

LCNB CORP  
Form 10-Q  
May 02, 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 March 31, 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

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

2 North Broadway, Lebanon, Ohio 45036

(Address of principal executive offices, including Zip Code)

(513) 932-1414

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

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

Emerging growth company

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



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

Yes            No

The number of shares outstanding of the issuer's common stock, without par value, as of May 1, 2018 was 10,041,668 shares.

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LCNB CORP. AND SUBSIDIARIES

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

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

	March 31, 2018 (Unaudited)	December 31, 2017
<b>ASSETS:</b>		
Cash and due from banks	\$12,713	\$21,159
Interest-bearing demand deposits	4,781	4,227
Total cash and cash equivalents	17,494	25,386
Investment securities:		
Equity securities with a readily determinable fair value, at fair value	2,144	2,160
Equity securities without a readily determinable fair value, at cost	1,099	1,099
Debt securities, available-for-sale, at fair value	267,894	275,213
Debt securities, held-to-maturity, at cost	32,502	32,571
Federal Reserve Bank stock, at cost	2,732	2,732
Federal Home Loan Bank stock, at cost	3,638	3,638
Loans, net	853,128	845,657
Premises and equipment, net	34,595	34,927
Goodwill	30,183	30,183
Core deposit and other intangibles	3,600	3,799
Bank owned life insurance	28,171	27,985
Other assets	11,611	10,288
<b>TOTAL ASSETS</b>	<b>\$1,288,791</b>	<b>\$1,295,638</b>
<b>LIABILITIES:</b>		
Deposits:		
Noninterest-bearing	\$286,186	\$283,212
Interest-bearing	837,277	802,609
Total deposits	1,123,463	1,085,821
Short-term borrowings	—	47,000
Long-term debt	6,219	303
Accrued interest and other liabilities	10,525	12,243
<b>TOTAL LIABILITIES</b>	<b>1,140,207</b>	<b>1,145,367</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>	<b>—</b>	<b>—</b>
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred shares – no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares – no par value; authorized 19,000,000 shares; issued 10,794,779 and 10,776,686 shares at March 31, 2018 and December 31, 2017, respectively	77,159	76,977
Retained earnings	88,933	87,301
Treasury shares at cost, 753,627 shares at March 31, 2018 and December 31, 2017	(11,665)	(11,665)

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Accumulated other comprehensive loss, net of taxes	(5,843	) (2,342	)
TOTAL SHAREHOLDERS' EQUITY	148,584	150,271	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,288,791	\$ 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.

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CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,	
	2018	2017
<b>INTEREST INCOME:</b>		
Interest and fees on loans	\$9,413	\$ 8,915
Dividends on equity securities with a readily determinable fair value	15	15
Dividends on equity securities without a readily determinable fair value	7	6
Interest on debt securities, taxable	931	1,072
Interest on debt securities non-taxable	704	799
Other investments	72	57
<b>TOTAL INTEREST INCOME</b>	<b>11,142</b>	<b>10,864</b>
<b>INTEREST EXPENSE:</b>		
Interest on deposits	871	843
Interest on short-term borrowings	69	30
Interest on long-term debt	14	4
<b>TOTAL INTEREST EXPENSE</b>	<b>954</b>	<b>877</b>
<b>NET INTEREST INCOME</b>	<b>10,188</b>	<b>9,987</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>79</b>	<b>15</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>10,109</b>	<b>9,972</b>
<b>NON-INTEREST INCOME:</b>		
Trust income	964	852
Service charges and fees on deposit accounts	1,305	1,222
Bank owned life insurance income	186	189
Gains from sales of loans	22	39
Other operating income	159	128
<b>TOTAL NON-INTEREST INCOME</b>	<b>2,636</b>	<b>2,430</b>
<b>NON-INTEREST EXPENSE:</b>		
Salaries and employee benefits	4,977	4,526
Equipment expenses	253	211
Occupancy expense, net	727	568
State franchise tax	303	284
Marketing	132	143
Amortization of intangibles	185	185
FDIC insurance premiums	99	104
Contracted services	315	248
Other real estate owned	2	5
Merger-related expenses	758	—
Other non-interest expense	1,798	1,694
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>9,549</b>	<b>7,968</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>3,196</b>	<b>4,434</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>483</b>	<b>1,188</b>
<b>NET INCOME</b>	<b>\$2,713</b>	<b>\$ 3,246</b>

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Dividends declared per common share	\$0.16	\$ 0.16
Earnings per common share:		
Basic	\$0.27	\$ 0.32
Diluted	0.27	0.32
Weighted average common shares outstanding:		
Basic	10,020,611	9,950,541
Diluted	10,028,588	10,002,878

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

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

	Three Months Ended March 31,	
	2018	2017
Net income	\$2,713	\$3,246
Other comprehensive income (loss):		
Net unrealized gain (loss) on available-for-sale securities (net of taxes of \$(792) and \$256 for the three months ended March 31, 2018 and 2017, respectively)	(2,979 )	528
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of \$1 for the three months ended March 31, 2018)	3	—
Other comprehensive income (loss), net of tax	(2,976 )	528
<b>TOTAL COMPREHENSIVE INCOME (LOSS)</b>	<b>\$(263 )</b>	<b>\$3,774</b>

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

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LCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY  
(Dollars in thousands, except per share 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			3,246			3,246
Other comprehensive income, net of taxes					528	528
Dividend Reinvestment and Stock Purchase Plan	4,192	93				93
Exercise of stock options	3,398	51				51
Compensation expense relating to stock options		1				1
Compensation expense relating to restricted stock	4,027	56				56
Common stock dividends, \$0.16 per share			(1,601 )			(1,601 )
Balance at March 31, 2017	10,009,642	\$76,691	\$82,381	\$(11,665)	\$ (2,089 )	\$ 145,318
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			2,713			2,713
Other comprehensive loss, net of taxes					(2,976 )	(2,976 )
Dividend Reinvestment and Stock Purchase Plan	4,828	93				93
Exercise of stock options	2,631	33				33
Compensation expense relating to restricted stock	10,634	56				56
Common stock dividends, \$0.16 per share			(1,606 )			(1,606 )
Balance at March 31, 2018	10,041,152	\$77,159	\$88,933	\$(11,665)	\$ (5,843 )	\$ 148,584

(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.

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LCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$2,713	\$3,246
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization, and accretion	988	771
Provision for loan losses	79	15
Deferred income tax provision (benefit)	(871)	) 466
Increase in cash surrender value of bank owned life insurance	(186)	) (189)
Realized loss from equity securities	23	—
Realized gain from sales and impairment of premises and equipment	(1)	) —
Realized loss from sales and impairment of other real estate owned and repossessed assets	—	3
Origination of mortgage loans for sale	(868)	) (1,957)
Realized gains from sales of loans	(22)	) (39)
Proceeds from sales of mortgage loans	879	1,971
Compensation expense related to stock options	—	1
Compensation expense related to restricted stock	56	56
Changes in:		
Accrued income receivable	(692)	) (652)
Other assets	786	(631)
Other liabilities	(1,468)	) (1,192)
<b>TOTAL ADJUSTMENTS</b>	<b>(1,297)</b>	<b>) (1,377)</b>
<b>NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</b>	<b>1,416</b>	<b>1,869</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sales of equity securities with a readily determinable fair value	65	—
Proceeds from maturities and calls of debt securities:		
Available-for-sale	3,124	4,205
Held-to-maturity	589	5,398
Purchases of investment securities:		
Equity securities with a readily determinable fair value	(71)	) —
Debt securities, available-for-sale	—	(9,916)
Debt securities, held-to-maturity	(520)	) (2,850)
Net increase (decrease) in loans	(7,488)	) 8,263
Proceeds from sale of other real estate owned and repossessed assets	—	971
Purchases of premises and equipment	(86)	) (3,166)
Proceeds from sale of premises and equipment	1	—
<b>NET CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES</b>	<b>(4,386)</b>	<b>) 2,905</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in deposits	37,642	37,293
Net decrease in short-term borrowings	(47,000)	) (26,083)
Proceeds from long-term debt	6,000	—

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Principal payments on long-term debt	(84 )	(118 )
Proceeds from issuance of common stock	11	12
Proceeds from exercise of stock options	33	51
Cash dividends paid on common stock	(1,524 )	(1,520 )
NET CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES	(4,922 )	9,635
NET CHANGE IN CASH AND CASH EQUIVALENTS	(7,892 )	14,409
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	25,386	18,865
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$17,494	\$33,274
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$976	\$903
Income taxes paid	—	500
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Transfer from loans to other real estate owned and repossessed assets	—	974

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

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

Note 1 - Basis of Presentation

Basis of Presentation

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

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

The consolidated condensed balance sheet as of December 31, 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 months ended March 31, 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. Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a
2. 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.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 1 - Basis of Presentation (continued)

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.

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.

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.

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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 will merge with and into LCNB in an all-stock transaction. Immediately following the merger of CFB into LCNB, Columbus First Bank, a wholly-owned subsidiary of CFB, will

be merged into the Bank. Columbus First Bank operates from one full-service office located in Worthington, Ohio. Subject to customary regulatory approvals, LCNB shareholder approval, and other conditions set forth in the Merger Agreement, the transaction is anticipated to close in the second quarter of 2018. At that time, Columbus First Bank's sole office will become a branch of the Bank.

Under the terms of the Merger Agreement, which has been unanimously approved by the Board of Directors of each company, the shareholders of CFB will be entitled to receive two LCNB common shares for each outstanding CFB common share. Any unexercised stock options of CFB will be canceled in exchange for a cash payment. Based on LCNB's closing share price of \$19.00 as of March 31, 2018, the transaction is valued at \$38.00 for each CFB share or approximately \$60.4 million in aggregate. As of March 31, 2018, CFB has 1,589,516 shares outstanding, as well as 65,724 options with a weighted average strike price of \$14.06 per share.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 – Acquisition (continued)

The acquisition will be accounted for in accordance with applicable accounting guidance. Accordingly, the assets and liabilities of CFB will be recorded at their estimated fair values at the acquisition date. The excess of the estimated fair value of LCNB common shares issued over the net fair values of the assets acquired, including identifiable intangible assets and liabilities assumed, will be recorded as goodwill. The results of operations will be included in the consolidated income statement from the date of the acquisition. 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 estimated fair values of the assets and liabilities have not yet been determined. The recorded amounts reflected on the historic financial records of CFB as of March 31, 2018 include total assets of approximately \$324.1 million, consisting primarily of net loans of \$276.9 million and interest-bearing deposits of \$31.1 million. Recorded liabilities totaling approximately \$290.7 million consisted primarily of deposits totaling \$253.7 million.

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## 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 March 31, 2018 and December 31, 2017 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
March 31, 2018				
Debt Securities, Available-for-Sale:				
U.S. Treasury notes	\$ 2,281	\$ —	\$ 63	\$ 2,218
U.S. Agency notes	84,806	4	2,900	81,910
U.S. Agency mortgage-backed securities	65,412	23	2,212	63,223
Municipal securities:				
Non-taxable	102,625	131	2,050	100,706
Taxable	19,957	123	243	19,837
	\$ 275,081	\$ 281	\$ 7,468	\$ 267,894
Debt Securities, Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$ 28,802	\$ 31	\$ 614	\$ 28,219
Taxable	3,700	—	197	3,503
	\$ 32,502	\$ 31	\$ 811	\$ 31,722
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

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## 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 March 31, 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
March 31, 2018				
Available-for-Sale:				
U.S. Treasury notes	\$2,218	\$ 63	\$—	\$ —
U.S. Agency notes	33,216	778	43,696	2,122
U.S. Agency mortgage-backed securities	23,495	462	38,760	1,750
Municipal securities:				
Non-taxable	57,079	815	23,598	1,235
Taxable	15,808	225	1,381	18
	\$131,816	\$ 2,343	\$107,435	\$ 5,125
Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$17,357	514	3,535	100
Taxable	400	—	3,104	197
	\$17,757	\$ 514	\$6,639	\$ 297
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 March 31, 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.

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 3 - Investment Securities (continued)

Contractual maturities of debt securities at March 31, 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	\$ 14,575	\$ 14,576	\$ 4,023	\$ 4,022
Due from one to five years	94,912	93,591	4,111	4,020
Due from five to ten years	97,963	94,408	8,469	8,261
Due after ten years	2,219	2,096	15,899	15,419
	209,669	204,671	32,502	31,722
U.S. Agency mortgage-backed securities	65,412	63,223	—	—
	\$ 275,081	\$ 267,894	\$ 32,502	\$ 31,722

Debt securities with a market value of \$125,490,000 and \$108,751,000 at March 31, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes required or as permitted by law.

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 March 31, 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 March 31, 2018 are summarized as follows (in thousands):

	Amortized Fair	
	Cost	Value
Mutual funds	\$ 1,613	\$ 1,548
Trust preferred securities	49	50
Equity securities	478	546
Total equity securities with a readily determinable fair value	\$ 2,140	\$ 2,144

Certain information concerning changes in fair value of equity securities with a readily determinable fair value for the three months ended March 31, 2018 was as follows (in thousands):

Net gains (losses) recognized	\$(23)
Less: net gains (losses) recognized on equity securities sold	23
Unrealized gains (losses) recognized and still held at period end	\$(46)



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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 4 - Loans

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

	March 31, December 31,	
	2018	2017
Commercial and industrial	\$ 37,118	\$ 36,057
Commercial, secured by real estate	542,890	527,947
Residential real estate	246,487	251,582
Consumer	17,176	17,450
Agricultural	12,217	15,194
Other loans, including deposit overdrafts	506	539
	856,394	848,769
Deferred origination costs, net	263	291
	856,657	849,060
Less allowance for loan losses	3,529	3,403
Loans, net	\$ 853,128	\$ 845,657

Loans acquired through mergers are recorded at fair value with no carryover of the acquired entity's previously established allowance for loan losses. The excess of expected cash flows over the estimated fair value of acquired loans is recognized as interest income over the remaining contractual lives of the loans using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows result in the recognition of additional interest income over the then-remaining contractual lives of the loans.

Impaired loans acquired are accounted for under FASB Accounting Standards Codification ("ASC") 310-30. Factors considered in evaluating whether an acquired loan was impaired include delinquency status and history, updated borrower credit status, collateral information, and updated loan-to-value information. The difference between contractually required payments at the time of acquisition and the cash flows expected to be collected is referred to as the nonaccretable difference. The interest component of the cash flows expected to be collected is referred to as the accretable yield and is recognized as interest income over the remaining contractual life of the loan using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows will result in a reclassification from the nonaccretable difference to the accretable yield.

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

	March 31, 2018	December 31, 2017
Non-accrual loans:		
Commercial and industrial	\$ —	\$ —
Commercial, secured by real estate	1,876	2,183

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Residential real estate	691	604
Consumer	—	—
Agricultural	177	178
Total non-accrual loans	2,744	2,965
Past-due 90 days or more and still accruing	146	—
Total non-accrual and past-due 90 days or more and still accruing	2,890	2,965
Accruing restructured loans	10,366	10,469
Total	\$13,256	\$13,434

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 4 – Loans (continued)

The allowance for loan losses for the three months ended March 31, 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 March 31, 2018							
Balance, beginning of year	\$ 378	\$ 2,178	\$ 717	\$ 76	\$ 53	\$ 1	\$3,403
Provision charged to expenses	15	(131 )	186	8	(9 )	10	79
Losses charged off	—	(29 )	(35 )	(11 )	—	(31 )	(106 )
Recoveries	—	125	1	5	—	22	153
Balance, end of period	\$ 393	\$ 2,143	\$ 869	\$ 78	\$ 44	\$ 2	\$3,529
Three Months Ended March 31, 2017							
Balance, beginning of year	\$ 350	\$ 2,179	\$ 885	\$ 96	\$ 60	\$ 5	3,575
Provision charged to expenses	(2 )	90	(107 )	23	6	5	15
Losses charged off	—	(262 )	(17 )	(45 )	—	(30 )	(354 )
Recoveries	5	—	48	17	—	22	92
Balance, end of period	\$ 353	\$ 2,007	\$ 809	\$ 91	\$ 66	\$ 2	\$3,328

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## 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 March 31, 2018 and December 31, 2017 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
March 31, 2018							
Allowance for loan losses:							
Individually evaluated for impairment	\$ 11	\$ 4	\$ 189	\$ 12	\$ —	\$ —	\$ 216
Collectively evaluated for impairment	382	2,139	680	66	44	2	3,313
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of period	\$ 393	\$ 2,143	\$ 869	\$ 78	\$ 44	\$ 2	\$ 3,529
Loans:							
Individually evaluated for impairment	\$ 294	\$ 10,879	\$ 1,468	\$ 46	\$ 178	\$ —	\$ 12,865
Collectively evaluated for impairment	36,603	527,656	243,526	17,240	12,053	94	837,172
Acquired credit impaired loans	258	3,989	1,961	—	—	412	6,620
Balance, end of period	\$ 37,155	\$ 542,524	\$ 246,955	\$ 17,286	\$ 12,231	\$ 506	\$ 856,657
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

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

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

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

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

a loan to appraised value ratio of greater than 80%.

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

Consumer loans generally have higher interest rates, but pose additional risks of 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.

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## 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 March 31, 2018 and December 31, 2017 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
March 31, 2018					
Commercial & industrial	\$36,716	\$155	\$284	\$	—\$37,155
Commercial, secured by real estate	523,298	796	18,430	—	542,524
Residential real estate	244,998	—	1,957	—	246,955
Consumer	17,252	—	34	—	17,286
Agricultural	11,669	—	562	—	12,231
Other	506	—	—	—	506
Total	\$834,439	\$951	\$21,267	\$	—\$856,657
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





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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 4 – Loans (continued)

A loan portfolio aging analysis at March 31, 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
March 31, 2018							
Commercial & industrial	\$ 6	\$ —	\$ —	\$ 6	\$ 37,149	\$ 37,155	\$ —
Commercial, secured by real estate	59	—	335	394	542,130	542,524	—
Residential real estate	420	77	576	1,073	245,882	246,955	146
Consumer	30	8	—	38	17,248	17,286	—
Agricultural	185	—	177	362	11,869	12,231	—
Other	42	—	—	42	464	506	—
Total	\$ 742	\$ 85	\$ 1,088	\$ 1,915	\$ 854,742	\$ 856,657	\$ 146
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 March 31, 2018 and December 31, 2017 are as follows (in thousands):

	March 31, 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	\$ 264	\$ 348	\$ —	\$ 1,015	\$ 1,100	\$ —
Commercial, secured by real estate	14,713	15,504	—	12,677	13,608	—
Residential real estate	2,688	3,413	—	2,822	3,516	—
Consumer	6	6	—	6	6	—
Agricultural	178	178	—	177	177	—
Other	412	553	—	402	554	—
Total	\$ 18,261	\$ 20,002	\$ —	\$ 17,099	\$ 18,961	\$ —

With an allowance recorded:

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Commercial & industrial	\$288	\$ 288	\$ 11	\$296	\$ 301	\$ 8
Commercial, secured by real estate	155	155	4	2,660	2,660	146
Residential real estate	741	772	189	553	572	29
Consumer	40	40	12	41	41	8
Agricultural	—	—	—	—	—	—
Other	—	—	—	—	—	—
Total	\$1,224	\$ 1,255	\$ 216	\$3,550	\$ 3,574	\$ 191

Total:

Commercial & industrial	\$552	\$ 636	\$ 11	\$1,311	\$ 1,401	\$ 8
Commercial, secured by real estate	14,868	15,659	4	15,337	16,268	146
Residential real estate	3,429	4,185	189	3,375	4,088	29
Consumer	46	46	12	47	47	8
Agricultural	178	178	—	177	177	—
Other	412	553	—	402	554	—
Total	\$19,485	\$ 21,257	\$ 216	\$20,649	\$ 22,535	\$ 191

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## 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 months ended March 31, 2018 and 2017 (in thousands):

	2018		2017	
	Average Interest Recorded Investment	Interest Recognized	Average Interest Recorded Investment	Interest Recognized
With no related allowance recorded:				
Commercial & industrial	\$639	\$ 11	\$261	\$ 26
Commercial, secured by real estate	14,991	196	15,859	186
Residential real estate	2,791	45	3,219	89
Consumer	6	—	21	—
Agricultural	177	—	334	—
Other	407	11	463	18
Total	\$19,011	\$ 263	\$20,157	\$ 319
With an allowance recorded:				
Commercial & industrial	\$291	\$ 4	\$322	\$ 4
Commercial, secured by real estate	157	3	1,931	24
Residential real estate	755	9	704	8
Consumer	41	1	52	1
Agricultural	—	—	—	—
Other	—	—	—	—
Total	\$1,244	\$ 17	\$3,009	\$ 37
Total:				
Commercial & industrial	\$930	\$ 15	\$583	\$ 30
Commercial, secured by real estate	15,148	199	17,790	210
Residential real estate	3,546	54	3,923	97
Consumer	47	1	73	1
Agricultural	177	—	334	—
Other	407	11	463	18
Total	\$20,255	\$ 280	\$23,166	\$ 356

Of the interest income recognized on impaired loans during the three months ended March 31, 2018 and 2017, approximately \$20,000 and \$0, respectively, were recognized on a cash basis.

Loan modifications that were classified as troubled debt restructurings during the three months ended March 31, 2018 and 2017 are as follows (dollars in thousands):

	2018		2017	
	Pre-Modification Recorded	Post-Modification Recorded	Pre-Modification Recorded	Post-Modification Recorded

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	ofBalance Loans	Balance	ofBalance Loans	Balance
Commercial & industrial	—\$	— \$	— —\$	\$ —
Commercial, secured by real estate	—	—	—	—
Residential real estate	—	—	1 18	9
Consumer	—	—	1 14	14
Total	—\$	— \$	— 2 \$ 32	\$ 23

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 4 – Loans (continued)

Each restructured loan is separately negotiated with the borrower and includes terms and conditions that reflect the borrower's ability to pay the debt as modified. Modifications may include interest only payments for a period of time, temporary or permanent reduction of the loan's interest rate, capitalization of delinquent interest, forgiveness of principal, or extensions of the maturity date. Post-modification balances of newly restructured troubled debt by type of modification for the three months ended March 31, 2018 and 2017 were as follows (in thousands):

	Term Modification	Rate Modification	Interest Only	Principal Forgiveness	Combination	Total Modifications
Three Months Ended March 31, 2018						
Commercial & industrial	\$ —	\$ —	—\$	—\$	—	\$ —\$ —
Commercial, secured by real estate	—	—	—	—	—	—
Residential real estate	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	\$ —	\$ —	—\$	—\$	—	\$ —\$ —
Three Months Ended March 31, 2017						
Commercial & industrial	\$ —	\$ —	—\$	—\$	—	\$ —\$ —
Commercial, secured by real estate	—	—	—	—	—	—
Residential real estate	—	—	—	9	—	9
Consumer	14	—	—	—	—	14
Total	\$ 14	\$ —	—\$	—\$	9	\$ —\$ 23

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

Two commercial, secured by real estate loans to the same borrower totaling \$1,236,000 that were modified during the fourth quarter 2016 subsequently defaulted in February 2017. There were no troubled debt restructurings that subsequently defaulted within twelve months of the restructuring date for the three months ended March 31, 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 March 31, 2018 consisted of loans that were modified during the three months ended March 31, 2018 and were determined to be troubled debt restructurings. Approximately \$23,000 of impaired loans without a valuation allowance and \$0 of impaired loans with a valuation allowance at March 31, 2017 consisted of loans that were modified during the three months ended March 31, 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 are not included in the accompanying consolidated condensed balance sheets. The unpaid principal balances of those loans at March 31, 2018 and December 31, 2017 were approximately \$90,630,000 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 March 31, 2018 was \$335,000.



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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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(Continued)

## Note 5 - Acquired Credit Impaired Loans

The following table provides at March 31, 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):

	March 31, December 31,	
	2018	2017
Commercial & industrial	\$ 258	\$ 1,008
Commercial, secured by real estate	3,989	4,048
Residential real estate	1,961	2,024
Consumer	—	—
Agricultural	—	—
Other loans, including deposit overdrafts	412	402
	6,620	7,482
Less allowance for loan losses	—	—
Loans, net	\$ 6,620	\$ 7,482

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

	March 31, December 31,	
	2018	2017
Outstanding balance	\$ 8,179	\$ 9,065
Carrying amount	6,620	7,482

Activity during the three months ended March 31, 2018 and 2017 for the accretable discount related to acquired credit impaired loans is as follows (in thousands):

	2018	2017
Accretable discount at beginning of year	\$669	\$1,080
Accretable discount acquired during period	—	—
Reclassification from nonaccretable discount to accretable discount	—	99
Less disposals	—	(170 )
Less accretion	(34 )	(113 )
Accretable discount at end of period	\$635	\$896

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## 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 March 31, 2018 and December 31, 2017 (in thousands):

	March 31, December 31,	
	2018	2017
Affordable housing tax credit investment	\$ 3,000	\$ 3,000
Less amortization	287	231
Net affordable housing tax credit investment	\$ 2,713	\$ 2,769
Unfunded commitment	\$ 1,979	\$ 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 three months ended March 31, 2018 and 2017 (in thousands):

	2018	2017
Tax credits and other tax benefits recognized	\$ 56	\$ 51
Tax credit amortization expense included in provision for income taxes	56	41

## Note 7 – Borrowings

Short-term borrowings at March 31, 2018 and December 31, 2017 are as follows (dollars in thousands):

	March 31, December 31,			
	2018		2017	
	Amount	Rate	Amount	Rate
Line of credit	\$ —	%	\$ —	— %
FHLB short-term advance	\$ —	%	\$ 47,000	1.43 %
Repurchase agreements	—	%	—	— %
	\$ —	%	\$ 47,000	1.43 %



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 \$213 million and \$217 million at March 31, 2018 and December 31, 2017, respectively. Additionally, LCNB is required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 8 – 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 March 31,	
	2018	2017
Statutory tax rate	21.0 %	34.6 %
Increase (decrease) resulting from:		
Tax exempt interest	(4.5 )%	(6.1 )%
Tax exempt income on bank owned life insurance	(1.2 )%	(1.5 )%
Captive insurance premium income	(0.6 )%	— %
Other, net	0.4 %	(0.2 )%
Effective tax rate	15.1 %	26.8 %

## Note 9 - Commitments and Contingent Liabilities

LCNB is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

Exposure to credit loss in the event of nonperformance by the other parties to financial instruments for commitments to extend credit is represented by the contract amount of those instruments.

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

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

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

	March 31, 2018	December 31, 2017
Commitments to extend credit:		
Commercial loans	\$36,896	\$18,964
Other loans		
Fixed rate	3,649	2,747

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Adjustable rate	1,456	1,150
Unused lines of credit:		
Fixed rate	19,350	20,984
Adjustable rate	113,699	90,147
Unused overdraft protection amounts on demand and NOW accounts	16,319	16,441
Standby letters of credit	259	294
Total commitments	\$191,628	\$150,727

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 9 – 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 March 31, 2018 totaled approximately \$255,000.

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 10 – Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) for the three months ended March 31, 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
Three Months Ended March 31, 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	(2,979 )	3	(2,976 )
Reclassifications	—	—	—
Balance at end of period	\$ (5,677 )	\$ (166 )	\$(5,843)
Year Ended December 31, 2017:			
Balance at beginning of period	\$ (2,633 )	\$ 16	\$(2,617)

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

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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## Note 11 – Retirement Plans

LCNB participates in a noncontributory defined benefit multi-employer retirement plan that covers substantially all regular full-time employees hired before January 1, 2009. Employees hired 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-month periods ended March 31, 2018 and 2017 are as follows (in thousands):

	For the Three Months Ended March 31, 2018 2017	
Qualified noncontributory defined benefit retirement plan	\$261	\$260
401(k) plan	110	102

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 months ended March 31, 2018 and 2017 are summarized as follows (in thousands):

	Three Months Ended March 31, 20182017	
Service cost	\$—	\$—
Interest cost	17	17
Amortization of unrecognized net loss	4	—
Net periodic pension cost	\$21	\$17

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

	March 31, 2018	December 31, 2017
Net actuarial (gain) loss	\$ 166	\$ 141
Past service cost	—	—
Total recognized, net of tax	\$ 166	\$ 141

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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(Continued)

## Note 12 – Stock Based Compensation

LCNB established an Ownership Incentive Plan (the "2002 Plan") during 2002 that allowed for stock-based awards to eligible employees, as determined by the Board of Directors. The awards were made in the form of stock options, share awards, and/or appreciation rights. The 2002 Plan provided for the issuance of up to 200,000 shares 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 March 31, 2018 were as follows:

Exercise Price Range	Outstanding Stock Options			Exercisable Stock Options		
	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
\$9.00 - \$10.99	4,356	\$ 9.00	0.8	4,356	\$ 9.00	0.8
\$11.00 - \$12.99	13,278	11.98	2.9	13,278	11.98	2.9
	17,634	11.25	2.4	17,634	11.25	2.4

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

	Three Months Ended March 31,			
	2018		2017	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, January 1,	20,265	\$ 11.42	24,669	\$ 12.17
Exercised	(2,631 )	12.55	(3,398 )	14.97
Expired	—	—	(1,006 )	17.88
Outstanding, March 31,	17,634	11.25	20,265	11.42
Exercisable, March 31,	17,634	11.25	20,265	11.42



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

	Three Months Ended March 31, 2018	2017
Intrinsic value of options exercised	\$17	\$25
Cash received from options exercised	33	51
Tax benefit realized from options exercised	2	5

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 12 – Stock Based Compensation (continued)

The aggregate intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) for options outstanding and exercisable at March 31, 2018 that were "in the money" (market price greater than exercise price) was \$137,000. The aggregate intrinsic value for options outstanding and exercisable at March 31, 2017 that were in the money was \$252,000. 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 three months ended March 31, 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, March 31,	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 months ended March 31, 2018 was \$56,000 and the related tax benefit was \$12,000. Unrecognized compensation expense for restricted stock awards was \$232,000 at March 31, 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 months ended March 31, 2017 was \$56,000 and the related tax benefit was \$19,000, respectively.

## Note 13 – Earnings per Common Share

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



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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 13 – Earnings per Common Share (continued)

Earnings per share for the three months ended March 31, 2018 and 2017 were calculated as follows (dollars in thousands, except share and per share data):

	For the Three Months Ended March 31,	
	2018	2017
Net income	\$2,713	\$ 3,246
Less allocation of earnings and dividends to participating securities	4	2
Net income allocated to common shareholders	\$2,709	\$ 3,244
Weighted average common shares outstanding, gross	10,035,870	10,001,087
Less average participating securities	15,260	6,033
Weighted average number of shares outstanding used in the calculation of basic earnings per common share	10,020,610	9,950,054
Add dilutive effect of:		
Stock options	7,977	7,824
Stock warrants	—	—
Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share	10,028,587	10,002,878
Earnings per common share:		
Basic	\$0.27	\$ 0.32
Diluted	0.27	0.32

There were no anti-dilutive stock options outstanding at March 31, 2018 or 2017.

## Note 14 - Fair Value Measurements

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

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

Level 1 – quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.

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

Level 3 – inputs that are unobservable for the asset or liability.



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(Continued)

Note 14 - Fair Value Measurements (continued)

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.



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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 14 - Fair Value Measurements (continued)

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

	Fair Value Measurements	Fair Value Measurements at the End of the Reporting Period Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2018				
Recurring fair value measurements:				
Equity securities with a readily determinable fair value:				
Trust preferred securities	\$ 50	\$50	\$ —	\$ —
Equity securities	546	546	—	—
Mutual funds	39	39	—	—
Mutual funds measured at net asset value	1,509	1,509	—	—
Debt securities available-for-sale:				
U.S. Treasury notes	2,218	2,218	—	—
U.S. Agency notes	81,910	—	81,910	—
U.S. Agency mortgage-backed securities	63,223	—	63,223	—
Municipal securities:				
Non-taxable	100,706	—	100,706	—
Taxable	19,837	—	19,837	—
Total recurring fair value measurements	\$ 270,038	\$4,362	\$ 265,676	\$ —
Nonrecurring fair value measurements:				
Impaired loans	1,010	—	—	1,010
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	—	—



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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

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 14 - Fair Value Measurements (continued)

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

	Fair Value	Valuation Technique	Unobservable Inputs	Range		Weighted Average
				High	Low	
March 31, 2018						
Impaired loans	\$63	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
	947	Discounted cash flows	Discount rate	8.25%	4.50%	6.88 %
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 %

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

## Note 14 - Fair Value Measurements (continued)

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

	Carrying Amount		Fair Value Measurements at the End of the Reporting Period Using Quoted Prices in Active Markets for Identical Assets (Level 1)		
			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
March 31, 2018					
FINANCIAL ASSETS:					
Cash and cash equivalents	\$17,494	\$17,494	\$17,494	\$	—
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	32,502	31,722	—	—	31,722
Federal Reserve Bank stock	2,732	2,732	2,732	—	—
Federal Home Loan Bank stock	3,638	3,638	3,638	—	—
Loans, net	853,128	813,225	—	—	813,225
Accrued interest receivable	4,159	4,159	—	4,159	—
FINANCIAL LIABILITIES:					
Deposits	1,123,463	1,123,997	935,667	188,330	—
Long-term debt	6,219	6,383	—	6,383	—
Accrued interest payable	306	306	—	306	—
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:					

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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	—

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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(Continued)

Note 14 - 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 March 31, 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 March 31, 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 March 31, 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.

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 15 – 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.



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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 15 – 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.

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LCNB CORP. AND SUBSIDIARIES

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

Forward Looking Statements

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

These forward-looking statements reflect management's current expectations based on all information available to management and its knowledge of LCNB's business and operations. 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 future acquisitions, including the pending merger with Columbus First Bancorp, Inc., may be unsuccessful or may be more difficult, time-consuming, or costly than expected;
3. LCNB's ability to obtain regulatory approvals of the proposed merger of LCNB with Columbus First Bancorp, Inc. on the proposed terms and schedule and approval of the merger by the shareholders of LCNB may be unsuccessful;
4. LCNB may incur increased charge-offs in the future;
5. LCNB may face competitive loss of customers;
6. 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;
7. changes in general economic conditions and increased competition could adversely affect LCNB's operating results;
8. 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;
9. LCNB may experience difficulties growing loan and deposit balances;
10. the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations;
11. 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;
12. 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
13. 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.



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LCNB CORP. AND SUBSIDIARIES

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

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 March 31, 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.

#### Results of Operations

Net income for the three months ended March 31, 2018 was \$2,713,000 (total basic and diluted earnings per share of \$0.27). This compares to net income of \$3,246,000 (total basic and diluted earnings per share of \$0.32) for the same three-month period in 2017. Items significantly affecting net income during the 2018 period were:

- expenses relating to the pending merger with Columbus First Bancorp, Inc. ("CFB") totaling \$758,000, 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.

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LCNB CORP. AND SUBSIDIARIES

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

Net interest income for the three months ended March 31, 2018 was \$201,000 greater than the comparable period 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 and short-term borrowings.

The provision for loan losses for the three months ended March 31, 2018 was \$64,000 greater than the comparable period in 2017. Non-accrual loans and loans past due 90 days or more and still accruing interest decreased \$75,000, from \$2,965,000 or 0.35% of total loans at December 31, 2017, to \$2,890,000 or 0.34% of total loans at March 31, 2018.

Non-interest income for the three months ended March 31, 2018 was \$206,000 greater than the comparable periods in 2017 primarily due to increases in fiduciary income and service charges and fees on deposit accounts.

Non-interest expense for the three months ended March 31, 2018 was \$1,581,000 greater than the comparable period in 2017 primarily due to increases in salaries and employee benefits, merger-related expenses, and various expenses related to the new operations center. Merger-related expenses increased due to costs connected to the pending acquisition of CFB. Subject to customary regulatory approvals, LCNB shareholder approval, and other conditions set forth in the Merger Agreement, this transaction is anticipated to close in the second quarter of 2018.

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## LCNB CORP. AND SUBSIDIARIES

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

## Net Interest Income

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 March 31, 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 March 31,					
	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)	\$853,152	\$9,413	4.47 %	\$813,597	\$8,915	4.44 %
Interest-bearing demand deposits	3,867	19	1.99 %	8,287	16	0.78 %
Federal Reserve Bank stock	2,732	—	— %	2,732	—	— %
Federal Home Loan Bank stock	3,638	53	5.91 %	3,638	41	4.57 %
Investment securities:						
Equity securities	3,255	22	2.74 %	3,222	21	2.64 %
Debt securities, taxable	173,586	931	2.18 %	212,258	1,072	2.05 %
Debt securities, non-taxable (2)	130,478	891	2.77 %	144,649	1,222	3.43 %
Total earnings assets	1,170,708	11,329	3.92 %	1,188,383	11,287	3.85 %
Non-earning assets	125,068			123,765		
Allowance for loan losses	(3,401 )			(3,557 )		
Total assets	\$1,292,375			\$1,308,591		
Savings deposits	\$646,690	199	0.12 %	\$645,953	146	0.09 %
IRA and time certificates	189,322	672	1.44 %	213,544	697	1.32 %
Short-term borrowings	14,086	69	1.99 %	28,500	30	0.43 %
Long-term debt	2,255	14	2.52 %	537	4	3.02 %
Total interest-bearing liabilities	852,353	954	0.45 %	888,534	877	0.40 %
Demand deposits	278,967			265,960		
Other liabilities	10,997			9,425		
Capital	150,058			144,672		
Total liabilities and capital	\$1,292,375			\$1,308,591		
Net interest rate spread (3)			3.47 %			3.45 %
Net interest income and net interest margin on a taxable-equivalent basis (4)		\$10,375	3.59 %		\$10,410	3.55 %
Ratio of interest-earning assets to interest-bearing liabilities	137.35	%		133.75	%	

(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 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.

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## LCNB CORP. AND SUBSIDIARIES

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

The following table presents the changes in taxable-equivalent basis interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the three months ended March 31, 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 March 31, 2018 vs. 2017		
	Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
<b>Interest-earning Assets:</b>			
Loans	\$436	\$62	\$498
Interest-bearing demand deposits	(12 )	15	3
Federal Reserve Bank stock	—	—	—
Federal Home Loan Bank stock	—	12	12
<b>Investment securities:</b>			
Equity securities	—	1	1
Debt securities, taxable	(204 )	63	(141 )
Debt securities, non-taxable	(112 )	(219 )	(331 )
Total interest income	108	(66 )	42
<b>Interest-bearing Liabilities:</b>			
Savings deposits	—	53	53
IRA and time certificates	(83 )	58	(25 )
Short-term borrowings	(22 )	61	39
Long-term debt	11	(1 )	10
Total interest expense	(94 )	171	77
Net interest income	\$202	\$(237)	\$(35 )

Net interest income on a fully taxable-equivalent basis for the three months ended March 31, 2018 totaled \$10,375,000, a decrease of \$35,000 from the comparable period in 2017. Total interest expense increased \$77,000, partially offset by an increase in interest income of \$42,000.

The increase in total interest income was due primarily to a \$498,000 increase in loan interest income caused by a \$39.6 million increase in average loans and by a 3 basis point (a basis point equals 0.01%) increase in the average rate earned on loans. Largely offsetting the increase in loan interest income were a \$141,000 decrease in interest income from taxable debt securities and a \$331,000 decrease in interest income from non-taxable debt securities. The decrease in interest income from taxable investment securities was caused by a \$38.7 million decrease in average taxable debt securities, partially offset by a 13 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 66 basis point decrease in the average rate earned and to a \$14.2 million decrease in average non-taxable debt securities. One of the reasons for the 66 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 5 basis point increase in the average rate paid on total interest-bearing liabilities, partially offset by a \$36.2 million decrease in average total interest-bearing liabilities.

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## LCNB CORP. AND SUBSIDIARIES

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

## Provision and Allowance For Loan Losses

The total provision for loan losses is determined based upon management's evaluation as to the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, and current economic conditions that may affect borrowers' ability to pay.

The provision for loan losses for the three months ended March 31, 2018 was \$79,000, as compared to \$15,000 for the same period in 2017. Net charge-offs (recoveries) for the three months ended March 31, 2018 were \$(47,000), as compared to net charge-offs (recoveries) of \$262,000 for the comparable period in 2017.

## Non-Interest Income

A comparison of non-interest income for the three months ended March 31, 2018 and 2017 is as follows (in thousands):

	Three Months Ended		
	March 31,		
	2018	2017	Difference
Fiduciary income	\$964	\$852	\$ 112
Service charges and fees on deposit accounts	1,305	1,222	83
Bank owned life insurance income	186	189	(3 )
Gains from sales of loans	22	39	(17 )
Other operating income	159	128	31
Total non-interest income	\$2,636	\$2,430	\$ 206

Reasons for material increases and decreases include:

• Fiduciary income increased due to an increase in trust 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. The ICS product provides depositors with the security and convenience of access to FDIC insurance on balances greater than \$250,000. 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.

## Non-Interest Expense

A comparison of non-interest expense for the three months ended March 31, 2018 and 2017 is as follows (in thousands):

	Three Months Ended		
	March 31,		
	2018	2017	Difference
Salaries and employee benefits	\$4,977	\$4,526	\$ 451

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Equipment expenses	253	211	42
Occupancy expense, net	727	568	159
State franchise tax	303	284	19
Marketing	132	143	(11 )
Amortization of intangibles	185	185	—
FDIC insurance premiums	99	104	(5 )
Contracted services	315	248	67
Other real estate owned	2	5	(3 )
Merger-related expenses	758	—	758
Other non-interest expense	1,798	1,694	104
Total non-interest expense	\$9,549	\$7,968	\$ 1,581

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LCNB CORP. AND SUBSIDIARIES

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

Reasons for material increases and decreases include:

Salaries and employee benefits increased 10.0% for the three months ended March 31, 2018 as compared to the same period in 2017. These increases were primarily due to salary and wage increases, newly hired employees, and an increase in health insurance costs. Full-time equivalent employees at March 31, 2018 totaled 297, compared with 271 full-time equivalent employees at March 31, 2017.

Occupancy expense increased primarily due to increased depreciation expense on bank premises and to increased maintenance and repair costs. The depreciation increase was largely due to the new Operations Center. Maintenance and repair costs increased largely due to snow and ice removal costs during the 2017-2018 winter.

Merger-related expenses during the 2018 period are due to the pending acquisition of CFB. Subject to customary regulatory approvals, LCNB shareholder approval, and other conditions set forth in the definitive merger agreement, this transaction is anticipated to close in the second quarter of 2018.

Other non-interest expense increased due to provisions for loss reserves recognized by LCNB Risk Management, Inc.

Income Taxes

LCNB's effective tax rates for the three months ended March 31, 2018 and 2017 were 15.1% and 26.8%, respectively.

The difference between the statutory rate of 21% for 2018 and 34.6% 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, and tax credits and losses related to investments in affordable housing tax credit limited partnerships.

Financial Condition

Available-for-sale debt securities at March 31, 2018 were \$7.3 million less than at December 31, 2017 primarily due to maturities and calls totaling \$3.1 million and net decreases in fair values totaling \$3.8 million.

Net loans at March 31, 2018 were \$7.5 million greater than at December 31, 2017. Commercial, secured by real estate loans increased \$14.9 million, partially offset by a \$5.1 million decrease in residential real estate loans and a \$3.0 million decrease in agricultural loans.

Total deposits at March 31, 2018 were \$37.6 million greater than at December 31, 2017. Included in this increase was a \$13.7 million increase in public fund deposits by local government entities. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities. Historically, public fund deposits tend to be at their lowest balances at year-ends.

Long-term debt at March 31, 2018 was \$5.9 million greater than at December 31, 2017 due to \$6.0 million in new borrowings.

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 March 31, 2018 and to the increase in net loans.

Shareholders' equity at March 31, 2018 was \$1.7 million less than at December 31, 2017, primarily due to a 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.

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## LCNB CORP. AND SUBSIDIARIES

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

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.

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):

	March 31, 2018	December 31, 2017		
Regulatory Capital:				
Shareholders' equity	\$148,584	\$150,271		
Goodwill and other intangibles	(33,401 )	(32,906 )		
Accumulated other comprehensive loss	5,843	2,828		
Tier 1 risk-based capital	121,026	120,193		
Eligible allowance for loan losses	3,529	3,403		
Total risk-based capital	\$124,555	\$123,596		
Capital ratios:				
Common Equity Tier 1 Capital to risk-weighted assets	13.18	%	13.29	%
Tier 1 Capital to risk-weighted assets	13.18	%	13.29	%
Total Capital to risk-weighted assets	13.57	%	13.66	%
Leverage	9.57	%	9.51	%

## Liquidity



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

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LCNB CORP. AND SUBSIDIARIES

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

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. Asset liquidity is provided by cash and assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash and cash equivalents and securities available for sale. At March 31, 2018, LCNB's liquid assets amounted to \$288.6 million or 22.4% of total assets. This compares to liquid assets totaling \$303.9 million, or 23.5% of total assets, at December 31, 2017.

Liquidity is also provided by access to core funding sources, primarily core depositors in LCNB's market area. Approximately 84.3% of total deposits at March 31, 2018 were "core" deposits, compared to 85.1% of deposits at December 31, 2017. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than \$100,000. The percentage of core deposits to total deposits decreased because of the growth in public fund deposits discussed above in relation to total growth in deposits.

Secondary sources of liquidity include LCNB's ability to sell loan participations, borrow funds from the FHLB, purchase federal funds, issue repurchase agreements, or using lines of credit established with two other banks.

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

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## LCNB CORP. AND SUBSIDIARIES

## Item 3. Quantitative and Qualitative Disclosures about Market 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 March 31, 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	\$46,686	2,535	5.74 %
Up 200	45,815	1,664	3.77 %
Up 100	44,975	824	1.87 %
Base	44,151	—	— %

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 March 31, 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	\$149,783	980	0.66 %
Up 200	150,255	1,452	0.98 %
Up 100	149,261	458	0.31 %
Base	148,803	—	— %

The IRSA and EVE simulations discussed above are not projections of future income or equity and should not be relied on as being indicative of future operating results. Assumptions used, including the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment or replacement of asset and liability cash flows, are inherently uncertain and, as a result,

the models cannot precisely measure future net interest income or equity. Furthermore, the models do not reflect actions that borrowers, depositors, and management may take in response to changing economic conditions and interest rate levels.

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LCNB CORP. AND SUBSIDIARIES

Item 4. Controls and Procedures

a) Disclosure controls and procedures. The Chief Executive Officer and the Chief Financial Officer have carried out an evaluation of the effectiveness of LCNB's disclosure controls and procedures that ensure that information relating to LCNB required to be disclosed by LCNB in the reports that it files or submits under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to LCNB's management, including its principal executive officer and principal financial officer, as appropriate, in order to allow timely decisions to be made regarding required disclosures. Based upon this evaluation, these officers have concluded that, as of March 31, 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.

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PART II. OTHER INFORMATION

LCNB CORP. AND SUBSIDIARIES

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

No material changes.

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

During the period 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.

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LCNB CORP. AND SUBSIDIARIES

Item 6. Exhibits

Exhibit No.	Exhibit Description
2.1	<u>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.</u>
3.1	<u>Amended and Restated Articles of Incorporation of LCNB Corp., as amended – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010, Exhibit 3.1.</u>
3.2	<u>Code of Regulations of LCNB Corp. – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005, Exhibit 3(ii).</u>
10.1	<u>LCNB Corp. Ownership Incentive Plan – incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 15, 2002, Exhibit A (000-26121).</u>
10.2	<u>LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 13, 2015, Exhibit A (001-35292)</u>
10.3	<u>Form of Option Grant Agreement under the LCNB Corp. Ownership Incentive Plan – incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2005, Exhibit 10.2.</u>
10.4	<u>Nonqualified Executive Retirement Plan – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2009, Exhibit 10.4.</u>
10.5	<u>Form of Restricted Share Grant Agreement under the LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2015, Exhibit 10.7.</u>
31.1	<u>Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2	<u>Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32	<u>Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101	The following financial information from LCNB Corp.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 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.

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LCNB CORP. AND SUBSIDIARIES  
SIGNATURES

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

LCNB Corp.

May 2, 2018 /s/ Steve P. Foster

Steve P. Foster

Chief Executive Officer and President

May 2, 2018 /s/ Robert C. Haines, II

Robert C. Haines, II

Executive Vice President and Chief  
Financial Officer