

LCNB CORP  
Form 10-Q  
October 29, 2007

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

**FORM 10-Q**

(Mark One)

( X )

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

For the quarterly period ended September 30, 2007

( )

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

For the transition period from

to

**LCNB Corp.**

(Exact name of registrant as specified in its charter)

**Ohio**

**31-1626393**

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer

Edgar Filing: LCNB CORP - Form 10-Q

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 October 26, 2007 was 6,345,486 shares.

**LCNB Corp.**

INDEX

Page No.

Part I - Financial Information

Item 1. Financial Statements

Consolidated Balance Sheets -

September 30, 2007, and December 31, 2006

1

Consolidated Statements of Income -

Three and Nine Months Ended September 30, 2007 and 2006

2

Consolidated Statements of Comprehensive Income -

Three and Nine Months Ended September 30, 2007 and 2006

3

Consolidated Statements of Stockholders' Equity -

Nine Months Ended September 30, 2007 and 2006

4

Consolidated Statements of Cash Flows -

Nine Months Ended September 30, 2007 and 2006

5

Notes to Consolidated Financial Statements

6-16

Report of Independent Registered Public Accounting Firm

17

Item 2. Management's Discussion and Analysis of Financial

Condition and Results of Operations

18-28

Item 3. Quantitative and Qualitative Disclosures about

Market Risks

29

Item 4. Controls and Procedures

30

Part II - Other Information

Item 1. Legal Proceedings

31

Item 1A. Risk Factors

31

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

31

Item 3. Defaults Upon Senior Securities

31

Item 4. Submission of Matters to a Vote of Security Holders

31

Item 5. Other Information

31

Item 6. Exhibits

32

Signatures

33

**LCNB CORP. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

	September 30, 2007 (Unaudited)	December 31, 2006
<b>ASSETS:</b>		
Cash and due from banks	\$ 18,085	14,864
Federal funds sold and interest-bearing demand deposits	25,078	641
Total cash and cash equivalents	43,163	15,505
Securities available for sale, at estimated fair value	91,123	111,142
Federal Reserve Bank stock and Federal Home Loan Bank stock, at cost	2,332	3,332
Loans, net	394,116	388,320
Premises and equipment, net	12,780	12,090
Intangibles, net	939	1,426
Bank owned life insurance	11,330	10,979
Other assets	6,079	5,421
<b>TOTAL ASSETS</b>	<b>\$ 561,862</b>	<b>548,215</b>
<b>LIABILITIES:</b>		
Deposits		
Noninterest-bearing	\$ 83,929	82,360
Interest-bearing	414,443	396,255
Total deposits	498,372	478,615
Short-term borrowings	2,805	15,370
Long-term debt	5,000	-
Accrued interest and other liabilities	3,555	3,231
<b>TOTAL LIABILITIES</b>	<b>509,732</b>	<b>497,216</b>
<b>SHAREHOLDERS EQUITY:</b>		
Preferred stock no par value, authorized 1,000,000 shares,		

Edgar Filing: LCNB CORP - Form 10-Q

none outstanding	-	-
Common stock no par value, authorized 8,000,000 shares, issued 7,103,768 shares	10,560	10,560
Surplus	10,595	10,577
Retained earnings	43,655	42,245
Treasury shares at cost, 758,282 and 724,132 shares at September 30, 2007 and December 31, 2006, respectively	(11,737)	(11,242)
Accumulated other comprehensive loss, net of taxes	(943)	(1,141)
<b>TOTAL SHAREHOLDERS EQUITY</b>	52,130	50,999
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	\$ 561,862	548,215

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



**LCNB CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

(Dollars in thousands, except per share data)

(Unaudited)

Three Months Ended

Nine Months Ended

September 30,

September 30,

2007

2006

2007

2006

**INTEREST INCOME:**

Interest and fees on loans

\$

6,732

6,489

20,096

18,624

Dividends on Federal Reserve Bank

and Federal Home Loan Bank stock

27

38

111

130

Interest on investment securities

Taxable

533

678

12

	1,719
	2,024
Non-taxable	
	452
	464
	1,417
	1,491
Other short-term investments	
	176
	154
	360
	349
	13

TOTAL INTEREST INCOME

7,920

7,823

23,703

22,618

**INTEREST EXPENSE:**

Interest on deposits

3,455

3,289

9,908

8,856

Interest on short-term borrowings

11

13

15

	172
	55
Interest on long-term debt	
	66
	1
	146
	30
TOTAL INTEREST EXPENSE	
	3,532
	3,303
	10,226
	8,941
	16



NET INTEREST INCOME

4,388

4,520

13,477

13,677

PROVISION FOR LOAN LOSSES

75

66

158

100

NET INTEREST INCOME AFTER

PROVISION FOR LOAN LOSSES

4,313

4,454

13,319

13,577

**NON-INTEREST INCOME:**

Trust income

472

485

1,416

1,388

Service charges and fees

1,081

1,071

3,031

3,075

Net loss on sales of securities

-

-

-

(12)

Insurance agency income

392

391

1,228

1,239

Bank-owned life insurance income

118

117

21

		351
	347	
Other operating income		54
		9
		194
	135	
TOTAL NON-INTEREST INCOME		2,117
		2,073
		6,220

6,172

**NON-INTEREST EXPENSE:**

Salaries and wages

	2,027
	2,009
	6,075
5,912	
Pension and other employee benefits	
	536
	501
	1,576
1,517	
Equipment expenses	
	274
	267
	758
	24



788

Occupancy expense, net

426

367

1,147

1,018

State franchise tax

155

154

476

467

Marketing

		108
		85
		317
	280	
Intangible amortization		151
		162
		466
	459	
Other non-interest expense		951
		965
		2,962
		26

2,991

**TOTAL NON-INTEREST EXPENSE**

4,628

4,510

13,777

13,432

**INCOME BEFORE INCOME TAXES**

1,802

2,017

5,762

6,317

PROVISION FOR INCOME TAXES

432

511

1,397

1,593

**NET INCOME**

\$

1,370

1,506

4,365

4,724

Dividends declared per common share

\$

0.155

0.15

0.465

0.45

Earnings per common share:

Basic

\$

0.22

0.23

0.69

0.73

Diluted

0.22

0.23

0.69

0.73

Average shares outstanding:

Basic

6,345,486

6,472,132

6,360,654

6,506,383

Diluted

6,345,615

6,474,569

6,361,415

6,508,862



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

-2-

**LCNB CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Net Income	\$ 1,370	1,506	4,365	4,724
Other comprehensive income (loss):				
Net unrealized gain (loss) on available-for-sale securities (net of taxes of \$312 and \$218 for the three months ended September 30, 2007 and 2006, respectively, and net of taxes of \$100 and \$33 for the nine months ended September 30, 2007 and 2006, respectively)	607	423	194	(64)
Reclassification adjustment for net realized loss on sale of available-for-sale securities included in net income (net of taxes of \$4 for the nine months ended September 30, 2006)	-	-	-	8
Amortization of pension plan unrecognized net loss (net of taxes of \$1 and \$2 for the three and nine months ended September 30, 2007)	1	-	4	-

<b>TOTAL COMPREHENSIVE INCOME</b>	\$ 1,978	1,929	4,563	4,668
-----------------------------------	----------	-------	-------	-------

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

**LCNB CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

(In thousands)

(Unaudited)

		Common <u>Shares</u>	Surplus	Retained <u>Earnings</u>	Treasury <u>Shares</u>	Accumulated Other Comprehensive <u>Income (Loss)</u>	Total Shareholders <u>Equity</u>
Balance January 1, 2007	\$	10,560	10,577	42,245	(11,242)	(1,141)	50,999
Net income				4,365			4,365
Change in estimated fair value of							
securities available for sale, net of tax						194	194
Amortization of pension plan							
unrecognized net loss, net of tax						4	4
Compensation expense relating to							
stock options			18				18
Treasury shares purchased					(495)		(495)
Cash dividends declared, \$0.465 per				(2,955)			(2,955)

Edgar Filing: LCNB CORP - Form 10-Q

share							
Balance September 30, 2007	\$	10,560	10,595	43,655	(11,737)	(943)	52,130
Balance January 1, 2006	\$	10,560	10,562	39,612	(8,011)	(701)	52,022
Net income				4,724			4,724
Change in estimated fair value of securities available for sale, net of tax and reclassification adjustment						(56)	(56)
Compensation expense relating to stock options			11				11
Treasury shares purchased					(1,877)		(1,877)
Cash dividends declared, \$0.45 per share				(2,924)			(2,924)
Balance September 30, 2006	\$	10,560	10,573	41,412	(9,888)	(757)	51,900

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



**LCNB CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(unaudited)

	Nine Months Ended September 30,	
	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 4,365	4,724
Adjustments to reconcile net income to net cash flows from operating activities		
Depreciation, amortization, and accretion	1,640	1,680
Provision for loan losses	158	100
Federal Home Loan Bank stock dividends	-	(111)
Bank-owned life insurance income	(351)	(347)
Realized loss on sales of securities available for sale	-	12
Realized loss (gain) on sale of premises and equipment	(6)	32
Mortgage loans originated for sale	(2,517)	(2,471)
Realized gains from sales of mortgage loans	(42)	(41)
Proceeds from sales of mortgage loans	2,532	2,485
Compensation expense related to stock options	18	11
Increase (decrease) due to changes in assets and liabilities:		
Income receivable	(255)	(238)
Other assets	525	(886)
Other liabilities	(695)	34
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>5,372</b>	<b>4,984</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sales of securities available for sale	-	8,204
Proceeds from maturities of securities available for sale	27,842	34,162
Purchases of securities available for sale	(7,629)	(16,218)

Edgar Filing: LCNB CORP - Form 10-Q

Proceeds from redemption of Federal Home Loan Bank stock	1,000	-
Net decrease (increase) in loans	(6,190)	(29,754)
Net cash paid for acquisition	-	(515)
Proceeds from sale of other real estate acquired through foreclosure	-	84
Additions to other real estate acquired through foreclosure	(5)	-
Purchases of premises and equipment	(1,480)	(332)
Proceeds from sales of premises and equipment	6	6
<b>NET CASH FLOWS FROM INVESTING ACTIVITIES</b>	<b>13,544</b>	<b>(4,363)</b>
 <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net change in deposits	19,757	11,725
Net change in short-term borrowings	(12,565)	921
Proceeds from long-term debt	5,000	-
Principal payments on long-term debt	-	(2,050)
Cash dividends paid	(2,955)	(2,924)
Purchases of treasury shares	(495)	(1,877)
<b>NET CASH FLOWS FROM FINANCING ACTIVITIES</b>	<b>8,742</b>	<b>5,795</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>27,658</b>	<b>6,416</b>
 <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	 <b>15,505</b>	 <b>15,324</b>
 <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	 <b>\$ 43,163</b>	 <b>21,740</b>
 <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
<b>CASH PAID DURING THE YEAR FOR:</b>		
Interest	\$ 10,200	8,947
Income taxes	1,809	1,646
 <b>NON-CASH INVESTING ACTIVITY:</b>		
Transfer from loans to real estate acquired through foreclosure	-	752

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





**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1 - Basis of Presentation**

Substantially all of the assets, liabilities and operations of LCNB Corp. ("LCNB") are attributable to its wholly-owned subsidiaries, LCNB National Bank (formerly Lebanon Citizens National Bank) (the "Bank"), and Dakin Insurance Agency, Inc. ("Dakin"). The accompanying unaudited consolidated financial statements include the accounts of LCNB, the Bank, and Dakin.

The unaudited interim consolidated financial statements, which have been reviewed by J.D. Cloud & Co. L.L.P., LCNB's independent registered public accounting firm, in accordance with standards established by the Public Company Accounting Oversight Board, as indicated by their report included herein and which does not express an opinion on those statements, have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation of financial position, results of operations, and cash flows for the interim periods, as required by Regulation S-X, Rule 10-01.

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

Share and per share data have been restated to reflect a 100% stock dividend, accounted for as a stock split, declared by the Board of Directors on April 10, 2007 and paid on May 10, 2007 to shareholders of record on April 25, 2007.

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

Results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for the full year ending December 31, 2007. 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 2006 Form 10-K filed with the SEC.

**Note 2 Acquisition**

On August 13, 2007, LCNB signed a definitive agreement to acquire Sycamore National Bank ( Sycamore ) in a stock and cash transaction valued at approximately \$9.7 million. Sycamore operates two full service branches in Cincinnati, Ohio. As of September 30, 2007, Sycamore had total assets of \$49.1 million, deposits of \$44.2 million, loans of \$44.0 million and shareholders equity of \$4.6 million.

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 2 Acquisition (continued)**

Under the terms of the agreement, Sycamore will be merged with and into the Bank and Sycamore's two offices will become branches of the Bank. Each share of Sycamore common stock will be exchanged for, at the election of each shareholder, \$33.75 in cash, 2.444 shares of LCNB common stock, or a combination of cash and shares. A Sycamore shareholder's election to receive cash or stock is subject to allocation procedures that will ensure that, in the aggregate, 50% of the shares of Sycamore common stock will be exchanged for cash and 50% will be exchanged for stock. Subject to regulatory approvals and Sycamore shareholder approval, the transaction is anticipated to be completed during the fourth quarter, 2007.

**Note 3 - Earnings Per Share**

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is adjusted for the dilutive effects of stock options. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock options with proceeds used to purchase treasury shares at the average market price for the period. The computations were as follows for the three and nine months ended September 30 (dollars in thousands, except share and per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	\$ 1,370	1,506	4,365	4,724

Weighted average number of shares  
outstanding used in the calculation of  
basic earnings per common share

Edgar Filing: LCNB CORP - Form 10-Q

		6,345,486	6,472,132	6,360,654	6,506,383
Add- Dilutive effect of stock options		129	2,437	761	2,479
Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share					
		6,345,615	6,474,569	6,361,415	6,508,862
Basic earnings per common share	\$	0.22	0.23	0.69	0.73
Diluted earnings per common share	\$	0.22	0.23	0.69	0.73

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 4 - Investment Securities**

The amortized cost and estimated fair value of available-for-sale investment securities at September 30, 2007 and December 31, 2006 are summarized as follows (in thousands):

	Amortized Cost	September 30, 2007		Fair Value
		Unrealized Gains	Unrealized Losses	
U.S. Treasury notes	\$ 1,200	-	2	1,198
U.S. Agency notes	19,124	1	78	19,047
U.S. Agency mortgage-backed securities	20,745	-	401	20,344
Municipal securities:				
Non-taxable	45,311	252	166	45,397
Taxable	5,137	28	49	5,116
Marketable equity securities	15	6	-	21
	\$ 91,532	287	696	91,123

  

	Amortized Cost	December 31, 2006		Fair Value
		Unrealized Gains	Unrealized Losses	
U.S. Treasury notes	\$ 1,198	-	19	1,179
U.S. Agency notes	30,749	16	272	30,493
	22,792	26	518	22,300

Edgar Filing: LCNB CORP - Form 10-Q

U.S. Agency mortgage-backed securities

Municipal securities:

Non-taxable	50,409	351	247	50,513
Taxable	6,683	32	79	6,636
Marketable equity securities	14	7	-	21
	\$ 111,845	432	1,135	111,142

Information concerning securities with gross unrealized losses at September 30, 2007, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	<u>Less than Twelve Months</u>		<u>Twelve Months or Greater</u>	
	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses
U.S. Treasury notes	\$ -	-	1,198	2
U.S. Agency notes	8,956	21	9,091	57
U.S. Agency mortgage-backed securities	7,108	14	13,072	387
Municipal securities:				
Non-taxable	3,908	18	19,087	148
Taxable	-	-	2,277	49
	\$ 19,972	53	44,725	643

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 4 - Investment Securities (continued)**

The decline in fair values is primarily due to increases in market interest rates. Unrealized losses on securities at September 30, 2007 have not been recognized into income currently because management has the intent and ability to hold the securities for a period of time sufficient to allow for any anticipated recovery in fair values. Therefore, no individual declines are deemed to be other than temporary.

**Note 5 - Loans**

Major classifications of loans at September 30, 2007 and December 31, 2006 are as follows (in thousands):

	September 30, 2007	December 31, 2006
Commercial and industrial	\$ 29,056	26,952
Commercial, secured by real estate	144,181	141,863
Residential real estate	175,912	173,890
Consumer	33,248	36,471
Agricultural	3,636	2,232
Other loans, including deposit overdrafts	9,352	8,101
Lease financing	-	16
	395,385	389,525
Deferred net origination costs	782	845
	396,167	390,370
Less allowance for loan losses	2,051	2,050
Loans, net	\$ 394,116	388,320





## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 5 - Loans (continued)**

Changes in the allowance for loan losses for the nine months ended September 30, 2007 and 2006 were as follows (in thousands):

	Nine Months Ended	
	September 30,	
	2007	2006
Balance, beginning of period	\$ 2,050	2,150
Provision for loan losses	158	100
Charge-offs	(434)	(495)
Recoveries	277	296
Balance, end of period	\$ 2,051	2,051

Charge-offs for the nine months ended September 30, 2007 and 2006 consisted primarily of consumer loans, and checking and NOW account overdrafts, but also included some residential and commercial real estate loans.

Non-accrual, past-due, and restructured loans as of September 30, 2007 and December 31, 2006 were as follows (in thousands):

	September 30,	December 31,
	2007	2006
Non-accrual loans	\$ 1,480	872
Past-due 90 days or more and still accruing	210	126
Restructured loans	2,198	-

Edgar Filing: LCNB CORP - Form 10-Q

Total	\$	3,888	998
-------	----	-------	-----

Non-accrual loans at September 30, 2007 consisted of two home equity line of credit loans, one residential real estate mortgage loan, and one commercial real estate mortgage loan. Non-accrual loans at December 31, 2006 consisted of a residential real estate mortgage loan and a home equity line of credit loan made to the same borrower, and a loan secured by farmland. The residential real estate mortgage loan and home equity loan were paid current during the second quarter, 2007 and the loan secured by farmland was paid in full during the second quarter, 2007.

The commercial real estate mortgage loan included in non-accrual loans at September 30, 2007 had a balance of \$1,277,000 at that date. This loan was previously classified as a restructured loan and was removed from that classification during the fourth quarter, 2006 because it was current at that time and had a market interest rate.

**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**Note 5 - Loans (continued)**

Loans past-due 90 days or more and still accruing interest at September 30, 2007 and December 31, 2006 consisted of consumer loans and residential mortgage loans.

Restructured loans at September 30, 2007 consisted of a commercial loan secured by commercial real estate. It was previously classified as restructured and was removed from that classification during the fourth quarter, 2006 because it was current and had a market interest rate. It was returned to the restructured classification during the second quarter, 2007 because of the Bank's agreement to waive the required principal payments for a period of one year, pending the sale of the underlying collateral property.

Real estate acquired through foreclosure was \$757,000 and \$752,000 at September 30, 2007 and December 31, 2006, respectively, and is included in other assets in the consolidated balance sheets. Real estate acquired at September 30, 2007 and December 31, 2006 consisted of one single-family residential home.

Mortgage loans sold to and serviced for the Federal Home Loan Mortgage Corporation ("FHLMC") are not included in the accompanying balance sheets. The unpaid principal balances of those loans at September 30, 2007 and December 31, 2006 were \$40,809,000 and \$42,431,000, respectively. Loans sold to the FHLMC during the three and nine months ended September 30, 2007 totaled \$511,000 and \$2,517,000, respectively, and \$346,000 and \$2,471,000 during the three and nine months ended September 30, 2006, respectively.

**Note 6 Borrowings**

During March, 2007, LCNB obtained a \$5 million advance from the Federal Home Loan Bank of Cincinnati. The term of the advance is ten years and interest is payable monthly at a fixed rate of 5.25%. The loan is secured by a

blanket pledge of LCNB s 1-4 family first lien mortgage loans.

At September 30, 2007, short-term borrowings included U.S. Treasury demand note borrowings of approximately \$2,805,000. The interest rate on the U.S. Treasury demand note borrowings is variable and was 4.52% at September 30, 2007.

At December 31, 2006, short-term borrowings included federal funds borrowed of \$14,100,000 and U.S. Treasury demand note borrowings of approximately \$1,264,000. The interest rate on federal funds borrowed was 5.25% and the interest rate on the U.S. Treasury demand note borrowings was 5.04% at December 31, 2006.

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 7 Regulatory Capital**

The Bank and LCNB are required by regulators to meet certain minimum levels of capital adequacy. These are expressed in the form of certain ratios. Capital is separated into Tier 1 capital (essentially shareholders' equity less goodwill and other intangibles) and Tier 2 capital (essentially the allowance for loan losses limited to 1.25% of risk-weighted assets). The first two ratios, which are based on the degree of credit risk in LCNB's assets, provide for weighting assets based on assigned risk factors and include off-balance sheet items such as loan commitments and stand-by letters of credit. The ratio of Tier 1 capital to risk-weighted assets must be at least 4.0% and the ratio of Total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8.0%. The capital leverage ratio supplements the risk-based capital guidelines. Banks are required to maintain a minimum ratio of Tier 1 capital to adjusted quarterly average total assets of 3.0%.

For various regulatory purposes, financial institutions are classified into categories based upon capital adequacy. The highest "well-capitalized" category requires capital ratios of at least 10% for total risk-based, 6% for Tier 1 risk-based, and 5% for leverage. 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:

	At September 30, 2007	At December 31, 2006
	(Dollars in thousands)	
Regulatory Capital:		
Shareholders' equity	\$ 52,130	50,999
Goodwill and other intangibles	(770)	(1,238)
Accumulated other comprehensive loss	943	1,141
Tier 1 risk-based capital	52,303	50,902

Eligible allowance for loan losses		2,051	2,050
Total risk-based capital	\$	54,354	52,952

## Capital ratios:

Total risk-based (required 8.00%)		14.04%	13.95%
Tier 1 risk-based (required 4.00%)		13.51%	13.41%
Leverage (required 3.00%)		9.54%	9.27%

-12-

**LCNB CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(Continued)****Note 8 - Commitments and Contingent Liabilities**

LCNB is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments included commitments to extend credit and stand-by letters of 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 and stand-by letters of credit is represented by the contract amount of those instruments.

LCNB uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Financial instruments whose contract amounts represent off-balance-sheet credit risk at September 30, 2007 and December 31, 2006 were as follows (in thousands):

	September 30, 2007	December 31, 2006
Commitments to extend credit:		

Edgar Filing: LCNB CORP - Form 10-Q

Fixed rate	\$	1,228	679
Adjustable rate		836	1,425
Unused lines of credit:			
Fixed rate		4,050	5,201
Adjustable rate		68,232	65,845
Unused overdraft protection amounts on			
demand and NOW accounts		9,932	10,082
Standby letters of credit		8,615	5,728
	\$	92,893	88,960

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 in line of credit loans. Commitments to extend credit and unused lines of credit generally have fixed expiration dates or other termination clauses.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. At September 30, 2007 and December 31, 2006, outstanding guarantees of \$2,276,000 and \$1,674,000, respectively, were issued to developers and contractors. These guarantees generally are fully secured and have varying maturities. In addition, LCNB has a participation in a letter of credit securing payment of principal and interest on a bond issue. The participation amount at September 30, 2007 and December 31, 2006 were approximately \$6.3 million and \$4.1 million, respectively. The letter of credit balance is greater at September 30, 2007 because it was re-written in April, 2007. At that time, LCNB's participation amount was increased to the higher amount. The new agreement has a final maturity date of January, 2012.



**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**Note 8 Commitments and Contingent Liabilities (continued)**

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

At September 30, 2007, LCNB is committed under various contracts to expend approximately \$720,000 to complete certain building and office acquisition and/or renovation projects and computer upgrades. Management believes that LCNB has sufficient liquidity to fund its lending and capital expenditure commitments.

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

**Note 9 - Stock Options**

Under the Ownership Incentive Plan (the "Plan"), LCNB may grant stock-based awards to eligible employees. The awards may be in the form of stock options, share awards, and/or appreciation rights. The Plan provides for the issuance of up to 200,000 shares. As of September 30, 2007, only stock options have been granted under the Plan.

Options granted to date vest ratably over a five year period and expire ten years after the date of grant. Stock options outstanding at September 30, 2007, as adjusted for the 100% stock dividend paid May 10, 2007, were as follows:

Outstanding

Exercisable

Edgar Filing: LCNB CORP - Form 10-Q

Exercise		Weighted Average Exercise		Weighted Average Exercise		Number	Expiration
<u>Price</u>	<u>Number</u>	<u>Price</u>	<u>Number</u>	<u>Price</u>	<u>Exercised</u>		<u>Date</u>
\$ 13.09	11,056	\$ 13.09	8,845	\$ 13.09	-		Feb, 2013
17.66	8,108	17.66	4,865	17.66	-		Jan, 2014
18.95	7,934	18.95	1,587	18.95	-		Jan, 2016
17.88	8,116	17.88	-	17.88	-		Feb, 2017
	35,214	16.57	15,297	15.15	-		

- 14 -

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 9 - Stock Options (continued)**

The following table summarizes stock option activity for the periods indicated, as restated for the 100% stock dividend paid May 10, 2007:

	Nine Months ended September 30,			
	2007		2006	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, January 1,	27,098	\$16.17	19,164	\$15.02
Granted	8,116	17.88	7,934	18.95
Exercised	-	-	-	-
Outstanding, September 30,	35,214	\$16.57	27,098	\$16.17
Exercisable, September 30,	15,297	\$15.15	9,877	\$14.59

At September 30, 2007, the aggregate intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) for options outstanding at that date and that were in the money (market price greater than exercise price) was approximately \$10,000. The aggregate intrinsic value at that date for only the options that were exercisable was approximately \$8,000. The intrinsic value changes based on changes in the market value of the Company's stock.

The estimated weighted-average fair value of the options granted in the first quarter of 2007 and 2006 were \$3.76 and \$4.51 per option, respectively. The fair value was estimated at the dates of grant using the Black-Scholes

option-pricing model and the following assumptions:

	<u>2007</u>	<u>2006</u>
Risk-free interest rate	4.83%	4.64%
Average dividend yield	3.68%	3.04%
Volatility factor of the expected market price of LCNB's common stock	22.41%	22.70%
Average life	8.3 years	8.5 years

Total expense related to options included in salaries and wages in the consolidated statements of income for the three and nine months ended September 30, 2007 were \$6,000 and \$18,000, respectively and \$4,000 and \$11,000 for the three and nine months ended September 30, 2006, respectively.

**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**Note 10 Employee Benefits**

LCNB has a noncontributory defined benefit retirement plan that covers all regular full-time employees. The components of net periodic pension cost for the three and nine months ended September 30, 2007 and 2006, are summarized as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Service cost	\$ 171	162	512	484
Interest cost	97	83	288	248
Expected return on plan assets	(107)	(92)	(316)	(273)
Amortization of net loss	2	-	6	1
Net periodic pension cost	163	153	490	460

LCNB previously disclosed in its consolidated financial statements for the year ended December 31, 2006, that it expected to contribute \$975,000 to its pension plan in 2007. A contribution of \$1,004,000 was made to the pension plan on October 1, 2007. LCNB expects to contribute another \$52,000 during the fourth quarter, 2007.

At September 30, 2007, accumulated other comprehensive income included \$673,000, net of tax, of unrecognized net actuarial loss.

**Note 11 Recent Accounting Pronouncements**

SFAS No. 157, *Fair Value Measurements*, was issued by the FASB in September, 2006. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but increases consistency and comparability in the use of fair value measurements and calculations. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and for interim periods within those fiscal years. Management does not anticipate that the adoption of SFAS No. 157 will have a material effect on LCNB's consolidated balance sheet or income statement.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, was issued by the FASB in February, 2007. It permits, but does not require, corporations to measure many financial instruments and certain other items at fair value. The decision to elect the fair value option is made individually for each instrument and is irrevocable once made. Changes in fair value will be recorded in earnings. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted. Management intends to adopt SFAS No. 159 in the year beginning January 1, 2008 and does not anticipate that adoption of this standard will have a material effect on LCNB's consolidated balance sheet or income statement.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

LCNB Corp. and subsidiaries

Lebanon, Ohio

We have reviewed the accompanying consolidated balance sheet of LCNB Corp. and subsidiaries as of September 30, 2007, and the related consolidated statements of income and comprehensive income for the three-month and nine-month periods ended September 30, 2007 and 2006, and the related consolidated statements of shareholders equity and cash flows for the nine-month periods ended September 30, 2007 and 2006. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of LCNB Corp. and subsidiaries as of December 31, 2006 (presented herein), and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated February 21, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated in all material respects, in relation to the consolidated balance sheet

from which it has been derived.

/s/ J.D. Cloud & Co. L.L.P.

Cincinnati, Ohio

October 26, 2007



## LCNB Corp. and Subsidiaries

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

#### **Forward Looking Statements**

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

#### **Acquisition**

On May 31, 2006, Dakin purchased the existing book of business of Altemeier Oliver & Company Agency, Inc. ( AOC ), an independent insurance agency located in Blue Ash, Ohio. The acquisition of AOC was accounted for using the purchase accounting method and the results of operations of AOC have been included in the consolidated financial statements of LCNB since the acquisition date. The acquired assets consisted solely of a customer list intangible asset. This intangible asset is being amortized on a straight-line basis over a ten year period.

#### **Results of Operations**

LCNB earned \$1,370,000 or \$0.22 per diluted share for the three months ended September 30, 2007, compared to \$1,506,000 or \$0.23 per diluted share for the three months ended September 30, 2006. The return on average assets (ROAA) for the third quarter, 2007 was 0.99% and the return on average equity (ROAE) was 10.47%, compared with an ROAA of 1.08% and an ROAE of 11.47% for the third quarter of 2006. The decrease in net income for the third

quarter, 2007 is primarily attributable to a decrease in net interest income and an increase in non-interest expense.

LCNB earned \$4,365,000 or \$0.69 per diluted share during the first nine months of 2007 compared to \$4,724,000 or \$0.73 per diluted share for the first nine months of 2006. The ROAA and ROAE for the first nine months of 2007 were 1.07% and 11.28%, respectively. The comparable ratios for the first nine months of 2006 were 1.16% and 12.09%, respectively. The decrease in net income for the nine months ended September 30, 2007 is primarily attributable to a decrease in net interest income, an increase in the provision for loan losses, and an increase in non-interest expense.

**LCNB Corp. and Subsidiaries**

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

**Net Interest Income**

Three Months Ended September 30, 2007 vs. 2006.

LCNB's primary source of earnings is net interest income, which is the difference between earnings from loans and other investments and interest paid on deposits and other liabilities. The following table presents, for the three months ended September 30, 2007 and 2006, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resulting average yields earned or rates paid.

	Three Months Ended September 30,					
	2007			2006		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Loans (1)	\$ 395,202	\$ 6,732	6.76%	\$ 381,228	\$ 6,489	6.75%
Federal funds sold and interest-bearing demand deposits	14,096	176	4.95%	11,433	154	5.34%
Federal Reserve Bank stock	648	-	-%	647	-	-%
Federal Home Loan Bank stock	1,685	27	6.36%	2,607	38	5.78%
Investment securities:						
Taxable	47,491	533	4.45%	65,730	678	4.09%
Non-taxable (2)	44,917	685	6.05%	47,115	703	5.92%
Total earnings assets	504,039	8,153	6.42%	508,760	8,062	6.29%

Edgar Filing: LCNB CORP - Form 10-Q

Non-earning assets	45,334			45,696			
Allowance for loan losses	(2,055)			(2,052)			
Total assets	\$ 547,318			\$ 552,404			
Interest-bearing deposits	\$ 406,559	3,455	3.37%	\$ 417,017	3,289	3.13%	
Short-term borrowings	980	11	4.45%	1,046	13	4.93%	
Long-term debt	5,000	66	5.24%	32	1	12.40%	
Total interest-bearing liabilities	412,539	3,532	3.40%	418,095	3,303	3.13%	
Demand deposits	79,510			78,863			
Other liabilities	3,367			3,361			
Capital	51,902			52,085			
Total liabilities and capital	\$ 547,318			\$ 552,404			
Net interest rate spread (3)			3.02%			3.16%	
Net interest income and net interest margin on a taxable-equivalent basis (4)	\$ 4,621	3.64%		\$ 4,759	3.71%		
Ratio of interest-earning assets to interest-bearing liabilities	122.18%			121.69%			

(1)

Includes nonaccrual loans, if any.

(2)

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

(3)

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

(4)

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



**LCNB Corp. and Subsidiaries**

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

The following table presents the changes in taxable-equivalent basis interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the three months ended September 30, 2007 as compared to the same period in 2006. Changes not solely attributable to rate or volume have been allocated to volume and rate changes in proportion to the relationship of absolute dollar amounts of the changes in each.

	Three Months Ended September 30, 2007 vs. 2006		
	Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
<b>Interest-earning Assets:</b>			
Loans	\$ 238	5	243
Federal funds sold and interest-bearing			
demand deposits	34	(12)	22
Federal Home Loan Bank stock	(14)	3	(11)
Investment securities:			
Taxable	(201)	56	(145)
Nontaxable	(33)	15	(18)
Total interest income	24	67	91
<b>Interest-bearing Liabilities:</b>			
Deposits	(84)	250	166
Short-term borrowings	(1)	(1)	(2)
Long-term debt	66	(1)	65
Total interest expense	(19)	248	229
Net interest income	\$ 43	(181)	(138)



**LCNB Corp. and Subsidiaries**

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

Net interest income on a fully tax-equivalent basis for the three months ended September 30, 2007 totaled \$4,621,000, a decrease of \$138,000 from the comparable period in 2006. Total interest expense increased \$229,000, which was partially offset by an increase in total interest income of \$91,000.

The increase in total interest expense was primarily due to a 27 basis point increase in the average rate paid, which was primarily due to general increases in market interest rates, slightly offset by the decrease in average interest-bearing liabilities referred to above.

The increase in total interest income was due to a 13 basis point (one basis point equals 0.01%) increase in the average rate earned on earning assets and to a \$14.0 million increase in average loans, partially offset by a \$20.4 million decrease in average investment securities. The increase in the average rate earned on earning assets was primarily due to general increases in market interest rates. The decrease in average investment securities was used primarily to fund the growth in average loans.

The net interest margin decreased 7 basis points in the third quarter, 2007 compared to the third quarter, 2006. The lower margin reflects highly competitive market pricing conditions for both loans and deposits. As a result, average deposit rates increased faster than average loan rates.

Nine Months Ended September 30, 2007 vs. 2006.

The following table presents, for the nine months ended September 30, 2007 and 2006, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resultant average yields earned or rates paid.





## LCNB Corp. and Subsidiaries

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

	Nine Months Ended September 30,					
	2007			2006		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Loans (1)	\$ 392,038	\$ 20,096	6.85%	\$ 370,813	\$ 18,624	6.72%
Federal funds sold and interest-						
bearing demand deposits	9,338	360	5.15%	9,338	349	5.00%
Federal Reserve Bank stock	648	19	3.92%	647	19	3.93%
Federal Home Loan Bank stock	1,901	92	6.47%	2,571	111	5.77%
Investment securities:						
Taxable	51,468	1,719	4.47%	67,506	2,024	4.01%
Non-taxable (2)	47,216	2,147	6.08%	50,925	2,259	5.93%
Total earnings assets	502,609	24,433	6.50%	501,800	23,386	6.23%
Non-earning assets	44,665			44,744		
Allowance for loan losses	(2,056)			(2,088)		
Total assets	\$ 545,218			\$ 544,456		
Interest-bearing deposits	\$ 402,835	9,908	3.29%	\$ 407,589	8,856	2.90%
Short-term borrowings	4,263	172	5.39%	1,561	55	4.71%
Long-term debt	3,718	146	5.25%	700	30	5.73%
Total interest-bearing liabilities	410,816	10,226	3.33%	409,850	8,941	2.92%
Demand deposits	79,510			79,399		
Other liabilities	3,163			2,969		
Capital	51,729			52,238		

Edgar Filing: LCNB CORP - Form 10-Q

Total liabilities and capital	\$ 545,218		\$ 544,456	
Net interest rate spread (3)		3.17%		3.31%
Net interest income and net interest margin on a taxable-equivalent basis (4)	\$ 14,207	3.78%	\$ 14,445	3.85%
Ratio of interest-earning assets to interest-bearing liabilities	122.34%		122.44%	

(1)

Includes nonaccrual loans, if any.

(2)

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

(3)

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

(4)

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

**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 nine months ended September 30, 2007 as compared to the same period in 2006.

	Nine Months Ended September 30, 2007 vs. 2006		
	Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
<b>Interest-earning Assets:</b>			
Loans	\$ 1,082	390	1,472
Federal funds sold and interest-bearing			
demand deposits	-	11	11
Federal Home Loan Bank stock	(31)	12	(19)
<b>Investment securities:</b>			
Taxable	(518)	213	(305)
Nontaxable	(168)	56	(112)
Total interest income	365	682	1,047
<b>Interest-bearing Liabilities:</b>			
Deposits	(104)	1,156	1,052
Short-term borrowings	108	9	117
Long-term debt	119	(3)	116
Total interest expense	123	1,162	1,285
Net interest income	\$ 242	(480)	(238)

Net interest income on a fully tax-equivalent basis for the first nine months of 2007 totaled \$14,207,000, a \$238,000 decrease from the same period in 2006. Total interest expense increased \$1,285,000 and was partially offset by an increase in total interest income of \$1,047,000.

The increase in total interest expense was due primarily to a 41 basis point increase in the average rate paid on interest-bearing liabilities. The net interest margin decreased 7 basis points during the first nine months of 2007 compared to the first nine months of 2006 primarily due to competitive market pricing conditions for both loans and deposits and to a flat or inverted yield curve during much of the 2007 period. As a result, average deposit rates increased faster than average loan rates.

**LCNB Corp. and Subsidiaries**

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

The increase in total interest income was due to a 27 basis point increase in the average rate earned on earning assets, from 6.23% for the first nine months of 2006 to 6.50% for the comparable period in 2007, and to a \$21.2 million increase in average loans, partially offset by a \$19.7 million decrease in average investment securities. The decrease in average investment securities was used to fund the growth in average loans.

**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 September 30, 2007 and 2006 was \$75,000 and \$66,000, respectively, and \$158,000 and \$100,000 for the nine months ended September 30, 2007 and 2006, respectively.

**Non -Interest Income**

**Three Months Ended September 30, 2007 vs. 2006.**

Non-interest income of \$2,117,000 for the third quarter of 2007 was \$44,000 greater than for the same period in 2006 primarily due to the absence of a loss on abandonment of an ATM recognized during the 2006 period, which was netted against other operating income.

**Nine Months Ended September 30, 2007 vs. 2006.**

Non-interest income of \$6,220,000 for the first nine months of 2007 was \$48,000 greater than for the same period in 2006 for primarily the same reason mentioned above. In addition trust income increased \$28,000 primarily due to executor fees received during the 2007 period. Service charges and fees decreased \$44,000 due to a decrease in non-sufficient fund charges, partially offset by an increase in check card income.

**Non-Interest Expense**

**Three Months Ended September 30, 2007 vs. 2006.**

Total non-interest expense increased \$118,000 during the third quarter, 2007 compared to the third quarter, 2006, primarily due to an \$18,000 increase in salaries and wages, a \$35,000 increase in pension and other employee benefits, and a \$59,000 increase in occupancy expense. Pension and other employee benefits increased primarily due to an increase in pension costs and occupancy expense increased primarily due to maintenance and repair costs and increased utilities expense.

**LCNB Corp. and Subsidiaries**

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

Nine Months Ended September 30, 2007 vs. 2006.

Total non-interest expense increased \$345,000 during the nine months ended September 30, 2007 compared to the same period in 2006 primarily due to a \$163,000 increase in salaries and wages, a \$59,000 increase in pension and other employee benefits, and a \$129,000 increase in occupancy expense. Salaries and wages increased primarily due to additional employees and routine salary and wage increases. Pension and other employee benefits increased primarily due to an increase in pension expense. Occupancy expense increased primarily due to increased maintenance and repair costs, rent expense for the land for the new Oakwood office (opened May, 2007), and real estate taxes for the Oakwood office.

**Income Taxes**

LCNB's effective tax rates for the nine months ended September 30, 2007 and 2006 were 24.2% and 25.2%, respectively. The difference between the statutory rate of 34.0% and the effective tax rate is primarily due to tax-exempt interest income from municipal securities and tax-exempt earnings from bank owned life insurance.

**Financial Condition**

The fair value of securities available for sale was \$91.1 million at September 30, 2007, approximately \$20.0 million less than at December 31, 2006. The decrease was due to maturities and calls; no securities were sold during the first nine months of 2007. These additional funds, along with a \$5.0 million FHLB advance obtained in March, 2007, and a \$19.8 million increase in total deposits were primarily used to pay down short-term borrowings, fund loan growth, and build liquidity through investments in federal funds sold and interest-bearing demand deposits.

The term of the \$5.0 million FHLB advance is ten years and interest is payable monthly at a fixed rate of 5.25%.



The \$19.8 million increase in total deposits is due to public fund deposits from local governmental entities, which increased \$20.5 million.

Short-term borrowings at September 30, 2007 were \$2.8 million, a \$12.6 million decrease from the December 31, 2006 balance of \$15.4 million.

Net loans outstanding at September 30, 2007 totaled \$394.1 million, approximately \$5.8 million greater than at December 31, 2006. Commercial and industrial loans, commercial real estate loans, and residential real estate loans comprised most of the increase.

**LCNB Corp. and Subsidiaries**

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

The following table highlights the changes in the balance sheets. The analysis uses quarterly averages to give a better indication of balance sheet trends.

**CONDENSED QUARTERLY AVERAGE BALANCE SHEETS**

	September 30, 2007	June 30, 2007	March 31, 2007
(In thousands)			
<b>ASSETS</b>			
Interest earning:			
Federal funds sold and			
interest-bearing demand deposits	\$ 14,096	11,862	1,923
Investment securities	94,741	100,048	109,066
Loans	395,202	390,468	390,392
Total interest-earning assets	504,039	502,378	501,381
Noninterest-earning:			
Cash and due from banks	14,699	12,669	15,067
All other assets	30,635	30,679	30,265
Allowance for credit losses	(2,055)	(2,055)	(2,056)
<b>TOTAL ASSETS</b>	<b>\$ 547,318</b>	<b>543,671</b>	<b>544,657</b>
<b>LIABILITIES</b>			
Interest-bearing:			
Interest-bearing deposits	\$ 406,559	402,689	399,176
Short-term borrowings	980	1,090	10,825
Long-term debt	5,000	5,000	1,111
Total interest-bearing liabilities	412,539	408,779	411,112

Noninterest-bearing:			
Noninterest-bearing deposits	79,510	80,038	78,940
All other liabilities	3,367	3,014	3,164
<b>TOTAL LIABILITIES</b>	<b>495,416</b>	<b>491,831</b>	<b>493,216</b>
<b>SHAREHOLDERS' EQUITY</b>	<b>51,902</b>	<b>51,840</b>	<b>51,441</b>
<b>TOTAL LIABILITIES AND</b>			
<b>SHAREHOLDERS EQUITY</b>	<b>\$ 547,318</b>	<b>543,671</b>	<b>544,657</b>

**LCNB Corp. and Subsidiaries**

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

**Liquidity**

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

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. Asset liquidity is provided by cash and assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash and cash equivalents and securities available for sale. At September 30, 2007, LCNB's liquid assets amounted to \$134.3 million or 23.9% of total gross assets, a slight increase from \$126.6 million or 23.1% at December 31, 2006.

Liquidity is also provided by access to core funding sources, primarily core depositors in the bank's market area. Approximately 76.2% of total deposits at September 30, 2007 were core deposits, a decrease from 80.4% at December 31, 2006. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than \$100,000. Core deposits decreased because all of the growth in total deposits during 2007 has been due to public fund deposits.

Secondary sources of liquidity include LCNB's ability to sell loan participations, borrow funds from the Federal Home Loan Bank, purchase federal funds, or use a line of credit established with another bank.

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

-27-

**LCNB Corp. and Subsidiaries**

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

**Recent Accounting Pronouncements**

SFAS No. 157, *Fair Value Measurements*, was issued by the FASB in September, 2006. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but increases consistency and comparability in the use of fair value measurements and calculations. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and for interim periods within those fiscal years. Management does not anticipate that the adoption of SFAS No. 157 will have a material effect on LCNB's consolidated balance sheet or income statement.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, was issued by the FASB in February, 2007. It permits, but does not require, corporations to measure many financial instruments and certain other items at fair value. The decision to elect the fair value option is made individually for each instrument and is irrevocable once made. Changes in fair value will be recorded in earnings. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted. Management intends to adopt SFAS No. 159 in the year beginning January 1, 2008 and does not anticipate that adoption of this standard will have a material effect on LCNB's consolidated balance sheet or income statement.



**LCNB Corp. and Subsidiaries**

**Item 3. Quantitative and Qualitative Disclosures about Market Risks**

The Bank's Asset and Liability Management Committee ("ALCO") primarily uses a combination of Interest Rate Sensitivity Analysis (IRSA) and Economic Value of Equity (EVE) analysis for measuring and managing interest rate risk. The IRSA model is used to estimate the effect on net interest income during a one-year period of instantaneous and sustained movements in interest rates, also called interest rate shocks, of 100, 200, and 300 basis points. The base projection uses a current interest rate scenario. As shown below, the September 30, 2007 IRSA indicates that either an increase or a decrease in rates would have a negative effect on net interest income. The changes in net interest income for the up and down 100, 200, and 300 basis point rate assumptions are within LCNB's acceptable ranges.

Rate Shock Scenario in <u>Basis Points</u>	Amount  (In thousands)	\$ Change in Net Interest Income	% Change in Net Interest Income
Up 300	\$ 18,509	(41)	-0.22%
Up 200	18,530	(20)	-0.11%
Up 100	18,546	(4)	-0.02%
Base	18,550	-	-%
Down 100	18,505	(45)	-0.24%
Down 200	18,329	(221)	-1.19%
Down 300	18,049	(501)	-2.70%

IRSA shows the affect on net interest income during a one-year period only. A more long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. The EVE analysis at September 30, 2007 is shown below. The changes in the economic value of equity for these rate assumptions are within LCNB's acceptable ranges, except for the up 300 basis points scenario. The change for the up 300 basis points scenario is slightly outside LCNB's policy range of a 25% change for this category, but management has determined the change is acceptable in the current economic environment.

Rate Shock Scenario in <u>Basis Points</u>	Amount  (In thousands)	\$ Change in EVE	% Change in EVE
---	------------------------------	---------------------	--------------------



Edgar Filing: LCNB CORP - Form 10-Q

Up 300	\$	57,571	(19,259)	-25.07%
Up 200		60,130	(16,700)	-21.74%
Up 100		62,350	(14,480)	-18.85%
Base		76,830	-	-%
Down 100		64,138	(12,692)	-16.52%
Down 200		62,168	(14,662)	-19.08%
Down 300		60,574	(16,256)	-21.16%

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.

**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. Based upon this evaluation, these officers have concluded, that as of September 30, 2007, 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.

## **PART II. OTHER INFORMATION**

### **LCNB Corp. and Subsidiaries**

#### **Item 1. Legal Proceedings - None**

#### **Item 1A. Risk Factors No material changes**

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

There were no sales of unregistered equity securities of LCNB during the third quarter, 2007.

On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two phases of which continue. The shares purchased will be held for future corporate purposes.

Under the "Market Repurchase Program" LCNB was originally authorized to purchase up to 100,000 shares of its stock through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 200,000 total shares. Through September 30, 2007, 290,440 shares had been purchased under this program. No shares were purchased under this program during the third quarter, 2007.

The "Private Sale Repurchase Program" is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. There is no limit to the number of shares that may be purchased under this program. A total of 466,018 shares have been purchased under this program since its inception. No shares were purchased under this program during the third quarter, 2007.

#### **Item 3. Defaults Upon Senior Securities - None**

**Item 4. Submission of Matters to a Vote of Security Holders - None**

**Item 5. Other Information - None**

-31-

**PART II. OTHER INFORMATION**

**LCNB Corp. and Subsidiaries**

**Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Title</u>
2	Amended and Restated Affiliation Agreement dated September 24, 2007 by and among LCNB Corp., Lebanon-Citizens National Bank, and Sycamore National Bank incorporated by reference to Form S-4A filed on October 22, 2007, Annex A.
3(i)	Articles of Incorporation incorporated by reference to Form 10-Q for the quarterly period ended March 31, 2005, Exhibit 3(i).
3(ii)	Regulations incorporated by reference to Form 10-Q for the quarterly period ended March 31, 2005, Exhibit 3(ii).
10.1	LCNB Corp. Ownership Incentive Plan incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), Dated March 15, 2002, Exhibit A (000-26121).
10.2	Form of Option Grant Agreement under the LCNB Corp. Ownership Incentive Plan incorporated by reference to Form 10-K for the fiscal year Ended December 31, 2005, Exhibit 10.2.
15	Letter regarding unaudited interim financial information.
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Financial Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.



**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.

October 29, 2007

/s/ Stephen P. Wilson

Stephen P. Wilson, President, CEO &

Chairman of the Board of Directors

October 29, 2007

/s/Steve P. Foster

Steve P. Foster, Executive Vice President

and Chief Financial Officer

