

LCNB CORP
Form 10-K
February 26, 2013

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, 2012

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

(State or other jurisdiction of incorporation or
organization)

31-1626393

(I.R.S. Employer Identification Number)

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

(513) 932-1414

(Registrant's telephone number, including area code)

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

Title of Each Class
None

Name of each exchange on which registered
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, 2012, determined using a per share closing price on that date of \$13.33 as quoted on the NASDAQ Capital Market, was \$85,277,689.

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

DOCUMENTS INCORPORATED BY REFERENCE

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

LCNB CORP.

For the Year Ended December 31, 2012

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

Certain matters disclosed herein may be deemed to be forward-looking statements that involve risks and uncertainties. Forward looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualifying words and their derivatives such as “expects,” “anticipates,” “believes,” “estimates,” “plans,” “projects” 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. and its subsidiary are herein collectively referred to as “LCNB.”

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

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

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

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

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

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

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

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

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

Market Area

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

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

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

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

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

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

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

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

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

Competition

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

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

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

Supervision and Regulation

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

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

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

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

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

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

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

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

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

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

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

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

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

1. Certification of financial reports by the chief executive officer ("CEO") and the chief financial officer ("CFO"), who are responsible for designing and monitoring internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to the certifying officers by others within the company;
2. Inclusion of an internal control report in annual reports that include management's assessment of the effectiveness of a company's internal control over financial reporting and a report by the company's independent registered public accounting firm attesting to the effectiveness of internal control over financial reporting;
3. Accelerated reporting of stock trades on Form 4 by directors and executive officers;
4. Disgorgement requirements of incentive pay or stock-based compensation profits received within twelve months of the release of financial statements if the company is later required to restate those financial statements due to material noncompliance with any financial reporting requirement that resulted from misconduct;
5. Disclosure in a company's periodic reports stating if it has adopted a code of ethics for its CFO and principal accounting officer or controller and, if such code of ethics has been implemented, immediate disclosure of any change in or waiver of the code of ethics;

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6. Disclosure in a company's periodic reports stating if at least one member of the audit committee is a "financial expert," as that term is defined by the Securities and Exchange Commission (the "SEC"); and
7. Implementation of new duties and responsibilities for a company's audit committee, including independence requirements, the direct responsibility to appoint the outside auditing firm and to provide oversight of the auditing firm's work, and a requirement to establish procedures for the receipt, retention, and treatment of complaints from a company's employees regarding questionable accounting, internal control, or auditing matters.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Employees

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

Divestitures

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

Availability of Financial Information

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

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

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

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FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

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

STATISTICAL INFORMATION

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

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

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

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

Investment Portfolio

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

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

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Contractual maturities of securities at December 31, 2012, were as follows. Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

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

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

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

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Loan Portfolio

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

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

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

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

	2012		2011		At December 31, 2010		2009		2008	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
(Dollars in thousands)										
Commercial and industrial	\$26,236	5.8 %	30,990	6.7 %	36,122	7.9 %	42,807	9.3 %	38,724	8.6 %
Commercial, secured by real estate	230,256	50.7 %	219,188	47.6 %	196,136	43.1 %	185,024	40.2 %	174,493	38.5 %
Residential real estate	183,132	40.4 %	186,904	40.5 %	190,277	41.9 %	193,293	42.0 %	194,039	42.8 %
Consumer	10,554	2.3 %	14,562	3.2 %	19,691	4.3 %	26,185	5.7 %	33,369	7.4 %
Agricultural	1,668	0.4 %	2,835	0.6 %	2,966	0.7 %	3,125	0.7 %	3,216	0.7 %
Other loans, including deposit overdrafts	1,875	0.4 %	6,554	1.4 %	9,413	2.1 %	9,422	2.1 %	9,203	2.0 %
	453,721	100.0 %								