21% for 2018 and 35% for 2017.
(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.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

The following table presents the changes in taxable-equivalent basis interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the three months ended June 30, 2018 as compared to the same period in 2017. Changes not solely attributable to rate or volume have been allocated to volume and rate changes in proportion to the relationship of absolute dollar amounts of the changes in each.

	Three Months Ended June 30, 2018 vs. 2017 Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
Interest-earning Assets:			
Loans	$1,671	$209	$1,880
Federal funds sold	—	—	—
Interest-bearing demand deposits	(32)	42	10
Interest-bearing time deposits	2	—	2
Federal Reserve Bank stock	—	—	—
Federal Home Loan Bank stock	5	13	18
Investment securities:			
Equity securities	—	3	3
Debt securities, taxable	(273)	79	(194)
Debt securities, non-taxable	(161)	(201)	(362)
Total interest income	1,212	145	1,357
Interest-bearing Liabilities:			
Savings deposits	2	87	89
IRA and time certificates	56	105	161
Short-term borrowings	(14)	9	(5)
Long-term debt	65	(1)	64
Total interest expense	109	200	309
Net interest income	$1,103	$(55)	$1,048

Net interest income on a fully taxable-equivalent basis for the three months ended June 30, 2018 totaled $11,549,000, an increase of $1,048,000 from the comparable period in 2017. Total interest income increased $1,357,000, partially offset by an increase in interest expense of $309,000.

The increase in total interest income was due primarily to a $1,880,000 increase in loan interest income caused by a $150.5 million increase in average loans and by a 10 basis point (a basis point equals 0.01%) increase in the average rate earned on loans. Partially offsetting the increase in loan interest income were a $194,000 decrease in interest income from taxable debt securities and a $362,000 decrease in interest income from non-taxable debt securities. The decrease in interest income from taxable investment securities was caused by a $50.0 million decrease in average taxable debt securities, partially offset by a 16 basis point increase in the average rate earned on these securities. The decrease in interest income from non-taxable investment securities was due to a 60 basis point decrease in the average rate earned and to a $20.8 million decrease in average non-taxable debt securities. One of the reasons for the 60 basis point decrease in the average rate earned on non-taxable debt securities was the decrease in the Federal corporate tax rate to 21%, which decreased the effective yield earned on these securities.

The increase in total interest expense was due to a 12 basis point increase in the average rate paid on total interest-bearing liabilities and to a $27.6 million increase in average total interest-bearing liabilities.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

Six Months Ended June 30, 2018 vs. 2017

The following table presents, for the six months ended June 30, 2018 and 2017, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resulting average yields earned or rates paid.

	Six Months Ended June 30,					
	2018			2017		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
			(Dollars in thousands)			
Loans (1)	$907,739	$20,116	4.47%	$812,385	$17,738	4.40 %
Federal funds sold	—	—	— %	—	—	— %
Interest-bearing demand deposits	5,987	71	2.39%	12,993	58	0.90 %
Interest-bearing time deposits	1,740	2	0.23%	—	—	— %
Federal Reserve Bank stock	2,732	82	6.05%	2,732	82	6.05 %
Federal Home Loan Bank stock	3,838	114	5.99%	3,638	84	4.66 %
Investment securities:						
Equity securities	3,273	46	2.83%	3,240	42	2.61 %
Debt securities, taxable	170,901	1,865	2.20%	215,257	2,200	2.06 %
Debt securities, non-taxable (2)	127,523	1,752	2.77%	145,049	2,452	3.41 %
Total earnings assets	1,223,733	24,048	3.96%	1,195,294	22,656	3.82 %
Non-earning assets	131,447			123,203		
Allowance for loan losses	(3,825)			(3,445)		
Total assets	$1,351,355			$1,315,052		
Savings deposits	$661,680	441	0.13%	$656,192	299	0.09 %
IRA and time certificates	207,989	1,526	1.48%	211,927	1,390	1.32 %
Short-term borrowings	8,759	76	1.75%	21,728	42	0.39 %
Long-term debt	7,784	81	2.10%	489	7	2.89 %
Total interest-bearing liabilities	886,212	2,124	0.48%	890,336	1,738	0.39 %
Demand deposits	294,141			268,776		
Other liabilities	10,879			9,682		
Capital	160,123			146,258		
Total liabilities and capital	$1,351,355			$1,315,052		
Net interest rate spread (3)			3.48%			3.43 %
Net interest income and net interest margin on a taxable-equivalent basis (4)		$21,924	3.61%		$20,918	3.53 %
Ratio of interest-earning assets to interest-bearing liabilities	138.09 %			134.25 %		

(1)Includes non-accrual loans.

(2)Income from tax-exempt securities is included in interest income on a taxable-equivalent basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 21% for 2018 and 34.6% for 2017.
(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.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

The following table presents the changes in taxable-equivalent basis interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the six months ended June 30, 2018 as compared to the same period in 2017. Changes not solely attributable to rate or volume have been allocated to volume and rate changes in proportion to the relationship of absolute dollar amounts of the changes in each.

	Six Months Ended June 30, 2018 vs. 2017 Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
Interest-earning Assets:			
Loans	$2,110	$268	$2,378
Federal funds sold	—	—	—
Interest-bearing demand deposits	(44)	57	13
Interest-bearing time deposits	2	—	2
Federal Reserve Bank stock	—	—	—
Federal Home Loan Bank stock	5	25	30
Investment securities:			
Equity securities	—	4	4
Debt securities, taxable	(476)	141	(335)
Debt securities, non-taxable	(275)	(425)	(700)
Total interest income	1,322	70	1,392
Interest-bearing Liabilities:			
Savings deposits	3	139	142
IRA and time certificates	(26)	162	136
Short-term borrowings	(38)	72	34
Long-term debt	76	(2)	74
Total interest expense	15	371	386
Net interest income	$1,307	$(301)	$1,006

Net interest income on a fully taxable-equivalent basis for the six months ended June 30, 2018 totaled $21,924,000, an increase of $1,006,000 from the comparable period in 2017. Total interest income increased $1,392,000 and total interest expense increased $386,000.

The increase in total interest income was due primarily to a $2,378,000 increase in loan interest income caused by a $95.4 million increase in average loans and by a 7 basis point increase in the average rate earned on loans. Largely offsetting the increase in loan interest income were a $335,000 decrease in interest income from taxable debt securities and a $700,000 decrease in interest income from non-taxable debt securities. The decrease in interest income from taxable investment securities was caused by a $44.4 million decrease in average taxable debt securities, partially offset by a 14 basis point increase in the average rate earned on these securities. The decrease in interest income from non-taxable investment securities was due to a 64 basis point decrease in the average rate earned and to a $17.5

million decrease in average non-taxable debt securities. One of the reasons for the 64 basis point decrease in the average rate earned on non-taxable debt securities was the decrease in the Federal corporate tax rate to 21%, which decreased the effective yield earned on these securities.

The increase in total interest expense was due primarily to a $142,000 increase in interest paid on savings deposits and to a $136,000 increase in interest paid on IRA and time certificates. Savings deposit interest increased primarily due to a 4 basis point increase in the average rate paid and secondarily to a $5.5 million increase in average savings deposits. IRA and time certificates increased due to a 16 basis point increase in the average rate paid, slightly offset by a $3.9 million decrease in average IRA and time certificates. Interest on long-term debt increased $74,000 due to a $7.3 million increase in average long-term debt, slightly offset by a 79 basis point decrease in the average rate paid.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

Provision and Allowance For Loan Losses

The total provision for loan losses is determined based upon management's evaluation as to the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, and current economic conditions that may affect borrowers' ability to pay. The provision for loan losses for the three and six months ended June 30, 2018 was $224,000 and $303,000, respectively, as compared to $222,000 and $237,000 for the same three and six month periods in 2017. Net charge-offs for the three and six months ended June 30, 2018 were $150,000 and $103,000, respectively, as compared to net charge-offs of $168,000 and $430,000 for the comparable periods in 2017.

Non-Interest Income

A comparison of non-interest income for the three and six months ended June 30, 2018 and 2017 is as follows (in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	Difference	2018	2017	Difference
Fiduciary income	$942	$881	$ 61	$1,906	$1,733	$ 173
Service charges and fees on deposit accounts	1,426	1,312	114	2,731	2,534	197
Net gain (loss) on sales of debt securities, available-for-sale	(1)	140	(141)	(1)	140	(141)
Bank owned life insurance income	182	297	(115)	368	486	(118)
Gains from sales of loans	97	63	34	119	102	17
Other operating income	145	97	48	304	225	79
Total non-interest income	$2,791	$2,790	$ 1	$5,427	$5,220	$ 207

Reasons for material increases and decreases include:

- Fiduciary income increased due to an increase in trust and brokerage assets managed.
- Service charges and fees on deposit accounts increased primarily due to fees earned from an Insured Cash Sweep (ICS®) product that was introduced during the second quarter 2017 and from an increase in debit card income. Debit card income increased due to greater depositor utilization of the cards and due to more favorable interchange rates received by LCNB resulting from a change in the processing vendor.
- Net gain (loss) on sales of securities decreased due to a lower volume of sales.
- Bank owned life insurance income decreased due to the absence of mortality benefits received during the second quarter 2017.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

Non-Interest Expense

A comparison of non-interest expense for the three and six months ended June 30, 2018 and 2017 is as follows (in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	Difference	2018	2017	Difference
Salaries and employee benefits	$5,128	$4,703	$ 425	$10,105	$9,229	$ 876
Equipment expenses	268	264	4	521	475	46
Occupancy expense, net	658	636	22	1,385	1,204	181
State franchise tax	296	286	10	599	570	29
Marketing	284	216	68	416	359	57
Amortization of intangibles	188	188	—	373	373	—
FDIC insurance premiums	99	108	(9)	198	212	(14)
Contracted services	391	375	16	706	623	83
Other real estate owned	1	—	1	3	5	(2)
Merger-related expenses	855	—	855	1,613	—	1,613
Other non-interest expense	2,543	1,835	708	4,341	3,529	812
Total non-interest expense	$10,711	$8,611	$ 2,100	$20,260	$16,579	$ 3,681

Reasons for material increases and decreases include:

- Salaries and employee benefits increased 9.0% and 9.5% for the three and six months ended June 30, 2018, respectively, as compared to the same periods in 2017. These increases were primarily due to salary and wage increases, newly hired employees, and CFB employees retained. Full-time equivalent employees at June 30, 2018 totaled 344, compared with 290 full-time equivalent employees at June 30, 2017.
- Occupancy expense for the six-month period increased primarily due to increased depreciation expense on bank premises and increased maintenance and repair costs. The depreciation increase was largely due to the Operations Center, which went into service during March 2017. Maintenance and repair costs increased largely due to snow and ice removal costs during the 2017-2018 winter.
- Merger-related expenses during the 2018 periods are due to the acquisition of CFB.
- Other non-interest expense increased primarily due to a $645,000 impairment charge recognized by LCNB on one of its office buildings during the second quarter 2018.

Income Taxes

LCNB's effective tax rates for the three and six months ended June 30, 2018 were 15.1% and 15.1%, respectively, compared to 25.5% and 26.2% for the three and six months ended June 30, 2017, respectively. The difference between the statutory rate of 21% for 2018 and 35.0% for 2017 and the effective tax rates is primarily due to tax-exempt interest income from municipal securities, tax-exempt earnings from bank owned life insurance, tax-exempt earnings from LCNB Risk Management, Inc., and tax credits and losses related to investments in affordable housing tax credit limited partnerships.

Financial Condition

Assets

Total assets at June 30, 2018 were $335.8 million greater than at December 31, 2017 primarily due to the merger with CFB. The carrying values of loans, deposits, and long-term debt were significantly influenced by this merger. See Note 2 - Acquisition to the consolidated condensed financial statements for a description of the merger and a summary of the estimated fair values of CFB's assets and liabilities added to LCNB's balance sheet.

Interest-bearing time deposits of $9.9 million at June 30, 2018 were obtained through the merger with CFB. This line item represents certificates of deposit with individual balances of less than $250,000 invested in various financial institutions.

Equity securities without a readily determinable fair value increased $1.0 million, from $1.1 million at December 31, 2017 to $2.1 million at June 30, 2018. The increase represents an additional investment in a mutual fund.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

Available-for-sale debt securities at June 30, 2018 were $17.5 million less than at December 31, 2017 primarily due to maturities and calls totaling $8.9 million, sales totaling $3.3 million, and net decreases in fair values totaling $4.5 million.

Federal Home Loan Bank stock at June 30, 2018 was $1.2 million greater than at December 31, 2017. The additional stock was obtained through the merger with CFB.

Net loans at June 30, 2018 were $309.8 million greater than at December 31, 2017. The merger with CFB added approximately $282.7 million to LCNB's loan portfolio as of the merger date. The balance of the increase is due to organic growth.

Liabilities and Shareholders' Equity

Total deposits at June 30, 2018 were $295.1 million greater than at December 31, 2017. The merger with CFB added approximately $245.0 million of deposits to LCNB's balance sheet as of the merger date. Another $16.2 million of the increase was due to public fund deposits by local government entities. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities. Historically, public fund deposits tend to be at their lowest balances at year-ends.

Long-term debt at June 30, 2018 was $26.8 million greater than at December 31, 2017. LCNB borrowed $6.0 million during the first quarter 2018 and assumed $22.9 million of long-term debt from CFB. These additions were slightly offset by a $2.0 million payoff of matured debt.

The increase in total deposits and long-term debt, along with the decrease in available-for-sale debt securities mentioned above, contributed to a $47.0 million decrease in short-term borrowings between December 31, 2017 and June 30, 2018 and to the organic growth in the loan portfolio.

Total shareholders' equity at June 30, 2018 was $62.1 million greater than at December 31, 2017. Common stock issued to CFB shareholders had a merger-date fair value of $63.6 million. This addition was slightly offset by a $4.0 million decrease in accumulated other comprehensive income (loss), net of taxes, resulting from market driven net decreases in the fair values of available-for-sale debt securities.

Regulatory Capital

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

A rule requiring a Capital Conservation Buffer began phase-in on January 1, 2016 and will be fully implemented at the beginning of 2019. Under the fully-implemented rule, a financial institution will need to maintain a Capital

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

LCNB CORP. AND SUBSIDIARIES

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

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

	Minimum Requirement	Minimum Requirement with Capital Conservation Buffer for 2018	To Be Considered Well-Capitalized
Ratio of Common Equity Tier 1 Capital to risk-weighted assets	4.5 %	6.375 %	6.5 %
Ratio of Tier 1 Capital to risk-weighted assets	6.0 %	7.875 %	8.0 %
Ratio of Total Capital (Tier 1 Capital plus Tier 2 Capital) to risk-weighted assets	8.0 %	9.875 %	10.0 %
Leverage Ratio (Tier 1 Capital to adjusted quarterly average total assets)	4.0 %	N/A	5.0 %

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

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

	June 30, 2018	December 31, 2017
Regulatory Capital:		
Shareholders' equity	$212,366	$150,271
Goodwill and other intangibles	(64,188)	(32,906)
Accumulated other comprehensive loss	6,383	2,828
Tier 1 risk-based capital	154,561	120,193
Eligible allowance for loan losses	3,603	3,403
Total risk-based capital	$158,164	$123,596
Capital ratios:		
Common Equity Tier 1 Capital to risk-weighted assets	12.70 %	13.29 %
Tier 1 Capital to risk-weighted assets	12.70 %	13.29 %
Total Capital to risk-weighted assets	13.00 %	13.66 %
Leverage	11.42 %	9.51 %

Liquidity

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

Effective liquidity management ensures that cash is available to meet the cash flow needs of borrowers and depositors, as well as meeting LCNB's operating cash needs. Primary funding sources include customer deposits with the Bank, short-term and long-term borrowings from the Federal Home Loan Bank, short-term line of credit arrangements totaling $40.0 million with two correspondent banks, and interest and repayments received from LCNB's loan and investment portfolios.

Total remaining borrowing capacity with the Federal Home Loan Bank at June 30, 2018 was approximately $117.6 million. One of the factors limiting remaining borrowing capacity is ownership of FHLB stock. LCNB could increase its borrowing capacity by purchasing additional FHLB stock. In addition, additional borrowings of approximately $40.0 million were available through the line of credit arrangements at quarter-end.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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

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

Table of Contents

LCNB CORP. AND SUBSIDIARIES
Item 3. 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. IRSA is used to estimate the effect on net interest income ("NII") during a one-year period of instantaneous and sustained movements in interest rates, also called interest rate shocks, of 100, 200, and 300 basis points. Management considers the results of any significant downward scenarios to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the June 30, 2018 IRSA indicates that an increase in interest rates will have a positive effect on net interest income ("NII"). The changes in NII for all rate assumptions are within LCNB's acceptable ranges.

Rate Shock Scenario in Basis Points	Amount	$ Change in NII	% Change in NII
	(Dollars in thousands)		
Up 300	$60,708	4,755	8.50 %
Up 200	59,091	3,138	5.61 %
Up 100	57,496	1,543	2.76 %
Base	55,953	—	— %

IRSA shows the effect on NII during a one-year period only. A more long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. As shown below, the June 30, 2018 EVE analysis indicates that an increase in interest rates will have a positive effect on the EVE. The changes in EVE for all rate assumptions are within LCNB's acceptable ranges.

Rate Shock Scenario in Basis Points	Amount	$ Change in EVE	% Change in EVE
	(Dollars in thousands)		
Up 300	$221,352	2,768	1.27 %
Up 200	222,057	3,473	1.59 %
Up 100	220,850	2,266	1.04 %
Base	218,584	—	— %

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.

Table of Contents

LCNB CORP. AND SUBSIDIARIES
Item 4. Controls and Procedures

a) Disclosure controls and procedures. The Chief Executive Officer and the Chief Financial Officer have carried out an evaluation of the effectiveness of LCNB's disclosure controls and procedures that ensure that information relating to LCNB required to be disclosed by LCNB in the reports that it files or submits under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to LCNB's management, including its principal executive officer and principal financial officer, as appropriate, in order to allow timely decisions to be made regarding required disclosures. Based upon this evaluation, these officers have concluded that, as of June 30, 2018, LCNB's disclosure controls and procedures were effective.

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

Table of Contents

PART II. OTHER INFORMATION

LCNB CORP. AND SUBSIDIARIES

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

No material changes.

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

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

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

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents

LCNB CORP. AND SUBSIDIARIES
Item 6. Exhibits

Exhibit No.	Exhibit Description
2.1	Agreement and Plan of Merger dated as of December 20, 2017 by and between LCNB Corp. and Columbus First Bancorp, Inc. - incorporated by reference to the Registrant's Current Report on Form 8-K filed on December 21, 2017, Exhibit 2.1.
3.1	Amended and Restated Articles of Incorporation of LCNB Corp., as amended. (This document represents the Amended and Restated Articles of Incorporation of LCNB Corp. in compiled form incorporation all amendments. The compiled document has not been filed with the Ohio Secretary of State.)
3.2	Code of Regulations of LCNB Corp. – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005, Exhibit 3(ii).
10.1	LCNB Corp. Ownership Incentive Plan – incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 15, 2002, Exhibit A (000-26121).
10.2	LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 13, 2015, Exhibit A (001-35292)
10.3	Form of Option Grant Agreement under the LCNB Corp. Ownership Incentive Plan – incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2005, Exhibit 10.2.
10.4	Nonqualified Executive Retirement Plan – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2009, Exhibit 10.4.
10.5	Form of Restricted Share Grant Agreement under the LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2015, Exhibit 10.7.
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial information from LCNB Corp.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 is formatted in Extensible Business Reporting Language: (i) the Consolidated Condensed Balance Sheets, (ii) the Consolidated Condensed Statements of Income, (iii) the Consolidated Condensed Statements of Comprehensive Income, (iv) the Consolidated Condensed Statements of Shareholders' Equity, (v) the Consolidated Condensed Statements of Cash Flows, and (vi) the Notes to Consolidated Condensed Financial Statements.

Table of Contents

LCNB CORP. AND SUBSIDIARIES
SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	LCNB Corp.
August 9, 2018	/s/ Steve P. Foster Steve P. Foster Chief Executive Officer and President
August 9, 2018	/s/ Robert C. Haines, II Robert C. Haines, II Executive Vice President and Chief Financial Officer