

LCNB CORP  
Form 10-K  
February 28, 2012

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

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2011

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-26121

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

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

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

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

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

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

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

COMMON STOCK, NO PAR VALUE  
(Title of Class)

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

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

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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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

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

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

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

The aggregate market value of the registrant's outstanding voting common stock held by nonaffiliates on June 30, 2011 determined using a per share closing price on that date of \$11.92 as quoted on the Nasdaq Over-the-Counter Bulletin Board, was \$74,869,735.

As of February 27, 2012, 6,705,307 common shares were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement included in the Notice of Annual Meeting of Shareholders to be held April 24, 2012, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2011 are incorporated by reference into Part III.

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## LCNB CORP.

For the Year Ended December 31, 2011

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

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

DESCRIPTION OF LCNB CORP.'S BUSINESS

General Description

LCNB Corp., an Ohio corporation formed in December, 1998, is a financial holding company headquartered in Lebanon, Ohio. Substantially all of the assets, liabilities and operations of LCNB Corp. are attributable to its wholly-owned subsidiary, LCNB National Bank (the "Bank"). LCNB Corp. completed the sale of its subsidiary, Dakin Insurance Agency, Inc. (“Dakin”) to Rixey-Berry Insurance Group on March 23, 2011. LCNB Corp. and its subsidiary are herein collectively referred to as “LCNB”.

The predecessor of LCNB Corp., the Bank, was formed as a national banking association in 1877. On May 19, 1999, the Bank became a wholly-owned subsidiary of LCNB Corp. At the close of business on December 20, 2007, Sycamore National Bank (“Sycamore”) merged with and into the Bank. A Cincinnati, Ohio based commercial bank, Sycamore operated two offices located on Cincinnati’s West side. These two offices became branches of the Bank at the time of the merger. The Bank's main office is located in Warren County, Ohio and 24 branch offices are located in Warren, Butler, Clinton, Clermont, Hamilton, and Montgomery Counties, Ohio. In addition, the Bank operates 31 automated teller machines ("ATMs") in its market area.

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

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Loan products offered include commercial and industrial loans, commercial and residential real estate loans, construction loans, various types of consumer loans, and Small Business Administration loans. The Bank's residential mortgage lending activities consist primarily of loans for purchasing or refinancing personal residences, home equity lines of credit, and loans for commercial or consumer purposes secured by residential mortgages. Consumer lending activities include automobile, boat, home improvement and personal loans. The Bank also offers indirect financing through various automotive, boat, and lawn and garden dealers.

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

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

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

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

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

## Market Area

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

	Warren	Butler	Clinton	Hamilton	Montgomery
Population, 2000 census	158,383	332,807	40,543	845,303	559,062
Population, 2010 census	212,693	368,130	42,040	802,374	535,153
Percentage increase/decrease in population	34.3	% 10.6	% 3.0	% -5.1	% -4.3
Estimated percentage of persons below poverty level	6.1	% 12.7	% 12.9	% 14.2	% 15.4
Estimated median household income	\$ 70,939	\$ 54,344	\$ 47,842	\$ 48,363	\$ 43,815
Median age	36.8	35.4	37.4	36.8	38.2
Unemployment rate:					
December 2011	7.0	% 7.9	% 11.1	% 7.5	% 8.5
December 2010	8.4	% 8.8	% 15.0	% 8.5	% 10.1
December 2009	9.3	% 9.9	% 18.5	% 9.5	% 12.0

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

Butler County was historically a rural area with the exception of three urban centers. Hamilton and Middletown were both manufacturing centers. As is true with many manufacturing communities in the Midwest, many of the industries in Hamilton and Middletown have either closed or greatly diminished their workforces and these jobs have been largely replaced with lower-paying service oriented jobs. Oxford is the home of Miami University and Oxford's businesses primarily serve the college students. A fourth urban center, Fairfield, was incorporated in 1955.

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

Clinton County remains mostly rural. Wilmington, with a 2010 census population of 12,520, is the largest city. The next largest is Blanchester, with a 2010 census population of 4,243. The unemployment rates at December 2009, 2010, and 2011 are unusually high, even for the current economy, because of the loss of a dominant employer. DHL, an overnight shipping company, owned the Wilmington Air Park, a decommissioned air force base, and maintained hub operations at this location. In May 2008 DHL announced that its sorting and air freight operations at the Wilmington Air Park would be discontinued. This resulted in the direct loss of approximately 8,000 jobs, not including job losses sustained by other businesses dependent on the air park operations. Certain services subcontracted to ABX Air and ASTAR Air Cargo continue, but with greatly diminished work forces.

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

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

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

## Competition

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

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

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

## Supervision and Regulation

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

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

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

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

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

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

1. Required regulatory agencies to take "prompt corrective action" with financial institutions that do not meet minimum capital requirements;
2. Established five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized;
3. Imposed significant restrictions on the operations of a financial institution that is not rated well-capitalized or adequately capitalized;
4. Prohibited a depository institution from making any capital distributions, including payments of dividends or paying any management fee to its holding company, if the institution would be undercapitalized as a result;
5. Implemented a risk-based premium system;
6. Required an audit committee to be comprised of outside directors;
7. Required a financial institution with more than \$1 billion in total assets to issue annual, audited financial statements prepared in conformity with U.S. generally accepted accounting principles; and
8. Required a financial institution with more than \$1 billion in total assets to document, evaluate, and report on the effectiveness of the entity's internal control system and required an independent public accountant to attest to management's assertions concerning the bank's internal control system.

The members of an audit committee for banks with more than \$1 billion in total assets must be independent of management. Only a majority, rather than all, of the members of an audit committee for banks with total assets between \$500 million and \$1 billion must be independent.



Financial institutions that are public companies, such as LCNB, are not relieved from their SOX internal control reporting and attestation requirements or their audit committee independence requirements by the provisions of FDICIA.

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At December 31, 2011, the Bank was well capitalized based on FDICIA's guidelines.

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

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

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

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

1. Certification of financial reports by the chief executive officer ("CEO") and the chief financial officer ("CFO"), who are responsible for designing and monitoring internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to the certifying officers by others within the company;
2. Inclusion of an internal control report in annual reports that include management's assessment of the effectiveness of a company's internal control over financial reporting and a report by the company's independent registered public accounting firm attesting to the effectiveness of internal control over financial reporting;
3. Accelerated reporting of stock trades on Form 4 by directors and executive officers;

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4. Disgorgement requirements of incentive pay or stock-based compensation profits received within twelve months of the release of financial statements if the company is later required to restate those financial statements due to material noncompliance with any financial reporting requirement that resulted from misconduct;
5. Disclosure in a company's periodic reports stating if it has adopted a code of ethics for its CFO and principal accounting officer or controller and, if such code of ethics has been implemented, immediate disclosure of any change in or waiver of the code of ethics;
6. Disclosure in a company's periodic reports stating if at least one member of the audit committee is a "financial expert," as that term is defined by the Securities and Exchange Commission (the "SEC"); and
7. Implementation of new duties and responsibilities for a company's audit committee, including independence requirements, the direct responsibility to appoint the outside auditing firm and to provide oversight of the auditing firm's work, and a requirement to establish procedures for the receipt, retention, and treatment of complaints from a company's employees regarding questionable accounting, internal control, or auditing matters.

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

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

1. Merging the Bank Insurance Fund and the Savings Association Insurance Fund into a new fund called the Deposit Insurance Fund, effective March 31, 2006;
2. Increasing insurance coverage for retirement accounts from \$100,000 to \$250,000, effective April 1, 2006;
3. Adjusting deposit insurance levels of \$100,000 for non-retirement accounts and \$250,000 for retirement accounts every five years based on an inflation index, with the first adjustment to be effective on January 1, 2011;
4. Eliminating a 1.25% hard target Designated Reserve Ratio, as defined, and giving the FDIC discretion to set the Designated Reserve Ratio within a range of 1.15% to 1.50% for any given year;
5. Eliminating certain restrictions on premium rates the FDIC charges covered institutions and establishing a risk-based premium system; and
6. Providing for a one-time credit for institutions that paid premiums to the Bank Insurance Fund or the Savings Association Insurance Fund prior to December 31, 1996.

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President George W. Bush signed the Emergency Economic Stabilization Act of 2008 (the “EESA”) on October 3, 2008. The EESA provided broad authority to the Treasury Secretary to restore liquidity and stability to the United States’ financial system, primarily by authorizing the Secretary to establish the Troubled Asset Relief Program (“TARP”). In addition, the EESA temporarily raised the basic limit on federal deposit insurance coverage for non-retirement accounts from \$100,000 to \$250,000 effective immediately upon the President’s signature and continuing through December 31, 2013, as extended by the Helping Families Save Their Homes Act of 2009, at which time the insurance level would have returned to \$100,000.

On October 14, 2008, the Treasury Department announced the implementation of the TARP Capital Purchase Program (the “CPP”), which provided for direct equity investments, in the form of perpetual preferred stock, by the Treasury Department in qualifying financial institutions. The CPP was voluntary and provided for a minimum investment of 1% of an institution’s total risk-weighted assets and a maximum investment of 3% of total risk-weighted assets, not to exceed \$25 billion. The perpetual preferred stock had a dividend rate of 5% per year until the fifth anniversary of the CPP investment and 9% thereafter. Under the CPP, the Treasury Department received warrants for an institution’s common stock equal to 15% of the capital invested. The warrants have a ten-year term. Participants in the CPP program must comply with various restrictions and provisions, including, but not limited to, restrictions in compensation for certain executive officers, restrictions on dividends paid to shareholders, and limitations on treasury share purchases.

On January 9, 2009, LCNB received \$13.4 million of new capital from the Treasury Department under the CPP and issued 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A and a warrant for the purchase of 217,063 common shares of LCNB stock at an exercise price of \$9.26. LCNB redeemed all 13,400 shares of the preferred stock on October 21, 2009. In connection with this redemption, LCNB paid approximately \$13.5 million to the Treasury Department, which included the original investment amount of \$13.4 million plus accrued and unpaid dividends of approximately \$123,000. LCNB did not repurchase the warrant.

On November 21, 2008, the FDIC announced the final rules for the Temporary Liquidity Guarantee Program, which was designed to strengthen confidence and encourage liquidity in the banking system. The new program had two parts:

1. The FDIC guaranteed certain newly issued senior unsecured debt of eligible institutions, including FDIC-insured banks and thrifts and certain holding companies, issued on or after October 14, 2008 and before June 30, 2009; and
2. The FDIC temporarily provided full deposit insurance coverage for non-interest bearing deposit transaction accounts in FDIC-insured institutions, regardless of the dollar amount, through December 31, 2009, later extended to December 31, 2010.

For purposes of the Temporary Liquidity Guarantee Program, the FDIC included NOW accounts with an interest rate of 0.50% or less and accounts commonly known as Interest on Lawyers Trust Accounts in the definition of noninterest-bearing transaction accounts. The extension for the period from July 1, 2010 through December 31, 2010 reduced the interest rate for NOW accounts eligible for coverage under the program from 0.50% to 0.25%.

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All eligible banks and thrift institutions were automatically covered by the Temporary Liquidity Guarantee Program unless they opted out of one or both programs on or before December 5, 2008, as extended. Institutions that did not opt out of one or both programs were subject to additional fees for inclusion in the program or programs after the opt-out date. LCNB management chose not to opt out of either program.

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

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

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

The Dodd-Frank Act permanently raised the FDIC maximum deposit insurance amount to \$250,000. The maximum amount had been temporarily set at \$250,000 beginning October 3, 2008 and effective until December 31, 2013, as extended, when it would have reverted back to \$100,000. The increased limit also retroactively applied to any depositors of financial institutions for which the FDIC had been appointed as receiver or conservator between January 1 and October 3, 2008. In addition, the Dodd-Frank Act places a floor on the FDIC’s reserve ratio at 1.35% of estimated insured deposits or the comparable percentage of the assessment base.

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

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

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

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

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

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

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

Employees

As of December 31, 2011, LCNB employed 235 full-time equivalent employees. LCNB is not a party to any collective bargaining agreement. Management considers its relationship with its employees to be very good. Employee benefit programs are considered by management to be competitive with benefit programs provided by other financial institutions and major employers within LCNB's market area.

Divestitures

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

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Availability of Financial Information

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

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

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

FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

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

STATISTICAL INFORMATION

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

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

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

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

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## Investment Portfolio

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

	2011	At December 31, 2010	2009
	(Dollars in thousands)		
Securities available-for-sale:			
U.S. Treasury notes	\$ 17,550	19,585	13,308
U.S. Agency notes	82,927	82,862	45,888
U.S. Agency mortgage-backed securities	52,287	33,094	49,624
Corporate securities	6,365	2,025	8,488
Municipal securities	91,610	96,396	83,323
Mutual funds	2,125	1,053	538
Trust preferred securities	564	604	344
Equity securities	578	263	65
Total securities available-for-sale	254,006	235,882	201,578
Securities held-to-maturity:			
Municipal securities	10,734	12,141	13,030
Federal Reserve Bank Stock	940	939	940
Federal Home Loan Bank Stock	2,091	2,091	2,091
Total securities	\$ 267,771	251,053	217,639



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Contractual maturities of securities at December 31, 2011, were as follows. Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale			Held-to-Maturity			Yield	
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield		
(Dollars in thousands)								
U.S. Treasury notes:								
One to five years	\$7,709	7,824	0.97	% -	-	-	-	%
Five to ten years	9,676	9,726	1.22	% -	-	-	-	%
Total U.S. Treasury notes	17,385	17,550	1.11	% -	-	-	-	%
U.S. Agency notes:								
One to five years	81,415	82,927	1.42	% -	-	-	-	%
Total U.S. Agency notes	81,415	82,927	1.42	% -	-	-	-	%
Corporate securities:								
One to five years	6,334	6,365	1.30	% -	-	-	-	%
Total corporate securities	6,334	6,365	1.30	% -	-	-	-	%
Municipal securities (1):								
Within one year	4,364	4,398	1.70	%	1,837	1,837	3.05	%
One to five years	42,320	43,987	3.20	%	678	678	5.89	%
Five to ten years	35,159	37,833	4.58	%	4,314	4,314	6.62	%
After ten years	5,080	5,392	5.64	%	3,905	3,905	8.62	%
Total Municipal securities	86,923	91,610	3.89	%	10,734	10,734	6.69	%
U.S. Agency mortgage- backed securities								
	50,923	52,287	2.84	%	-	-	-	%
Mutual Funds	2,103	2,125	2.99	%	-	-	-	%
Trust preferred securities	549	564	7.98	%	-	-	-	%
Equity securities	526	578	3.70	%	-	-	-	%
Totals	\$246,158	254,006	2.59	%	10,734	10,734	6.69	%

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

Excluding holdings in U.S. Treasury securities and U.S. Government Agencies, there were no investments in securities of any issuer that exceeded 10% of LCNB's consolidated shareholders' equity at December 31, 2011.

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Loan Portfolio

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

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

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

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

	2011		2010		At December 31, 2009		2008		2007	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Commercial and industrial	\$30,990	6.7 %	36,122	7.9 %	42,807	9.3 %	38,724	8.6 %	37,325	8.4 %
Commercial, secured by real estate	219,188	47.6 %	196,136	43.1 %	185,024	40.2 %	174,493	38.5 %	159,384	35.8 %
Residential real estate	186,904	40.5 %	190,277	41.9 %	193,293	42.0 %	194,039	42.8 %	193,920	43.5 %
Consumer	14,562	3.2 %	19,691	4.3 %	26,185	5.7 %	33,369	7.4 %	43,410	9.7 %
Agricultural	2,835	0.6 %	2,966	0.7 %	3,125	0.7 %	3,216	0.7 %	2,707	0.6 %
Other loans, including deposit overdrafts	6,554	1.4 %								