

LCNB CORP  
Form 10-K  
March 09, 2018

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, 2017

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 organization) (I.R.S. Employer Identification Number)

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

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

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

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



Edgar Filing: LCNB CORP - Form 10-K

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, 2017, determined using a per share closing price on that date of \$20.00 as quoted on the NASDAQ Capital Market, was \$192,316,000.

As of March 8, 2018, 10,026,203 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, 2018, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2017 are incorporated by reference into Part III.

---

LCNB CORP.

For the Year Ended December 31, 2017

TABLE OF CONTENTS

PART I	<u>4</u>
Item 1. <u>Business</u>	<u>4</u>
Item 1A. <u>Risk Factors</u>	<u>15</u>
Item 1B. <u>Unresolved Staff Comments</u>	<u>20</u>
Item 2. <u>Properties</u>	<u>21</u>
Item 3. <u>Legal Proceedings</u>	<u>23</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>23</u>
 PART II	 <u>24</u>
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.</u>	<u>24</u>
Item 6. <u>Selected Financial Data</u>	<u>27</u>
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>28</u>
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>39</u>
Item 8. <u>Financial Statements and Supplementary Data</u>	<u>40</u>
<u>REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING</u>	<u>40</u>
<u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	<u>41</u>
<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	<u>44</u>
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosures</u>	<u>95</u>
Item 9A. <u>Controls and Procedures</u>	<u>95</u>
Item 9B. <u>Other Information</u>	<u>95</u>
 PART III	 <u>96</u>
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	<u>96</u>
Item 11. <u>Executive Compensation</u>	<u>96</u>
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.</u>	<u>96</u>
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>96</u>
Item 14. <u>Principal Accounting Fees and Services</u>	<u>96</u>
 PART IV	 <u>97</u>
Item 15. <u>Exhibits, Financial Statement Schedules</u>	<u>97</u>
 <u>SIGNATURES</u>	 <u>99</u>

Table of Contents

LCNB CORP. AND SUBSIDIARIES

PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

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

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

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

Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist shareholders and potential investors in understanding current and anticipated financial operations of LCNB and is included pursuant to the safe harbor provisions of the Private Securities

Litigation Reform Act of 1995. LCNB undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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 Risk Management, Inc., a captive insurance agency, was incorporated in Nevada by LCNB Corp. during the second quarter 2017. LCNB Corp. and its subsidiaries 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.

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 National"), a wholly-owned subsidiary of First Capital, was merged into LCNB National Bank. At that time, Citizens National's 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 office in Clarksburg, Ohio was closed on January 24, 2017.

On January 24, 2014, LCNB purchased all of the outstanding stock of Eaton National Bank & Trust Co. ("Eaton National") from its holding company, Colonial Banc Corp., in a cash transaction totaling \$24.75 million. Upon consummation of the transaction, Eaton National was merged into the Bank and its five offices became offices of the Bank. Two of these offices are located in Eaton, Ohio and one office is located in each of New Paris, Ohio, Lewisburg, Ohio, and West Alexandria, Ohio.

On April 30, 2015, LCNB consummated a merger with BNB Bancorp, Inc. ("BNB") in a stock and cash transaction valued at approximately \$13.5 million. Immediately following the merger of BNB into LCNB, Brookville National Bank ("Brookville National"), a wholly-owned subsidiary of BNB, was merged into LCNB National Bank. At that time, Brookville National's two offices, both located in Brookville, Ohio, became offices of LCNB. The office located on Hay Avenue in Brookville was closed on November 10, 2017.

On December 20, 2017, LCNB and Columbus First Bancorp, Inc. ("CFB") entered into an Agreement and Plan of Merger pursuant to which CFB will be merged into LCNB in an all-stock transaction valued at \$66.9 million. Immediately following the merger of CFB into LCNB, Columbus First Bank ("Columbus First"), a wholly-owned subsidiary of CFB, will be merged into the Bank. Columbus First operates one full-service office in Worthington, Ohio. This office will become a branch of the Bank after the merger. The transaction is expected to close in the second quarter of 2018, assuming shareholder approval by LCNB and CFB shareholders and all applicable governmental approvals have been received by that date and all other conditions precedent to the merger have been satisfied or waived.

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, Lifetime Checking accounts (a senior citizen program), individual retirement accounts, and certificates of deposit. Additional supportive services include online banking, bill pay, mobile banking and telephone banking. Commercial customers also have both cash management and remote deposit capture products as potential options. 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”).

Loan products offered include commercial and industrial loans, commercial and residential real estate loans, agricultural 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 Trust and Investment Management Division of the Bank provides complete trust administrative, estate settlement, and fiduciary services and also offers investment management of trusts, agency accounts, individual retirement accounts, and foundations/endowments.

-5-

---



Table of Contents

LCNB CORP. AND SUBSIDIARIES

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, 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.

Primary Market Area

The Bank considers its primary market area to consist of counties where it has a physical presence and neighboring counties, which includes Southwestern and South Central Ohio. At December 31, 2017, the Bank had:  
• 34 offices, including a main office in Warren County, Ohio and branch offices in Warren, Butler, Clinton, Clermont, Hamilton, Montgomery, Preble, Ross, and Fayette Counties, Ohio,  
• a loan production office in Franklin County, Ohio,  
• an Operations Center in Warren County, Ohio,  
• and 38 ATMs.

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 CEO/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.

The ability to access and use technology is an increasingly competitive factor in the finance services industry. Technology relating to the delivery of financial services, the security and privacy of customer information, and the processing of information is evolving rapidly. LCNB must continually make technology investments to remain

competitive in the finance services industry.

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").

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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.

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 Bank's customers and depositors. 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 \$500 million 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. FDICIA does not relieve financial institutions that are public companies, such as LCNB, from internal control reporting and attestation requirements or audit committee independence requirements prescribed by the Sarbanes-Oxley Act of 2002 (see below).

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," as defined in the act, or "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:

Certification of financial reports by the chief executive officer ("CEO") and the chief financial officer ("CFO"), who 1. 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;

Table of Contents

LCNB CORP. AND SUBSIDIARIES

- Inclusion of an internal control report in annual reports that include management's assessment of the effectiveness of
2. 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;  
Disgorgement requirements of incentive pay or stock-based compensation profits received within twelve months of
4. 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;  
Disclosure in a company's periodic reports stating if it has adopted a code of ethics for its CFO and principal
5. 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  
Implementation of new duties and responsibilities for a company's audit committee, including independence
7. 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; and
3. 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.

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.

The Dodd-Frank Act established a new independent regulatory body within the Federal Reserve System known as the Consumer Financial Protection Bureau (the "CFPB"). The CFPB 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 CFPB 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 CFPB-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 CFPB.

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.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

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 advisers 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.

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, 2017, LCNB employed 310 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.

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](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 North 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 subsidiaries do not have any offices located in foreign countries and have no foreign assets, liabilities or related income and expense for the years presented.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## 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:

	At December 31,		
	2017	2016	2015
	(In thousands)		
Securities available-for-sale:			
U.S. Treasury notes	\$2,259	28,145	72,846
U.S. Agency notes	83,261	85,400	139,889
U.S. Agency mortgage-backed securities	67,153	71,047	29,378
Certificates of deposit	—	—	249
Municipal securities	122,540	132,860	132,420
Mutual funds	2,542	2,482	2,466
Trust preferred securities	50	48	50
Equity securities	667	677	680
Total securities available-for-sale	278,472	320,659	377,978
Securities held-to-maturity:			
Municipal securities	32,571	41,003	22,633
Federal Reserve Bank stock	2,732	2,732	2,732
Federal Home Loan Bank stock	3,638	3,638	3,638
Total securities	\$317,413	368,032	406,981

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

Contractual maturities of securities at December 31, 2017, 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		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
	(Dollars in thousands)					
U.S. Treasury notes:						
Within one year	\$—	—	— %	\$—	—	— %
One to five years	—	—	— %	—	—	— %
Five to ten years	2,283	2,259	2.07 %	—	—	— %
After ten years	—	—	— %	—	—	— %
Total U.S. Treasury notes	2,283	2,259	2.07 %	—	—	— %
U.S. Agency notes:						
Within one year	998	998	1.40 %	—	—	— %
One to five years	38,235	37,805	1.77 %	—	—	— %
Five to ten years	45,604	44,458	2.02 %	—	—	— %
After ten years	—	—	— %	—	—	— %
Total U.S. Agency notes	84,837	83,261	1.90 %	—	—	— %
Municipal securities (1):						
Within one year	10,224	10,269	3.29 %	4,047	4,047	3.15 %
One to five years	54,665	54,648	2.73 %	4,185	4,185	2.90 %
Five to ten years	54,633	54,119	2.94 %	8,186	8,186	3.04 %
After ten years	3,640	3,504	2.80 %	15,972	15,972	5.81 %
Total Municipal securities	123,162	122,540	2.93 %	32,390	32,390	4.40 %
U.S. Agency mortgage-backed securities	68,347	67,153	2.17 %	—	—	— %
Mutual funds	2,586	2,542	2.23 %	—	—	— %
Trust preferred securities	49	50	7.78 %	—	—	— %
Equity securities	574	667	3.59 %	—	—	— %
Totals	\$281,838	278,472	2.40 %	32,390	32,390	4.40 %

(1) Yields on tax-exempt obligations are computed on a taxable-equivalent basis based upon a 34.0% 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, 2017.

## Loan Portfolio

Administration of the lending function is the responsibility of the Chief Lending Officer and certain senior lenders. Lenders perform their 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 the commercial, agricultural, and retail loan portfolios.

-11-

---

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

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. Loans secured by residential or commercial real estate require the approval of two individuals with appropriate lending authority: Chief Executive Officer/President, Chief Lending Officer, Chief Credit Officer, Senior Vice President ("SVP") of Commercial Lending, SVP of Mortgage Lending, SVP of Consumer Lending, Assistant Vice President of Secondary Market Lending, or other board-designated lending officers. Board approval is required on any loan with policy exceptions or that will exceed 50% of the Bank's legal lending limit, rounded down to the previous \$100,000, in aggregate credit to any one borrower or entity, as defined by the OCC in 12 C.F.R § 32.2(b).

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.

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

	At December 31,											
	2017		2016		2015		2014		2013			
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%		%
	(Dollars in thousands)											
Commercial and industrial	\$36,057	4.2	\$41,878	5.1	\$45,275	5.9	\$35,424	5.1	\$29,337	5.1		
Commercial, secured by real estate	527,947	62.2	477,275	58.2	419,633	54.5	379,141	54.3	314,252	54.7		
Residential real estate	251,582	29.6	265,788	32.5	273,139	35.4	254,087	36.4	215,587	37.6		
Consumer	17,450	2.1	19,173	2.3	18,510	2.4	18,006	2.5	12,643	2.2		
Agricultural	15,194	1.8	14,802	1.8	13,479	1.7	11,472	1.6	2,472	0.4		
Other loans, including deposit overdrafts	539	0.1	633	0.1	665	0.1	680	0.1	91	—		
	848,769	100.0%	819,549	100.0%	770,701	100.0%	698,810	100.0%	574,382	100.0%		
Deferred origination costs (fees), net	291		254		237		146		(28)			
Total loans	849,060		819,803		770,938		698,956		574,354			
Less allowance for loan losses	3,403		3,575		3,129		3,121		3,588			
Loans, net	\$845,657		\$816,228		\$767,809		\$695,835		\$570,766			

As of December 31, 2017, there were no concentrations of loans exceeding 10% of total loans that are not already disclosed as a category of loans in the above table, except for loans secured by multifamily properties. Loans secured by multifamily properties, which are included in the commercial, secured by real estate category in the above table, totaled \$85,853,000, or 10.1% of total loans, at December 31, 2017.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

The following table summarizes the commercial and agricultural loan maturities and sensitivities to interest rate change at December 31, 2017:

	(In thousands)
Maturing in one year or less	\$ 32,732
Maturing after one year, but within five years	57,451
Maturing beyond five years	489,015
Total commercial and agricultural loans	\$ 579,198
Loans maturing beyond one year:	
Fixed rate	\$ 199,916
Variable rate	346,550
Total	\$ 546,466

## Risk Elements

The following table summarizes non-accrual, past-due, and accruing restructured loans for the dates indicated:

	At December 31,				
	2017	2016	2015	2014	2013
	(Dollars in thousands)				
Non-accrual loans	\$2,965	5,725	1,723	5,599	2,961
Past-due 90 days or more and still accruing	—	23	559	203	250
Accruing restructured loans	10,469	11,731	13,723	14,269	15,151
Total	\$13,434	17,479	16,005	20,071	18,362
Percent to total loans	1.58	% 2.13	% 2.08	% 2.87	% 3.20

LCNB is not committed to lend additional funds to debtors whose loans have been modified to provide a reduction or deferral of principal or interest because of deterioration in the financial position of the borrower.

At December 31, 2017, there were no material additional loans not classified as acquired credit impaired or already disclosed as non-accrual, accruing restructured, or accruing past due 90 days or more where known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with present loan repayment terms.

## Summary of Loan Loss Experience

The table summarizing the activity related to the allowance for loan losses is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Allocation of the Allowance for Loan Losses

The following table presents the allocation of the allowance for loan loss:

	At December 31,														
	2017			2016			2015			2014			2013		
	Amount	Percent of Loans in Each Category to Total Loans	%	Amount	Percent of Loans in Each Category to Total Loans	%	Amount	Percent of Loans in Each Category to Total Loans	%	Amount	Percent of Loans in Each Category to Total Loans	%	Amount	Percent of Loans in Each Category to Total Loans	%
	(Dollars in thousands)														
Commercial and industrial	\$378	4.2	%	\$350	5.1	%	\$244	5.9	%	\$129	5.1	%	\$175	5.1	%
Commercial, secured by real estate	2,178	62.2	%	2,179	58.2	%	1,908	54.5	%	1,990	54.3	%	2,520	54.7	%
Residential real estate	717	29.6	%	885	32.5	%	854	35.4	%	926	36.4	%	826	37.6	%
Consumer	76	2.1	%	96	2.3	%	54	2.4	%	63	2.5	%	66	2.2	%
Agricultural	53	1.8	%	60	1.8	%	66	1.7	%	11	1.6	%	—	0.4	%
Other loans, including deposit overdrafts	1	0.1	%	5	0.1	%	3	0.1	%	2	0.1	%	1	—	%
Unallocated	—	—		—	—		—	—		—	—		—	—	
Total	\$3,403	100.0	%	\$3,575	100.0	%	\$3,129	100.0	%	\$3,121	100.0	%	\$3,588	100.0	%

## Deposits

The statistical information regarding average amounts and average rates paid for the deposit categories is included in the "Distribution of Assets, Liabilities and Shareholders' Equity" table included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following table presents the contractual maturity of time deposits of \$100,000 or more at December 31, 2017:

	(In thousands)
Maturity within 3 months	\$ 4,311
After 3 but within 6 months	2,830
After 6 but within 12 months	14,526
After 12 months	44,940
	\$ 66,607

## Return on Equity and Assets

The statistical information regarding the return on assets, return on equity, dividend payout ratio, and equity to assets ratio is presented in Item 6, Selected Financial Data.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 1A. Risk Factors

There are risks inherent in LCNB's operations, many beyond management's control, which may adversely affect its financial condition and results from operations and should be considered in evaluating the Company. Credit, market, operational, liquidity, interest rate and other risks are described elsewhere in this report. Other risk factors may include the items described below.

New capital requirements could adversely affect LCNB's capital ratios

On July 2, 2013, the Federal Reserve Board approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. bank holding companies as well as state banks that are members of the Federal Reserve System and savings and loan holding companies (commonly known as Basel III). On July 9, 2013, the OCC adopted the same rules for national banks and federal savings associations, and the FDIC approved the same provisions, as an interim final rule, for state nonmember banks and state savings associations.

Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by banks and savings associations. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%.

The phase-in period for the final rules began for LCNB on January 1, 2015, with full compliance with all of the final rules' requirements phased in over a multi-year schedule through January 1, 2019. While management expects that LCNB's capital ratios under Basel III will continue to exceed the well capitalized minimum capital requirements, there can be no assurance that such will be the case. If LCNB is unable to meet or exceed the applicable minimum capital requirements, it may become subject to supervisory actions ranging in severity from losing its financial holding company status, to being precluded from making acquisitions or engaging in new activities or becoming subject to informal or formal regulatory enforcement actions.

LCNB's earnings are significantly affected by market interest rates.

Fluctuations in interest rates may negatively impact LCNB's profitability. A primary source of income from operations is net interest income, which is equal to the difference between interest income earned on loans and investment securities and the interest paid for deposits and other borrowings. These rates are highly sensitive to many factors beyond LCNB's control, including general economic conditions, the slope of the yield curve (that is, the relationship between short and long-term interest rates), and the monetary and fiscal policies of the United States Federal government. LCNB expects the current level of interest rates and the current slope of the yield curve will cause further downward pressure on its net interest margin.

Increases in general interest rates could have a negative impact on LCNB's results of operations by reducing the ability of borrowers to repay their current loan obligations. Some residential real estate mortgage loans, most home equity line of credit loans, and many of LCNB's commercial loans have adjustable rates. Borrower inability to make scheduled loan payments due to a higher loan cost could result in increased loan defaults, foreclosures, and write-offs and may necessitate additions to the allowance for loan losses. In addition, increases in the general level of interest rates may decrease the demand for new consumer and commercial loans, thus limiting LCNB's growth and profitability. A general increase in interest rates may also result in deposit disintermediation, which is the flow of deposits away from banks and other depository institutions into direct investments that have the potential for higher

rates of return, such as stocks, bonds, and mutual funds. If this occurs, LCNB may have to rely more heavily on borrowings as a source of funds in the future, which could negatively impact its net interest margin.

Gains from sales of mortgage loans may experience significant volatility.

Gains from sales of mortgage loans are highly influenced by the level and direction of mortgage interest rates, real estate activity, and refinancing activity. Current historically low market interest rates created a refinancing demand for residential fixed-rate mortgage loans. The increased volume of refinancing activity increased gains from sales of mortgage loans as LCNB sold most of these loans to the Federal Home Loan Mortgage Corporation. An increase in market interest rates may decrease the demand for refinanced loans and decrease the gains from sales of mortgage loans recognized in LCNB's consolidated statements of income. Gains from sales of mortgage loans may also be impacted by changes in LCNB's strategy to manage its residential mortgage portfolio. For example, LCNB may occasionally change the proportion of loan originations that are sold in the secondary market and instead add a greater proportion to its loan portfolio.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Banking competition in Southwestern and South Central Ohio is intense.

LCNB faces strong competition for deposits, loans, trust accounts, and other services from other banks, savings banks, credit unions, mortgage brokers, and other financial institutions. Many of LCNB's competitors include major financial institutions that have been in business for many years and have established customer bases, numerous branches, and substantially higher regulatory lending limits. Competitors in the Southwestern and South Central Ohio areas include U.S. Bank, PNC Bank, Fifth Third Bank, Chase, KeyBank, Park National Bank, Huntington National Bank, and First Financial Bank. In addition, credit unions are growing larger due to more flexible membership requirement regulations and are offering more financial services than they legally could in the past.

LCNB also competes with numerous real estate brokerage firms, some owned by realty companies, for residential real estate mortgage loans. Incentives offered by captive finance companies owned by the major automobile companies have limited the banking industry's opportunities for growth in the new automobile loan market. The banking industry now competes with brokerage firms and mutual fund companies for funds that would have historically been held as bank deposits. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of these competitors have fewer regulatory constraints and may have lower cost structures.

If LCNB is unable to attract and retain loan, deposit, brokerage, and trust customers, its growth and profitability levels may be negatively impacted.

Economic conditions in Southwestern and South Central Ohio could adversely affect LCNB's financial condition and results of operations.

LCNB conducts its operations from offices that are located in nine Southwestern and South Central Ohio counties, from which substantially all of its customer base is drawn. Because of this geographic concentration of operations and customer base, LCNB's financial performance is heavily influenced by economic conditions in these areas. Any material deterioration in economic conditions in these markets could have material direct or indirect adverse impacts on LCNB's customers and on LCNB. Such deterioration could increase the number of customers experiencing financial distress, negatively impacting their ability to obtain new loans or to repay existing loans. As a result, LCNB may experience increases in the levels of impaired loans, increased charge-offs, and increased provisions for loan losses. Deteriorating economic conditions may also affect the ability of depositors to maintain or add to deposit balances and may affect the demand for loans, trust, brokerage, and other products and services offered by LCNB. Such losses and decreased demand could have material adverse affects on LCNB's financial position, results of operations, and cash flows.

The allowance for loan losses may be inadequate.

The provision for loan losses is determined by management based upon its evaluation of the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated 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, the fair value of any underlying collateral, borrowers' cash flows, and current economic conditions that may affect borrowers' ability to make payments. Increases in the allowance result in an expense for the period. By its nature, the evaluation is imprecise and requires significant judgment. Actual results may vary significantly from management's assumptions. If, as a result of general economic conditions or a decrease in asset quality, management determines that additional increases in the allowance for loan losses are necessary, LCNB will incur additional expenses.

LCNB's loan portfolio includes a substantial amount of commercial and industrial loans and commercial real estate loans, which may have more risks than residential or consumer loans.

LCNB's commercial and industrial and commercial real estate loans comprise a substantial portion of its total loan portfolio. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity, residential mortgage, or consumer loans. The increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans, the size of loan balances, the effects of general economic conditions on income-producing properties, and the increased difficulty of evaluating and monitoring these types of loans.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

The repayment of loans secured by commercial real estate is often dependent upon the successful operation, development, or sale of the related real estate or commercial business and may, therefore, be subject to adverse conditions in the real estate market or economy. If the cash flow from operations is reduced, the borrower's ability to repay the loan may be impaired. In such cases, LCNB may take one or more actions to protect its financial interest in the loan. Such actions may include foreclosure on the real estate securing the loan, taking possession of other collateral that may have been pledged as security for the loan, or modifying the terms of the loan. If foreclosed on, commercial real estate is often unique and may not be as salable as a residential home.

The fair value of LCNB's investments could decline.

Most of LCNB's investment securities portfolio is designated as available-for-sale. Accordingly, unrealized gains and losses, net of tax, in the estimated fair value of the available-for-sale portfolio is recorded as other comprehensive income, a separate component of shareholders' equity. The fair value of LCNB's investment portfolio may decline, causing a corresponding decline in shareholders' equity. Management believes that several factors will affect the fair values of the investment portfolio including, but not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation, and the slope of the interest rate yield curve. These and other factors may impact specific categories of the portfolio differently and the effect any of these factors may have on any specific category of the portfolio cannot be predicted.

Many state and local governmental authorities have experienced deterioration of financial condition in recent years due to declining tax revenues, increased demand for services, and various other factors. To the extent LCNB has any municipal securities in its portfolio from issuers who are experiencing deterioration of financial condition or who may experience future deterioration of financial condition, the value of such securities may decline and could result in other-than-temporary impairment charges, which could have an adverse effect on LCNB's financial condition and results of operations. Additionally, a general, industry-wide decline in the fair value of municipal securities could significantly affect LCNB's financial condition and results of operations.

Changes in income tax laws or interpretations or in accounting standards could materially affect LCNB's financial condition or results of operations.

Changes in income tax laws could be enacted, or interpretations of existing income tax laws could change, causing an adverse effect to LCNB's financial condition or results of operations. Similarly, new accounting standards may be issued by the Financial Accounting Standards Board (the "FASB") or existing standards revised, changing the methods for preparing financial statements. These changes are not within LCNB's control and may significantly impact its reported financial condition and results of operations.

LCNB is subject to environmental liability risk associated with lending activities.

A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Bank to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Bank's exposure to environmental liability. Although the Bank has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on LCNB's financial

condition and results of operations.

The banking industry is highly regulated.

LCNB is subject to regulation, supervision, and examination by the Federal Reserve Board and the Bank is subject to regulation, supervision, and examination by the OCC. LCNB and the Bank are also subject to regulation and examination by the FDIC as the deposit insurer. The CFPB is responsible for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by banks. Federal and state laws and regulations govern numerous matters including, but not limited to, changes in the ownership or control of banks, maintenance of adequate capital, permissible business operations, maintenance of deposit insurance, protection of customer financial privacy, the level of reserves held against deposits, restrictions on dividend payments, the making of loans, and the acceptance of deposits. See the previous section titled "Supervision and Regulation" for more information on this subject.

-17-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Federal regulators may initiate various enforcement actions against a financial institution that violates laws or regulations or that operates in an unsafe or unsound manner. These enforcement actions may include, but are not limited to, the assessment of civil money penalties, the issuance of cease-and-desist or removal orders, and the imposition of written agreements.

Proposals to change the laws governing financial institutions are periodically introduced in Congress and proposals to change regulations are periodically considered by the regulatory bodies. Such future legislation and/or changes in regulations could increase or decrease the cost of doing business, limit or expand permissible activities, or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The likelihood of any major changes in the future and their effects are impossible to predict.

Federal income tax reform could have unforeseen effects on our financial condition and results of operations. On December 22, 2017, the President of the United States signed into law H.R. 1, originally known as the “Tax Cuts and Jobs Act.” The Company is still in the process of analyzing the Tax Cuts and Jobs Act and its possible effects on the Company. The Tax Cuts and Jobs Act includes a number of provisions, including the lowering of the U.S. corporate tax rate from 35 percent to 21 percent, effective January 1, 2018. There are also provisions that may partially offset the benefit of such rate reduction. Financial statement impacts include adjustments for, among other things, the re-measurement of deferred tax assets and liabilities. While there are benefits, there is also substantial uncertainty regarding the details of U.S. Tax Reform. The intended and unintended consequences of the Tax Cuts and Jobs Act on our business and on holders of our common shares is uncertain and could be adverse. The Company anticipates that the impact of the Tax Cuts and Jobs Act may be material to our business, financial condition and results of operations.

FDIC deposit insurance assessments may materially increase in the future.

Deposits of LCNB are insured up to statutory limits by the Federal Deposit Insurance Corporation (FDIC) and, accordingly, LCNB and other banks and financial institutions pay quarterly premiums to the FDIC to maintain the Deposit Insurance Fund. The likelihood and extent of future rate increases are indeterminable.

Future growth and expansion opportunities may contain risks.

From time to time LCNB may seek to acquire other financial institutions or parts of those institutions or may open new branch offices. It may also consider and enter into new lines of business or offer new products or services. Such activities involve a number of risks, which may include potential inaccuracies in estimates and judgments used to evaluate the expansion opportunity, diversion of management and employee attention, lack of experience in a new market or product or service, and difficulties in integrating a future acquisition or introducing a new product or service. There is no assurance that such growth or expansion activities will be successful or that they will achieve desired profitability levels.

The financial services industry, as well as the broader economy, may be subject to new legislation, regulation, and government policy.

At this time, it is difficult to predict the legislative and regulatory changes that will result from the combination of a new President of the United States and the first year since 2010 in which both Houses of Congress and the White House have majority memberships from the same political party. In recent years, however, both the new President and senior members of the House of Representatives have advocated for significant reduction of financial services regulation, to include amendments to the Dodd-Frank Act and structural changes to the CFPB. The new Administration and Congress also may cause broader economic changes due to changes in governing ideology and

governing style. New appointments to the Board of Governors of the Federal Reserve could affect monetary policy and interest rates and changes in fiscal policy could affect broader patterns of trade and economic growth. Future legislation, regulation, and government policy could affect the banking industry as a whole, including LCNB's business and results of operations, in ways that are difficult to predict. In addition, LCNB's results of operations could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

LCNB's controls and procedures may fail or be circumvented.

Management regularly reviews and updates LCNB's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of LCNB's controls and procedures or failure to comply with regulations related to its controls and procedures could have a material adverse effect on LCNB's business, results of operations, and financial condition.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

LCNB's information systems may experience an interruption, cyberattack, or other breach in security. LCNB relies heavily on communications and information systems to conduct its business. Significant resources are devoted to maintaining and regularly updating LCNB's data systems, there can be no assurance that these security measures will provide absolute security. Any failure, interruption, cyberattack, or other breach in security of these systems could result in failures or disruptions in LCNB's customer relationship management, general ledger, deposit, loan, and other systems. While LCNB has policies and procedures designed to prevent or limit the effect of the failure, interruption, cyberattack, or other security breach of its information systems, there can be no assurance that any such occurrences will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions, cyberattacks, or other security breaches of LCNB's information systems could significantly disrupt LCNB's operations, allow misappropriation of LCNB's confidential information, allow misappropriation of customer confidential information, damage LCNB's reputation, result in a loss of customer business, subject LCNB to additional regulatory scrutiny, or expose LCNB to significant civil litigation and possible financial liability, any of which could have a material adverse effect on its financial condition and results of operations.

LCNB continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. LCNB's future success depends, in part, upon its ability to address customer needs by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in LCNB's operations. LCNB may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could negatively affect LCNB's growth, revenue and profit.

Emergence of nonbank alternatives to the financial system.

Consumers may decide not to use banks to complete their financial transactions. Technology and other changes, including the emergence of "Fintech Companies," are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can complete transactions, such as paying bills and/or transferring funds, directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

Risk factors related to LCNB's trust business.

Competition for trust business is intense. Competitors include other commercial bank and trust companies, brokerage firms, investment advisory firms, mutual fund companies, accountants, and attorneys.

LCNB's trust business is directly affected by conditions in the debt and equity securities markets. The debt and equity securities markets are affected by, among other factors, domestic and foreign economic conditions and the monetary and fiscal policies of the United States Federal government, all of which are beyond LCNB's control. Changes in economic conditions may directly affect the economic performance of the trust accounts in which clients' assets are invested. A decline in the fair value of the trust accounts caused by a decline in general economic conditions directly affects LCNB's trust fee income because such fees are primarily based on the fair value of the trust accounts. In addition, a sustained decrease in the performance of the trust accounts or a lack of sustained growth may encourage clients to seek alternative investment options.

The management of trust accounts is subject to the risk of mistaken distributions, poor investment choices, and miscellaneous other incorrect decisions. Such mistakes may give rise to surcharge actions by beneficiaries, with damages substantially in excess of the fees earned from management of the accounts.

LCNB's ability to pay cash dividends is limited.

LCNB is dependent upon the earnings of the Bank for funds to pay dividends on its common shares. The payment of dividends by LCNB and the Bank is subject to certain regulatory restrictions. As a result, any payment of dividends in the future will be dependent, in large part, on the ability of LCNB and the Bank to satisfy these regulatory restrictions and on the Bank's earnings, capital levels, financial condition, and other factors. Although LCNB's financial earnings and financial condition have allowed it to declare and pay periodic cash dividends to shareholders, there can be no assurance that the current dividend policy or the amount of dividend distributions will continue in the future.

-19-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 1B. Unresolved Staff Comments

Not applicable.

-20-

---

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 2. Properties

The Bank conducts its business from the following offices:

Name of Office	Address	County	
1. Main Office	2 North Broadway Lebanon, Ohio 45036	Warren	Owned
2. Auto Bank	Silver and Mechanic Streets Lebanon, Ohio 45036	Warren	Owned
3. Barron Street Office	1697 North Barron Street Eaton, Ohio 45320	Preble	Leased
4. Bridge Street Office	1240 North Bridge Street Chillicothe, Ohio 45601	Ross	Owned
5. Brookville Office	225 West Upper Lewisburg Salem Road Brookville, Ohio 45309	Montgomery	Owned
6. Centerville Office	9605 Dayton-Lebanon Pike Centerville, Ohio 45458	Montgomery	Owned
7. Chillicothe Office	33 West Main Street Chillicothe, Ohio 45601	Ross	Owned
8. Colerain Township Office	3209 West Galbraith Road Cincinnati, Ohio 45239	Hamilton	Owned
9. Columbus Avenue Office	730 Columbus Avenue Lebanon, Ohio 45036	Warren	Owned
10. Eaton Office	110 West Main Street Eaton, Ohio 45320	Preble	Owned
11. Fairfield Office	765 Nilles Road Fairfield, Ohio 45014	Butler	Leased
12. Frankfort Office	Springfield and Main Streets Frankfort, Ohio 45628	Ross	Owned
13. Goshen Office	6726 Dick Flynn Blvd. Goshen, Ohio 45122	Clermont	Owned
14. Hamilton Office	794 NW Washington Blvd. Hamilton, Ohio 45013	Butler	Owned

Edgar Filing: LCNB CORP - Form 10-K

15. Hunter Office	3878 State Route 122 Franklin, Ohio 45005	Warren	Owned
16. Lewisburg Office	522 South Commerce Street Lewisburg, Ohio 45338	Preble	Owned
17. Loveland Office	500 Loveland-Madeira Road Loveland, Ohio 45140	Hamilton	Owned

-21-

---

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

Name of Office	Address	County	
18. Maineville Office	7795 South State Route 48 Maineville, Ohio 45039	Warren	Owned
19. Mason/West Chester Office	1050 Reading Road Mason, Ohio 45040	Warren	Owned
20. Middletown Office	4441 Marie Drive Middletown, Ohio 45044	Butler	Owned
21. Monroe Office	101 Clarence F. Warner Drive Monroe, Ohio 45050	Butler	Owned
22. New Paris Office	201 South Washington Street New Paris, Ohio 45347	Preble	Owned
23. Oakwood Office	2705 Far Hills Avenue Oakwood, Ohio 45419	Montgomery (2)	
24. Otterbein Office	Otterbein Retirement Community State Route 741 Lebanon, Ohio 45036	Warren	Leased
25. Oxford Office (1)	30 West Park Place Oxford, Ohio 45056	Butler	(2)
26. Rochester/Morrow Office	Route 22-3 at 123 Morrow, Ohio 45152	Warren	Owned
27. South Lebanon Office	603 Corwin Nixon Blvd. South Lebanon, Ohio 45065	Warren	Owned
28. Springboro/Franklin Office	525 West Central Avenue Springboro, Ohio 45066	Warren	Owned
29. Warrior Office	Lebanon High School 1916 Drake Road Lebanon, Ohio 45036	Warren	Leased
30. Washington Court House Office	100 Crossings Drive Washington Court House, Ohio 43160	Fayette	Owned
31. Waynesville Office	9 North Main Street Waynesville, Ohio 45068	Warren	Owned

Edgar Filing: LCNB CORP - Form 10-K

32. West Alexandria Office	55 East Dayton Street West Alexandria, Ohio 45381	Preble	Owned
33. Western Avenue Office	1006 Western Avenue Chillicothe, Ohio 45601	Ross	Owned
34. Wilmington Office	1243 Rombach Avenue Wilmington, Ohio 45177	Clinton	Owned
35. Loan Production Office	1500 West Third Ave., Suite 205 & 209 Grandview Heights, Ohio 43212	Franklin	Leased

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Name of Office	Address	County	
36. Operations Center	105 North Broadway Lebanon, Ohio 45036	Warren	Owned

(1) Excess space in this office is leased to third parties.

(2) The Bank owns the Oakwood and Oxford office buildings and leases the land.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not Applicable.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.

LCNB had approximately 962 registered holders of its common stock as of December 31, 2017. The number of shareholders includes banks and brokers who act as nominees, each of whom may represent more than one shareholder. LCNB's stock trades on the NASDAQ Capital Market exchange under the symbol "LCNB."

Trade prices for shares of LCNB Common Stock and cash dividends per share declared and paid are set forth below. The trade prices shown below are interdealer without retail markups, markdowns, or commissions.

	2017			2016		
	High	Low	Dividends Declared	High	Low	Dividends Declared
First Quarter	\$24.35	20.80	0.16	17.75	15.51	0.16
Second Quarter	23.90	19.00	0.16	17.24	15.69	0.16
Third Quarter	21.85	18.05	0.16	19.13	15.73	0.16
Fourth Quarter	22.84	19.40	0.16	25.00	16.55	0.16
Total dividends declared			0.64			0.64

It is expected that LCNB will continue to pay dividends on a similar schedule, to the extent permitted by business and potential factors beyond management's control.

LCNB depends on dividends from the Bank for the majority of its liquid assets, including the cash needed to pay dividends to its shareholders. National banking law limits the amount of dividends the Bank may pay to the sum of retained net income, as defined, for the current year plus retained net income for the previous two calendar years. Prior approval from the OCC, 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 ordinary dividends to LCNB without needing to request approval.

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

On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two of which continue to be in effect – the "Market Repurchase Program and the "Private Sale Repurchase Program." Any shares purchased will be held for future corporate purposes.

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 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 400,000 total shares. Through December 31, 2017, 290,444 shares have been purchased under this program. No shares were purchased under the Market Repurchase Program during 2017 and 2016.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's common 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 through December 31, 2017. No shares were purchased under the Private Sale Repurchase Program during 2017 and 2016.

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

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

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

The following table shows information relating to stock options outstanding under the 2002 Plan and 2015 Plan at December 31, 2017:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance
Equity compensation plans approved by security holders	20,265	\$ 11.42	429,935
Equity compensation plans not approved by security holders	—	—	—
Total	20,265	\$ 11.42	429,935

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

The graph below provides an indicator of cumulative total shareholder returns for LCNB as compared with the NASDAQ Composite, the SNL Midwest OTC-BB and Pink Sheet Banks, and the SNL Midwest Bank indexes. This graph covers the period from December 31, 2012 through December 31, 2017. The cumulative total shareholder returns included in the graph reflect the returns for the shares of common stock of LCNB. The information provided in the graph assumes that \$100 was invested on December 31, 2012 in LCNB common stock, the NASDAQ Composite, and the SNL Midwest Bank Index and that all dividends were reinvested.

Index	Period Ending					
	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
LCNB Corp.	\$ 100.00	135.14	118.72	134.15	197.63	179.39
NASDAQ Composite Index	\$ 100.00	140.12	160.78	171.97	187.22	242.71
SNL Midwest Bank index	\$ 100.00	136.91	148.84	151.10	201.89	216.95

Source: S&P Global Market Intelligence

© 2017

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 6. Selected Financial Data

The following represents selected consolidated financial data of LCNB for the years ended December 31, 2013 through 2017 and are derived from LCNB's consolidated financial statements. Certain prior year data presented in this table have been reclassified to conform with the current year presentation. This data should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 8 of this Form 10-K and Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures about Market Risk included in Items 7 and 7A, respectively, of this Form 10-K, and are qualified in their entirety thereby and by other detailed information elsewhere in this Form 10-K.

	For the Years Ended December 31,					
	2017	2016	2015	2014	2013	
	(Dollars in thousands, except per share data)					
<b>Income Statement:</b>						
Interest income	\$44,463	43,750	42,659	39,477	33,497	
Interest expense	3,599	3,504	3,328	3,590	4,065	
Net interest income	40,864	40,246	39,331	35,887	29,432	
Provision for loan losses	215	913	1,366	930	588	
Net interest income after provision for loan losses	40,649	39,333	37,965	34,957	28,844	
Non-interest income	10,458	10,853	10,123	9,142	9,090	
Non-interest expenses	33,863	33,261	32,392	30,844	26,212	
Income before income taxes	17,244	16,925	15,696	13,255	11,722	
Provision for income taxes	4,272	4,443	4,222	3,386	2,942	
Net income	\$12,972	12,482	11,474	9,869	8,780	
Dividends per common share	\$0.64	0.64	0.64	0.64	0.64	
<b>Earnings per common share:</b>						
Basic	1.30	1.26	1.18	1.06	1.12	
Diluted	1.29	1.25	1.17	1.05	1.10	
<b>Balance Sheet:</b>						
Securities	\$317,413	368,032	406,981	314,074	279,021	
Loans, net	845,657	816,228	767,809	695,835	570,766	
Total assets	1,295,638	1,306,799	1,280,531	1,108,066	932,338	
Total deposits	1,085,821	1,110,905	1,087,160	946,205	785,761	
Short-term borrowings	47,000	42,040	37,387	16,645	8,655	
Long-term debt	303	598	5,947	11,357	12,102	
Total shareholders' equity	150,271	142,944	140,108	125,695	118,873	
<b>Selected Financial Ratios and Other Data:</b>						
Return on average assets	0.99	% 0.96	% 0.94	% 0.88	% 0.93	%
Return on average equity	8.74	% 8.60	% 8.43	% 8.04	% 9.02	%
Equity-to-assets ratio	11.60	% 10.94	% 10.94	% 11.34	% 12.75	%
Dividend payout ratio	49.23	% 50.79	% 54.24	% 60.38	% 57.14	%
Net interest margin, fully taxable equivalent	3.58	% 3.51	% 3.64	% 3.66	% 3.57	%

Eaton National merged with and into LCNB as of the close of business on January 24, 2014. As of the date of the merger, LCNB recorded additional loans of \$115.9 million and additional deposits of \$165.3 million.

BNB merged with and into LCNB as of the close of business on April 30, 2015. As of the date of the merger, LCNB recorded additional loans of \$34.7 million and additional deposits of \$99.1 million.

-27-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following is management's discussion and analysis of the consolidated financial condition and consolidated results of operations of LCNB. It is intended to amplify certain financial information regarding LCNB and should be read in conjunction with the consolidated financial statements and related notes contained in the 2017 Annual Report to Shareholders.

Overview

Net income for 2017 was \$12,972,000 (basic and diluted earnings per share of \$1.30 and \$1.29, respectively), compared to \$12,482,000 (basic and diluted earnings per share of \$1.26 and \$1.25) in 2016 and \$11,474,000 (basic and diluted earnings per share of \$1.18 and \$1.17) in 2015.

The following items significantly affected earnings for 2017:

Net gain on sales of securities was significantly greater in 2016 as compared to 2017 and 2015 due primarily to market rates at the time of the sales. In addition, the amount of securities sold in 2017 was less than the amounts sold in 2016 and 2015.

Other real estate owned expense was greater in 2016 and 2015 as compared to 2017 because of valuation writedowns and losses on sales recognized during 2016 and 2015. Other real estate owned properties held during 2017 were minimal.

Other non-interest expense for 2017 included \$154,000 in organizational costs for LCNB Risk Management, Inc. and \$113,000 in losses from sales of fixed assets, primarily due to the sale of a closed office building.

As a result of the Tax Cuts and Jobs Act that was signed into law on December 22, 2017, LCNB revalued its net deferred tax liability position to reflect the reduction in its federal corporate income tax rate from 34% to 21%. This revaluation resulted in a one-time income tax benefit of approximately \$224,000, or \$0.02 of basic and diluted earnings per common share for the year ended December 31, 2017.

Net Interest Income

LCNB's primary source of earnings is net interest income, which is the difference between earnings from loans and other investments and interest paid on deposits and other liabilities. The following table presents, for the years indicated, 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.

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

	Years ended December 31,								
	2017			2016			2015		
	Average Outstanding Balance	Interest Earned/Paid	Average Yield/Rate	Average Outstanding Balance	Interest Earned/Paid	Average Yield/Rate	Average Outstanding Balance	Interest Earned/Paid	Average Yield/Rate
	(Dollars in thousands)								
Loans (1)	\$822,452	36,571	4.45%	\$792,526	35,600	4.49%	\$740,626	35,285	4.76%
Federal funds sold	—	—	— %	—	—	— %	452	1	0.22%
Interest-bearing demand deposits	7,972	88	1.10%	12,394	59	0.48%	12,245	30	0.24%
Federal Reserve Bank stock	2,732	164	6.00%	2,732	164	6.00%	2,495	152	6.09%
Federal Home Loan Bank stock	3,638	182	5.00%	3,638	146	4.01%	3,638	146	4.01%
Investment securities:									
Taxable	208,918	4,328	2.07%	243,559	4,582	1.88%	245,410	4,197	1.71%
Non-taxable (2)	143,394	4,815	3.36%	140,692	4,862	3.46%	115,215	4,315	3.75%
Total earning assets	1,189,106	46,148	3.88%	1,195,541	45,413	3.80%	1,120,081	44,126	3.94%
Non-earning assets	123,800			112,909			107,919		
Allowance for loan losses	(3,405 )			(3,318 )			(2,888 )		
Total assets	\$1,309,501			\$1,305,132			\$1,225,112		
Savings deposits	\$645,471	594	0.09%	\$654,891	652	0.10%	\$608,925	545	0.09%
IRA and time certificates	205,540	2,784	1.35%	217,228	2,788	1.28%	219,562	2,464	1.12%
Short-term borrowings	23,976	209	0.87%	17,952	38	0.21%	15,105	24	0.16%
Long-term debt	421	12	2.85%	826	26	3.15%	6,177	295	4.78%
Total interest-bearing liabilities	875,408	3,599	0.41%	890,897	3,504	0.39%	849,769	3,328	0.39%
Demand deposits	274,855			259,060			230,608		
Other liabilities	10,795			10,014			8,590		
Capital	148,443			145,161			136,145		
Total liabilities and capital	\$1,309,501			\$1,305,132			\$1,225,112		
Net interest rate spread (3)			3.47%			3.41%			3.55%
Net interest income and net interest margin on a tax equivalent basis (4)		42,549	3.58%		41,909	3.51%		40,798	3.64%
Ratio of interest-earning assets to interest-bearing liabilities	135.83	%		134.20	%		131.81	%	

(1) Includes non-accrual 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.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table presents the changes in 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 years indicated. 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.

	For the years ended December 31,					
	2017 vs. 2016			2016 vs. 2015		
	Increase (decrease)			Increase (decrease)		
	due to			due to		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income attributable to:						
Loans (1)	\$1,334	(363)	971	2,395	(2,080)	315
Federal funds sold	—	—	—	(1)	—	(1)
Interest-bearing demand deposits	(27)	56	29	—	29	29
Federal Reserve Bank stock	—	—	—	14	(2)	12
Federal Home Loan Bank stock	—	36	36	—	—	—
Investment securities:						
Taxable	(690)	436	(254)	(32)	417	385
Non-taxable (2)	92	(139)	(47)	900	(353)	547
Total interest income	709	26	735	3,276	(1,989)	1,287
Interest expense attributable to:						
Savings deposits	(9)	(49)	(58)	43	64	107
IRA and time certificates	(154)	150	(4)	(26)	350	324
Short-term borrowings	17	154	171	5	9	14
Long-term debt	(12)	(2)	(14)	(193)	(76)	(269)
Total interest expense	(158)	253	95	(171)	347	176
Net interest income	\$867	(227)	640	3,447	(2,336)	1,111

(1) Non-accrual loans, if any, are included in average loan balances.

Change in interest income from non-taxable investment securities is computed based on interest income

(2) determined on a taxable-equivalent yield basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34%.

2017 vs. 2016. Net interest income on a fully tax-equivalent basis for 2017 totaled \$42,549,000, an increase of \$640,000 from 2016. The increase resulted from an increase in total taxable-equivalent interest income of \$735,000, slightly offset by an increase in total interest expense of \$95,000.

The increase in total interest income was due primarily to a \$971,000 increase in loan interest income caused by a \$29.9 million increase in average loans, partially offset by a 4 basis point (a basis point equals 0.01%) decrease in the average rate earned on loans. Partially offsetting the increase in loan interest income was a \$254,000 decrease in interest income from taxable investment securities and a \$47,000 decrease in taxable-equivalent interest income from non-taxable investment securities. Interest income from taxable investment securities decreased due to a \$34.6 million decrease in average taxable investment securities, partially offset by a 19 basis point increase in the average rate earned on these securities. Interest income from non-taxable investment securities decreased due to a 10 basis point

decrease in the average rate earned on these securities, partially offset by a \$2.7 million increase in non-taxable investment securities.

-30-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The increase in total interest expense was primarily due to a \$171,000 increase in interest paid on short-term borrowings, partially offset by decreases in interest paid on savings deposits, IRA and time certificates, and long-term debt. Short-term borrowings increased due to a 66 basis point increase in the average rate paid and, secondarily, due to a \$6.0 million increase in the average balance of borrowings outstanding. Interest paid on savings deposits decreased due to a 1 basis point decrease in the average rate paid and due to a \$9.4 million decrease in average deposits outstanding. IRA and time certificates decreased due to an \$11.7 million decrease in average certificates outstanding, largely offset by a 7 basis point increase in the average rate paid. Long-term debt decreased primarily due to a \$405,000 decrease in average debt outstanding and to a 30 basis point decrease in the average rate paid.

2016 vs. 2015. Net interest income on a fully tax-equivalent basis for 2016 totaled \$41,909,000, an increase of \$1,111,000 from 2015. The increase resulted from an increase in total taxable-equivalent interest income of \$1,287,000, slightly offset by an increase in total interest expense of \$176,000.

The increase in taxable-equivalent interest income was due to a \$75.5 million increase in total average interest-earning assets, slightly offset by a 14 basis point decrease in the average rate earned on interest-earning assets. The increase in total average interest-earning assets reflects an increase of \$51.9 million in average loans and a \$25.5 million increase in non-taxable investment securities. The decrease in the average rate earned was primarily due to general decreases in market rates.

Interest expense increased primarily due to a 16 basis point increase in the average rate paid on IRA and time certificates and a 1 basis point increase in the average rate paid on savings deposits, partially offset by a 163 basis point decrease in the rate paid on long-term debt. The rate variance was partially offset by a \$5.4 million decrease in average long-term debt. The decrease in the average rate paid on long-term debt and the decrease in the average balance of long-term debt was due to the pre-payment in full during the first quarter of 2016 of a \$5.0 million borrowing from the Federal Home Loan Bank of Cincinnati bearing an interest rate of 5.25%. The borrowing was pre-paid to reduce future interest expense.

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

## Provisions and Allowance for Loan Losses

The following table presents the total loan loss provision and the other changes in the allowance for loan losses for the years 2013 through 2017:

	2017	2016	2015	2014	2013
	(Dollars in thousands)				
Balance – Beginning of year	\$3,575	3,129	3,121	3,588	3,437
Loans charged off:					
Commercial and industrial	—	234	100	261	119
Commercial, secured by real estate	462	185	1,133	573	58
Residential real estate	225	127	304	652	244
Consumer	90	85	52	129	181
Agricultural	—	—	67	—	—
Other loans, including deposit overdrafts	138	119	74	79	67
Total loans charged off	915	750	1,730	1,694	669
Recoveries:					
Commercial and industrial	99	26	7	42	4
Commercial, secured by real estate	113	98	96	63	26
Residential real estate	140	52	107	40	31
Consumer	114	53	60	108	127
Agricultural	—	—	67	—	—
Other loans, including deposit overdrafts	62	54	35	44	44
Total recoveries	528	283	372	297	232
Net charge offs	387	467	1,358	1,397	437
Provision charged to operations	215	913	1,366	930	588
Balance - End of year	\$3,403	3,575	3,129	3,121	3,588
Ratio of net charge-offs during the period to average loans outstanding	0.05	% 0.06	% 0.18	% 0.21	% 0.08
Ratio of allowance for loan losses to total loans at year-end	0.40	% 0.44	% 0.41	% 0.45	% 0.62

Charge-offs for the commercial, secured by real estate category had an elevated balance during 2015 due to the sale of impaired loans.

Charge-offs and recoveries classified as “Other” include charge-offs and recoveries on checking and NOW account overdrafts. LCNB charges off such overdrafts when considered uncollectible, but no later than 60 days from the date first overdrawn.

LCNB continuously reviews the loan portfolio for credit risk through the use of its lending and loan review functions. Independent loan reviews analyze specific loans, providing validation that credit risks are appropriately identified and reported to the Loan Committee and Board of Directors. In addition, the Board of Directors’ Audit Committee receives loan review reports throughout each year. New credits meeting specific criteria are analyzed

prior to origination and are reviewed by the Loan Committee and Board of Directors.

-32-

---

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Inputs from all of the Bank's credit risk identification processes are used by management to analyze and validate the adequacy and methodology of the allowance quarterly. The analysis includes two basic components: specific allocations for individual loans and general loss allocations for pools of loans based on average historic loss ratios for the sixty preceding months adjusted for identified economic and other risk factors. Due to the number, size, and complexity of loans within the loan portfolio, there is always a possibility of inherent undetected losses.

## Non-Interest Income

A comparison of non-interest income for 2017, 2016, and 2015 is as follows:

				Increase (Decrease)	
	2017	2016	2015	2017	2016
				vs.	vs.
				2016	2015
	(In thousands)				
Fiduciary income	\$3,473	3,286	3,262	187	24
Service charges and fees on deposit accounts	5,236	5,008	4,920	228	88
Net gains on sales of securities	233	1,082	495	(849)	587
Bank owned life insurance income	867	746	625	121	121
Net gains from sales of loans	166	244	343	(78 )	(99 )
Other operating income	483	487	478	(4 )	9
Total non-interest income	10,458	10,853	10,123	(395)	730

Reasons for material increases and decreases include:

Fiduciary income increased during 2017 due to an increase in assets managed and to fee adjustments.

Service charges and fees on deposit accounts increased during 2017 due to fee adjustments on certain services and greater customer utilization of various services.

Comparing 2017 to 2016, net gains on sales of securities were less during 2017 primarily due to a lower volume of sales. Comparing 2016 to 2015, net gains were greater in 2016 primarily due to market rates at the times of the sales.

Comparing 2017 to 2016, bank owned life insurance income was greater for 2017 primarily due to mortality benefits received during the second quarter. Comparing 2016 to 2015, income was greater for 2016 primarily due to \$4 million of new policies purchased during the first quarter 2016.

Comparing 2017 to 2016, net gains from sales of loans was less for 2017 primarily due to a lower volume of loans sold. Comparing 2016 to 2015, net gains were less, even though a higher volume of loans were sold during 2016, due to market pricing at the times of the sales.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

## Non-Interest Expense

A comparison of non-interest expense for 2017, 2016, and 2015 is as follows:

				Increase (Decrease)	
	2017	2016	2015	2017	2016
				vs.	vs.
				2016	2015
	(In thousands)				
Salaries and employee benefits	\$18,585	18,215	17,593	370	622
Equipment expenses	1,172	1,048	1,257	124	(209)
Occupancy expense, net	2,613	2,271	2,307	342	(36)
State financial institutions tax	1,137	1,114	1,001	23	113
Marketing	873	696	720	177	(24)
Amortization of intangibles	751	753	700	(2)	53
FDIC premiums	423	547	598	(124)	(51)
ATM expense	572	721	698	(149)	23
Computer maintenance and supplies	882	790	782	92	8
Telephone expense	735	746	707	(11)	39
Contracted services	1,255	1,033	842	222	191
Other real estate owned	10	624	489	(614)	135
Merger-related expenses	118	—	643	118	(643)
Other non-interest expense	4,737	4,703	4,055	34	648
Total non-interest expense	33,863	33,261	32,392	602	869

Reasons for material increases and decreases include:

Salaries and employee benefits were 2.0% greater in 2017 than in 2016 and 2016 was 3.5% greater than in 2015. The increase for 2017 was primarily due to salary and wage increases, an increase in the number of employees, and an increase in health insurance costs, partially offset by a net decrease in pension expenses. The increase for 2016 was primarily due to salary and wage increases and employees retained from the acquisition of BNB Bancorp, Inc. on April 30, 2015, partially offset by a net decrease in pension expenses. The number of full-time equivalent employees was 310 at December 31, 2017, 282 at December 31, 2016, and 280 at December 31, 2015.

Comparing 2017 to 2016, equipment expenses increased primarily due to increased depreciation expense on furniture and equipment purchased for the new Operations Center. Comparing 2016 to 2015, equipment expenses decreased primarily due to a decrease in depreciation expense.

Occupancy expense for 2017 increased primarily due to increased depreciation on bank premises and, secondarily, to increased maintenance-related expenses, both primarily due to the new Operations Center.

Marketing expense increased in 2017 primarily due to expanded use of television and digital methods of advertising.

FDIC premiums decreased in 2017 primarily due to a change in the calculation method used to determine periodic premiums.

ATM expense for 2017 decreased primarily due to a change in the ATM network that processes PIN-based transactions.

Contracted services for 2017 increased largely due to fees paid to professional placement services firms, enhanced utilization of loan review specialists, fees related to an after-hours call answering service, and costs related to moving departments from the Main Office to the Operations Center. The increase in 2016 reflects increased use of outside



professionals in general.

Other real estate owned expense decreased during 2017 because other real estate owned property held during the year was minimal.

Merger-related expenses for 2015 related to the acquisition of BNB Bancorp. Inc. Merger-related expenses for 2017 relate to the pending acquisition of Columbus First Bancorp, Inc.

Other non-interest expense for 2017 included \$154,000 in organizational costs for LCNB Risk Management, Inc. and \$113,000 in losses from sales of fixed assets, primarily due to the sale of a closed office building. Other non-interest expense for 2016 included a \$251,000 penalty incurred during the first quarter 2016 to pre-pay a Federal Home Loan Bank borrowing. The borrowing bore an interest rate of 5.25% and was paid off to reduce future interest expense.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Income Taxes

LCNB's effective tax rates for the years ended December 31, 2017, 2016, and 2015 were 24.8%, 26.3%, and 26.9%, respectively. The difference between the statutory rate of 34.0% and the effective tax rate is primarily due to tax-exempt interest income, tax-exempt earnings from bank owned life insurance, and tax credits and losses related to investments in affordable housing tax credit limited partnerships.

As a result of the Tax Cuts and Jobs Act that was signed into law on December 22, 2017, LCNB revalued its net deferred tax liability position to reflect the reduction in its federal corporate income tax rate from 34% to 21%. This revaluation resulted in a one-time income tax benefit of approximately \$224,000, or \$0.02 of basic and diluted earnings per common share for the year ended December 31, 2017.

Assets

Total cash and cash equivalents were \$6.5 million greater at December 31, 2017 than at December 31, 2016 primarily due to shrinkage in the investment securities portfolios and an increase in short-term borrowings, partially offset by growth in the loan portfolio and shrinkage in total deposits.

Available-for-sale and held-to-maturity investment securities at December 31, 2017 were respectively \$42.2 million less and \$8.4 million less than at December 31, 2016. Management used the decrease in investment funds to fund loan growth, to fund deposit shrinkage, and to maintain liquidity.

Net loans at year-end 2017 were \$29.4 million greater than at year-end 2016, primarily due to a \$50.7 million increase in the commercial, secured by real estate loans. This increase was partially offset by a \$5.8 million decrease in commercial and industrial loans, a \$14.2 million decrease in residential real estate loans, and a \$1.7 million decrease in consumer loans. The increase in the loan portfolio does not reflect \$7.5 million of residential fixed-rate real estate loans that were originated and sold to the Federal Home Loan Mortgage Corporation during 2017.

Net premises and equipment at December 31, 2017 was \$4.7 million greater than at December 31, 2016 primarily due to construction costs for the new Operations Center in Lebanon, Ohio.

Liabilities

Total deposits at December 31, 2017 were \$25.1 million less than at December 31, 2016. Part of the decrease can be attributed to growth in two off-balance sheet investment alternatives offered by LCNB. Assets managed by LCNB Investment Services, a brokerage partnership with LPL Financial LLC, grew from \$188.7 million at December 31, 2016 to \$229.0 at December 31, 2017. In addition, LCNB introduced a new product during 2017 that sweeps funds from larger balance LCNB deposits into multiple smaller balance, FDIC-insured deposits at other banks.

Short-term borrowings at December 31, 2017 were \$5.0 million greater than at December 31, 2016. The additional borrowings were used for liquidity purposes.

Liquidity

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. These commitments may include paying dividends to shareholders, funding new loans for borrowers, funding withdrawals by depositors, paying general and administrative expenses, and funding capital expenditures. Sources of liquidity include growth in deposits, principal payments received on loans, proceeds from the sale of loans, the sale or maturation of investment securities, cash generated by operating activities, and the ability to borrow funds. Management closely monitors the level of liquid assets available to meet ongoing funding requirements. 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 during the past year as a result of current liquidity levels.

The liquidity of LCNB is enhanced by the fact that 85.1% of total deposits at December 31, 2017 were "core" deposits. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than \$100,000.

-35-

---

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Liquid assets include cash and cash equivalents, federal funds sold and securities available-for-sale. Except for investments in the stock of the Federal Reserve Bank and the Federal Home Loan Bank of Cincinnati ("FHLB") and certain local municipal securities, all of LCNB's investment portfolio is classified as "available-for-sale" and can be readily sold to meet liquidity needs, subject to certain pledging commitments for public funds, repurchase agreements, and other requirements. At December 31, 2017, LCNB's liquid assets amounted to \$303.9 million or 23.5% of total assets, compared to \$339.5 million or 26.0% of total assets at December 31, 2016. The ratio for 2017 is less than 2016 because of a decrease in securities available-for-sale.

An additional source of funding is borrowings from the FHLB. Long-term advances totaling \$303,000 and short-term advances totaling \$47.0 million were outstanding at December 31, 2017. Total remaining available borrowing capacity with the FHLB, including short-term advances, at December 31, 2017 was approximately \$56.3 million. One of the factors limiting availability of FHLB borrowings is a bank's ownership of FHLB stock. LCNB could increase its available borrowing capacity by purchasing more FHLB stock.

Besides short-term FHLB advances, short-term borrowings may include federal funds purchased and advances from lines of credit with two other financial institutions. At December 31, 2017, LCNB could borrow up to \$30 million through the lines of credit and up to \$10 million under a federal funds arrangements with another financial institution.

Commitments to extend credit at December 31, 2017 totaled \$150.7 million, including standby letters of credit totaling \$294,000, and are more fully described in Note 14 - Commitments and Contingent Liabilities to LCNB's consolidated financial statements. Since many commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The following table provides information concerning LCNB's contractual obligations at December 31, 2017:

	Total	Payments due by period			More than 5 years
		1 year or less	Over 1 through 3 years	Over 3 through 5 years	
	(In thousands)				
Short-term borrowings	\$47,000	47,000	—	—	—
Long-term debt obligations	303	248	55	—	—
Operating lease obligations	4,459	321	450	325	3,363
Estimated pension plan contribution for 2018	224	224	—	—	—
Funding commitments for affordable housing tax credit limited partnerships	2,257	784	856	213	404
Estimated capital expenditure obligations	40	40	—	—	—
Certificates of deposit:					
\$100,000 and over	66,607	21,667	29,243	15,264	433
Other time certificates	125,292	42,787	54,939	25,773	1,793
Total	\$246,182	113,071	85,543	41,575	5,993

The following table provides information concerning LCNB's commitments at December 31, 2017:

Amount of Commitment  
Expiration Per Period

Edgar Filing: LCNB CORP - Form 10-K

	Total	1 year	Over 1	Over 3	More
	Amounts	or less	through	through	than
	Committed	3	5	5	5
		years	years	years	years
	(In thousands)				
Commitments to extend credit	\$22,861	22,861	—	—	—
Unused lines of credit	127,572	52,094	39,044	17,659	18,775
Standby letters of credit	294	294	—	—	—
Total	\$150,727	75,249	39,044	17,659	18,775

-36-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Capital Resources

LCNB and the Bank are required by banking regulators to meet certain minimum levels of capital adequacy. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on LCNB's and the Bank's financial statements. These minimum levels 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). Common Equity Tier 1 Capital is the sum of common stock, related surplus, and retained earnings, net of treasury stock, accumulated other comprehensive income, and other adjustments. The first three ratios, which are based on the degree of credit risk in the Bank'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. Information summarizing the regulatory capital of LCNB and the Bank at December 31, 2017 and 2016 and corresponding regulatory minimum requirements is included in Note 15 - Regulatory Matters of the consolidated financial statements.

The FDIC, the insurer of deposits in financial institutions, has adopted a risk-based insurance premium system based in part on an institution's capital adequacy. Under this system, a depository institution is required to pay successively higher premiums depending on its capital levels and its supervisory rating by its primary regulator. It is management's intention to maintain sufficient capital to permit the Bank to maintain a "well capitalized" designation (the FDIC's highest rating).

On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two of which continue to be in effect – the "Market Repurchase Program" and the "Private Sale Repurchase Program." Any shares purchased will be held for future corporate purposes.

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock, as restated for a 100% stock dividend issued in May, 2007, 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 400,000 total shares, as restated for a stock dividend. Through December 31, 2017, 290,444 shares, as restated for the stock dividend, had been purchased under this program. No shares were purchased under this program during 2017.

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. A total of 466,018 shares, as restated for the stock dividend, had been purchased under this program at December 31, 2017. No shares were purchased under this program during 2017.

LCNB established an Ownership Incentive Plan during 2002 that allowed for stock-based awards to eligible employees. Under the plan, awards could be in the form of stock options, share awards, and/or appreciation rights. The plan provided for the issuance of up to 200,000 shares, as restated for a stock dividend. The plan expired on April 16, 2012. Any outstanding unexercised options, however, continue to be exercisable in accordance with their terms.

The 2015 Ownership Incentive Plan (the "2015 Plan") was approved by LCNB's shareholders at the annual meeting on April 28, 2015 and allows for stock-based awards to eligible employees, as determined by the Compensation Committee of the Board of Directors. Awards may be made in the form of stock options, appreciation rights, restricted

shares, and/or restricted share units. The 2015 Plan provides for the issuance of up to 450,000 shares. The 2015 Plan will terminate on April 28, 2025 and is subject to earlier termination by the Compensation Committee.

#### Critical Accounting Policies

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

-37-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

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

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

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

**Accounting for Intangibles.** LCNB's intangible assets at December 31, 2017 are composed primarily of goodwill and core deposit intangibles related to acquisitions of other financial institutions. It also includes mortgage servicing rights recorded from sales of fixed-rate mortgage loans to the Federal Home Loan Mortgage Corporation and mortgage servicing rights acquired through the acquisition of Eaton National Bank & Trust Co. Goodwill is not subject to amortization, but is reviewed annually for impairment. Core deposit intangibles are being amortized on a straight line basis over their respective estimated weighted average lives. Mortgage servicing rights are capitalized by allocating the total cost of loans between mortgage servicing rights and the loans based on their estimated fair values. Capitalized mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income, subject to periodic review for impairment.

**Fair Value Accounting for Investment Securities.** Securities classified as available-for-sale are carried at estimated fair value. Unrealized gains and losses, net of taxes, are reported as accumulated other comprehensive income or loss in shareholders' equity. Fair value is estimated using market quotations for U.S. Treasury and equity investments. Fair value for the majority of the remaining available-for-sale securities is estimated using the discounted cash flow method for each security with discount rates based on rates observed in the market.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk for LCNB is primarily interest rate risk. LCNB attempts to mitigate this risk through asset/liability management strategies designed to decrease the vulnerability of its earnings to material and prolonged changes in interest rates. LCNB does not use derivatives such as interest rate swaps, caps or floors to hedge this risk. LCNB has not entered into any market risk instruments for trading purposes.

The Bank's Asset and Liability Management Committee ("ALCO") primarily uses a combination of Interest Rate Sensitivity Analysis (IRSA) and Economic Value of Equity (EVE) analysis for measuring and managing interest rate risk. 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. Management considers the results of any significant downward scenarios to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the December 31, 2017 IRSA indicates that an increase in interest rates at all shock levels will have a positive effect on net interest income. The changes in net interest income for all rate assumptions are within LCNB's acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	\$	%
		Change in Net Interest Income	Change in Net Interest Income
Up 300	\$ 46,728	2,196	4.93 %
Up 200	45,975	1,443	3.24 %
Up 100	45,239	707	1.59 %
Base	44,532	—	— %

IRSA shows the effect 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. As shown below, the December 31, 2017 EVE analysis indicates that an increase in interest rates would have a negative effect on the EVE for all shock levels. The changes in the EVE for all rate assumptions are within LCNB's acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	\$	%
		Change in EVE	Change in EVE
Up 300	\$ 151,988	(2,484 )	(1.61)%
Up 200	152,730	(1,742 )	(1.13)%
Up 100	152,384	(2,088 )	(1.35)%
Base	154,472	—	— %

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.

-39-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 8. Financial Statements and Supplementary Data

REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

LCNB Corp. ("LCNB") is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. Management of LCNB and its subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15f. LCNB's internal control over financial reporting is a process designed under the supervision of LCNB's Chief Executive Officer and the Chief Financial Officer. The purpose is to provide reasonable assurance to the Board of Directors regarding the reliability of financial reporting and the preparation of LCNB's consolidated financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Management maintains internal controls over financial reporting. The internal controls contain control processes and actions are taken to correct deficiencies as they are identified. The internal controls are evaluated on an ongoing basis by LCNB's management and Audit Committee. Even effective internal controls, no matter how well designed, have inherent limitations – including the possibility of circumvention or overriding of controls – and therefore can provide only reasonable assurance with respect to financial statement preparation. Also, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed LCNB's internal controls as of December 31, 2017, in relation to criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2017, LCNB's internal control over financial reporting met the criteria.

BKD LLP, an independent registered public accounting firm, has issued an attestation report on the effectiveness of LCNB's internal control over financial reporting as of December 31, 2017.

Submitted by:

LCNB Corp.

/s/ Steve P. Foster  
Steve P. Foster  
Chief Executive Officer & President  
March 9, 2018

/s/ Robert C. Haines II  
Robert C. Haines II  
Executive Vice President &  
Chief Financial Officer  
March 9, 2018

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

To the Shareholders, Board of Directors and Audit Committee  
LCNB Corp.  
Lebanon, Ohio

Opinion on the Internal Control Over Financial Reporting

We have audited LCNB Corp.'s (Company) internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework: (2013) issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements of the Company and our report dated March 9, 2018, expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Definitions and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BKD, LLP  
BKD, LLP

Cincinnati, Ohio  
March 9, 2018

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

To the Shareholders, Board of Directors and Audit Committee  
LCNB Corp.  
Lebanon, Ohio

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of LCNB Corp. (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, shareholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”). In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 9, 2018, expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits.

We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BKD, LLP  
BKD, LLP

We have served as the Company’s auditor since 2014.

Cincinnati, Ohio  
March 9, 2018



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## LCNB CORP. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

At December 31,

(Dollars in thousands)

	2017	2016
<b>ASSETS:</b>		
Cash and due from banks	\$21,159	18,378
Interest-bearing demand deposits	4,227	487
Total cash and cash equivalents	25,386	18,865
Investment securities:		
Available-for-sale, at fair value	278,472	320,659
Held-to-maturity, at cost	32,571	41,003
Federal Reserve Bank stock, at cost	2,732	2,732
Federal Home Loan Bank stock, at cost	3,638	3,638
Loans, net	845,657	816,228
Premises and equipment, net	34,927	30,244
Goodwill	30,183	30,183
Core deposit and other intangibles	3,799	4,582
Bank owned life insurance	27,985	27,307
Other assets	10,288	11,358
<b>TOTAL ASSETS</b>	<b>\$1,295,638</b>	<b>1,306,799</b>
<b>LIABILITIES:</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$283,212	271,332
Interest-bearing	802,609	839,573
Total deposits	1,085,821	1,110,905
Short-term borrowings	47,000	42,040
Long-term debt	303	598
Accrued interest and other liabilities	12,243	10,312
<b>TOTAL LIABILITIES</b>	<b>1,145,367</b>	<b>1,163,855</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>	<b>—</b>	<b>—</b>
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred shares - no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares - no par value; authorized 19,000,000 shares at December 31, 2017 and 2016; issued 10,776,686 and 10,751,652 shares at December 31, 2017 and 2016, respectively	76,977	76,490
Retained earnings	87,301	80,736
Treasury shares at cost, 753,627 shares at December 31, 2017 and 2016	(11,665)	(11,665)
Accumulated other comprehensive loss, net of taxes	(2,342)	(2,617)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>150,271</b>	<b>142,944</b>



TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,295,638	1,306,799
--	-------------	-----------

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

-44-

---

Table of ContentsLCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOMEFor the years ended December 31,  
(Dollars in thousands, except per share data)

	2017	2016	2015
<b>INTEREST INCOME:</b>			
Interest and fees on loans	\$ 36,571	35,600	35,285
<b>Interest on investment securities:</b>			
Taxable	4,328	4,582	4,197
Non-taxable	3,130	3,199	2,848
Other investments	434	369	329
<b>TOTAL INTEREST INCOME</b>	<b>44,463</b>	<b>43,750</b>	<b>42,659</b>
<b>INTEREST EXPENSE:</b>			
Interest on deposits	3,378	3,440	3,009
Interest on short-term borrowings	209	38	24
Interest on long-term debt	12	26	295
<b>TOTAL INTEREST EXPENSE</b>	<b>3,599</b>	<b>3,504</b>	<b>3,328</b>
<b>NET INTEREST INCOME</b>	<b>40,864</b>	<b>40,246</b>	<b>39,331</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>215</b>	<b>913</b>	<b>1,366</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>40,649</b>	<b>39,333</b>	<b>37,965</b>
<b>NON-INTEREST INCOME:</b>			
Fiduciary income	3,473	3,286	3,262
Service charges and fees on deposit accounts	5,236	5,008	4,920
Net gains on sales of securities	233	1,082	495
Bank owned life insurance income	867	746	625
Net gains from sales of loans	166	244	343
Other operating income	483	487	478
<b>TOTAL NON-INTEREST INCOME</b>	<b>10,458</b>	<b>10,853</b>	<b>10,123</b>
<b>NON-INTEREST EXPENSE:</b>			
Salaries and employee benefits	18,585	18,215	17,593
Equipment expenses	1,172	1,048	1,257
Occupancy expense, net	2,613	2,271	2,307
State financial institutions tax	1,137	1,114	1,001
Marketing	873	696	720
Amortization of intangibles	751	753	700
FDIC premiums	423	547	598
ATM expense	572	721	698
Computer maintenance and supplies	882	790	782
Telephone expense	735	746	707
Contracted services	1,255	1,033	842
Other real estate owned	10	624	489
Merger-related expenses	118	—	643
Other non-interest expense	4,737	4,703	4,055
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>33,863</b>	<b>33,261</b>	<b>32,392</b>

Edgar Filing: LCNB CORP - Form 10-K

INCOME BEFORE INCOME TAXES	17,244	16,925	15,696
PROVISION FOR INCOME TAXES	4,272	4,443	4,222
NET INCOME	\$ 12,972	12,482	11,474

Earnings per common share:

Basic	\$ 1.30	1.26	1.18
Diluted	1.29	1.25	1.17

Weighted average common shares outstanding:

Basic	10,005,575	9,948,057	9,704,965
Diluted	10,012,511	9,976,370	9,811,467

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

-45-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
For the years ended December 31,  
(Dollars in thousands)

	2017	2016	2015
Net income	\$12,972	12,482	11,474
Other comprehensive income (loss):			
Net unrealized gain (loss) on available-for-sale securities (net of tax expense (benefit) of \$285, \$(1,242), and \$(169) for 2017, 2016, and 2015, respectively)	585	(2,390)	(329)
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of tax expense of \$81, \$370, and \$168 for 2017, 2016 and 2015, respectively)	(152)	(712)	(327)
Change in nonqualified pension plan unrecognized net gain (loss) and unrecognized prior service cost (net of tax expense (benefit) of \$(53), \$128, and \$55 for 2017, 2016, and 2015, respectively)	(158)	249	107
Other comprehensive income (loss)	275	(2,853)	(549)
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$13,247</b>	<b>9,629</b>	<b>10,925</b>

SUPPLEMENTAL INFORMATION:  
COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS),  
NET OF TAX, AS OF YEAR-END:

Net unrealized gain (loss) on securities available-for-sale	\$(2,200)	(2,633)	469
Net unfunded liability for nonqualified pension plan	(142)	16	(233)
Balance at year-end	\$(2,342)	(2,617)	236

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

Table of ContentsLCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITYFor the years ended December 31,  
(Dollars in thousands, except share data)

	Common Shares Outstanding	Common Shares	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2014	9,311,318	\$67,181	69,394	(11,665 )	785	125,695
Net income			11,474			11,474
Other comprehensive loss, net of taxes					(549 )	(549 )
Dividend Reinvestment and Stock Purchase Plan	24,610	390				390
Acquisition of BNB Bancorp, Inc.	560,132	9,063				9,063
Exercise of stock options	13,449	152				152
Excess tax benefit on exercise and forfeiture of stock options		13				13
Compensation expense relating to stock options		19				19
Compensation expense relating to restricted stock	16,038	90				90
Common stock dividends, \$0.64 per share			(6,239 )			(6,239 )
Balance, December 31, 2015	9,925,547	76,908	74,629	(11,665 )	236	140,108
Net income			12,482			12,482
Other comprehensive loss, net of taxes					(2,853 )	(2,853 )
Dividend Reinvestment and Stock Purchase Plan	21,088	379				379
Repurchase of stock warrants		(1,545 )				(1,545 )
Exercise of stock options	51,390	592				592
Excess tax benefit on exercise and forfeiture of stock options and vesting of restricted common stock		61				61
Compensation expense relating to stock options		5				5
Compensation expense relating to restricted stock	—	90				90
Common stock dividends, \$0.64 per share			(6,375 )			(6,375 )
Balance, December 31, 2016	9,998,025	76,490	80,736	(11,665 )	(2,617 )	142,944
Net income			12,972			12,972
Other comprehensive income, net of taxes					275	275
Dividend Reinvestment and Stock Purchase Plan	17,609	360				360
Exercise of stock options	3,398	51				51
		1				1

Edgar Filing: LCNB CORP - Form 10-K

Compensation expense relating to stock options						
Compensation expense relating to restricted stock	4,027	75				75
Common stock dividends, \$0.64 per share				(6,407 )		(6,407 )
Balance, December 31, 2017	10,023,059	\$76,977	87,301	(11,665 )	(2,342 )	150,271

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

-47-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,  
(Dollars in thousands)

	2017	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$12,972	12,482	11,474
Adjustments to reconcile net income to net cash flows from operating activities-			
Depreciation, amortization and accretion	3,308	2,557	2,997
Provision for loan losses	215	913	1,366
Impact of Tax Cuts and Jobs Act on Accumulated Other Comprehensive Income	486	—	—
Deferred income tax provision (benefit)	1,254	928	(58 )
Increase in cash surrender value of bank owned life insurance	(760 )	(746 )	(625 )
Bank owned life insurance death benefits in excess of cash surrender value	(107 )	—	—
Realized gain on sales of securities available-for-sale	(233 )	(1,082 )	(495 )
Realized loss (gain) on sale of premises and equipment	113	33	(1 )
Realized loss from sale and write-downs of other real estate owned and repossessed assets	3	534	378
Origination of mortgage loans for sale	(7,513 )	(11,217 )	(7,725 )
Realized gains from sales of loans	(166 )	(244 )	(343 )
Proceeds from sales of loans	7,588	11,353	7,809
Penalty for prepayment of long-term debt	—	251	—
Compensation expense related to stock options	1	5	19
Compensation expense related to restricted stock	75	90	90
Changes in:			
Income receivable	(4 )	(216 )	(160 )
Other assets	(269 )	(791 )	(3,302 )
Other liabilities	1,172	634	1,815
<b>TOTAL ADJUSTMENTS</b>	<b>5,163</b>	<b>3,002</b>	<b>1,765</b>
<b>NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</b>	<b>18,135</b>	<b>15,484</b>	<b>13,239</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sales of investment securities available-for-sale	43,246	92,455	97,981
Proceeds from maturities and calls of investment securities:			
Available-for-sale	25,012	84,529	29,700
Held-to-maturity	14,057	6,640	3,515
Purchases of investment securities:			
Available-for-sale	(27,012 )	(124,934 )	(163,859 )
Held-to-maturity	(5,625 )	(25,010 )	(3,413 )
Purchase of Federal Reserve Bank stock	—	—	(256 )
Proceeds from sale of impaired loans	—	—	4,559
Net increase in loans	(29,692 )	(48,153 )	(42,530 )
Purchase of bank owned life insurance	—	(4,000 )	—
Proceeds from bank owned life insurance death benefits	189	—	—
Proceeds from sales of other real estate owned and repossessed assets	971	526	245
Additions to other real estate owned	—	(182 )	(20 )
Purchases of premises and equipment	(6,617 )	(9,450 )	(504 )

Edgar Filing: LCNB CORP - Form 10-K

Proceeds from sales of premises and equipment	272	63	22
Net cash acquired from acquisition	—	—	8,993
<b>NET CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>	<b>14,801</b>	<b>(27,516 )</b>	<b>(65,567 )</b>

**CASH FLOWS FROM FINANCING ACTIVITIES:**

Net increase (decrease) in deposits	(25,084 )	23,745	41,822
Net increase in short-term borrowings	4,960	4,653	20,742
Principal payments on long-term debt	(295 )	(5,349 )	(5,410 )
Penalty for prepayment of long-term debt	—	(251 )	—
Proceeds from issuance of common stock	41	52	66
Repurchase of stock warrants	—	(1,545 )	—
Proceeds from exercise of stock options	51	592	152
Excess tax benefit from exercise of stock options and vesting of restricted common stock	—	61	13
Cash dividends paid on common stock	(6,088 )	(6,048 )	(5,915 )
<b>NET CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>(26,415 )</b>	<b>15,910</b>	<b>51,470</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>6,521</b>	<b>3,878</b>	<b>(858 )</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>18,865</b>	<b>14,987</b>	<b>15,845</b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$25,386</b>	<b>18,865</b>	<b>14,987</b>

**SUPPLEMENTAL CASH FLOW INFORMATION:**

**CASH PAID DURING THE YEAR FOR:**

Interest	\$3,577	3,542	3,396
Income taxes	2,185	4,420	4,820

**SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING ACTIVITY:**

Transfer from loans to other real estate owned and repossessed assets	974	32	79
---	-----	----	----

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



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

LCNB Corp. (the "Company" or "LCNB"), an Ohio corporation formed in December 1998, is a financial holding company whose principal activity is the ownership of LCNB National Bank (the "Bank"). The Bank was founded in 1877 and provides full banking services, including trust and brokerage services, to customers primarily in Southwestern and South Central Ohio.

**BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of the Company and its subsidiaries. Significant intercompany accounts and transactions are eliminated in consolidation. The accounting and reporting policies of the Company conform with U.S. generally accepted accounting principles and with general practices in the banking industry.

Certain prior period data presented in the financial statements have been reclassified to conform with the current year presentation. These reclassifications had no effect on net income.

**USE OF ESTIMATES**

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.

**CASH AND CASH EQUIVALENTS**

For purposes of reporting cash flows, cash and cash equivalents include cash, balances due from banks, federal funds sold, and interest-bearing demand deposits with original maturities of twelve months or less. Deposits with other banks routinely have balances greater than FDIC insured limits. Management considers the risk of loss to be very low with respect to such deposits.

**INVESTMENT SECURITIES**

Certain municipal debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held-to-maturity are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, a separate component of shareholders' equity. Amortization of premiums and accretion of discounts are recognized as adjustments to interest income using the level-yield method. Realized gains or losses from the sale of securities are recorded on the trade date and are computed using the specific identification method.

Declines in the fair value of securities below their cost that are deemed to be other-than-temporarily impaired, and for which the Company does not intend to sell the securities and it is not more likely than not that the securities will be sold before the anticipated recovery of the impairment, are separated into losses related to credit factors and losses related to other factors. The losses related to credit factors are recognized in earnings and losses related to other factors are recognized in other comprehensive income. In estimating other than temporary impairment losses, management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Company's consolidated statements of income as of December 31, 2017, 2016, and 2015, do not reflect any such impairment.

Federal Home Loan Bank ("FHLB") stock is an equity interest in the Federal Home Loan Bank of Cincinnati. It can be sold only at its par value of \$100 per share and only to the FHLB or to another member institution. In addition, the equity ownership rights are more limited than would be the case for a public company because of the oversight role exercised by the Federal Housing Finance Agency in the process of budgeting and approving dividends. Federal Reserve Bank stock is similarly restricted in marketability and value. Both investments are carried at cost, which is their par value.

FHLB and Federal Reserve Bank stock are both subject to minimum ownership requirements by member banks. The required investments in common stock are based on predetermined formulas.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

LOANS

The Company's loan portfolio includes most types of commercial and industrial loans, commercial loans secured by real estate, residential real estate loans, consumer loans, agricultural loans and other types of loans. Most of the properties collateralizing the loan portfolio are located within the Company's market area.

Loans are stated at the principal amount outstanding, net of unearned income, deferred origination fees and costs, and the allowance for loan losses. Interest income is accrued on the unpaid principal balance. The delinquency status of a loan is based on contractual terms and not on how recently payments have been received. Generally, a loan is placed on non-accrual status when it is classified as impaired or there is an indication that the borrower's cash flow may not be sufficient to make payments as they come due, unless the loan is well secured and in the process of collection. Subsequent cash receipts on non-accrual loans are recorded as a reduction of principal and interest income is recorded once principal recovery is reasonably assured. The current year's accrued interest on loans placed on non-accrual status is charged against earnings. Previous years' accrued interest is charged against the allowance for loan losses. Non-accrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer a reasonable doubt as to the timely collection of interest or principal.

Loan origination fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of loan yields. These amounts are being amortized over the lives of the related loans.

In the ordinary course of business, the Company enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded. The credit risk associated with these commitments is evaluated in a manner similar to the allowance for loan losses.

Loans acquired from mergers are recorded at fair value with no carryover of the acquired entity's previously established allowance for loan losses. The excess of expected cash flows over the estimated fair value of acquired loans is recognized as interest income over the remaining contractual lives of the loans using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows result in the recognition of additional interest income over the then-remaining contractual lives of the loans. Management estimates the cash flows expected to be collected at acquisition using a third-party risk model, which incorporates the estimate of key assumptions, such as default rates, severity, and prepayment speeds.

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

**ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. Consumer loans are charged off when they reach 120 days past due. Subsequent recoveries, if any, are credited to the allowance.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The provision for loan losses is determined by management based upon its evaluation of the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated risk of losses inherent in the portfolio. Current methodology used by management to estimate the allowance takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, historic categorical trends, current delinquency levels as related to historical levels, portfolio growth rates, changes in composition of the portfolio, the current economic environment, as well as current allowance adequacy in relation to the portfolio. Management is cognizant that reliance on historical information coupled with the cyclical nature of the economy, including credit cycles, affects the allowance. Management considers all of these factors prior to making any adjustments to the allowance due to the subjectivity and imprecision involved in allocation methodology. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are specifically reviewed for impairment. For such loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers loans not specifically reviewed for impairment and homogeneous loan pools, such as residential real estate and consumer loans. The general component is measured for each loan category separately based on each category's average of historical loss experience over a trailing sixty month period, adjusted for qualitative factors. Such qualitative factors may include current economic conditions if different from the five-year historical loss period, trends in underperforming loans, trends in volume and terms of loan categories, concentrations of credit, and trends in loan quality.

A loan is considered impaired when management believes, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. An impaired loan is measured by the present value of expected future cash flows using the loan's effective interest rate. An impaired collateral-dependent loan may be measured based on collateral value. Smaller-balance homogeneous loans, including residential mortgage and consumer installment loans, that are not evaluated individually are collectively evaluated for impairment.

**PREMISES AND EQUIPMENT**

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on both the straight-line and accelerated methods over the estimated useful lives of the assets, generally 15 to 40 years for premises and 3 to 10 years for equipment. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Costs incurred for maintenance and repairs are expensed as incurred. Premises and equipment are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of a particular asset may not be recoverable.

**OTHER REAL ESTATE OWNED**

Other real estate owned includes properties acquired through foreclosure. Such property is held for sale and is initially recorded at fair value, less costs to sell, establishing a new cost basis. Fair value is primarily based on a property appraisal obtained at the time of transfer and any periodic updates that may be obtained thereafter. The allowance for loan losses is charged for any write down of the loan's carrying value to fair value at the date of transfer. Any subsequent reductions in fair value and expenses incurred from holding other real estate owned are

charged to other non-interest expense. Costs, excluding interest, relating to the improvement of other real estate owned are capitalized. Gains and losses from the sale of other real estate owned are included in other non-interest expense.

#### GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Goodwill is not amortized, but is instead subject to an annual review for impairment.

Mortgage servicing rights on originated mortgage loans that have been sold are initially recorded at their estimated fair values. Mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income. Such assets are periodically evaluated as to the recoverability of their carrying value.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The Company's other intangible assets relate to core deposits acquired from business combinations. These intangible assets are amortized on a straight-line basis over their estimated useful lives. Management evaluates whether events or circumstances have occurred that indicate the remaining useful life or carrying value of the amortizing intangible should be revised.

**BANK OWNED LIFE INSURANCE**

The Company has purchased life insurance policies on certain officers of the Company. The Company is the beneficiary of these policies and has recorded the estimated cash surrender value in other assets in the consolidated balance sheets. Income on the policies, based on the increase in cash surrender value and any incremental death benefits, is included in other non-interest income in the consolidated statements of income.

**AFFORDABLE HOUSING TAX CREDIT LIMITED PARTNERSHIP**

LCNB has elected to account for its investment in an affordable housing tax credit limited partnership using the proportional amortization method described in FASB ASU 2014-01, "Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (A Consensus of the FASB Emerging Issues Task Force)." Under the proportional amortization method, an investor amortizes the initial cost of the investment to income tax expense in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. The investment in the limited partnership is included in other assets and the unfunded amount is included in accrued interest and other liabilities in LCNB's consolidated balance sheets.

**FAIR VALUE MEASUREMENTS**

Accounting guidance establishes a fair value hierarchy to prioritize the inputs to valuation techniques used to measure fair value. A financial instrument's level within the hierarchy is based on the lowest level of input that is significant to the fair value measurement. The three broad input levels are:

- Level 1 – quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date;
- Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly; and
- Level 3 - inputs that are unobservable for the asset or liability.

Accounting guidance permits, but does not require, companies 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 for the selected instruments are recorded in earnings. The Company did not select any financial instruments for the fair value election in 2017 or 2016.

**ADVERTISING EXPENSE**

Advertising costs are expensed as incurred and are recorded as a marketing expense, a component of non-interest expense.

**PENSION PLANS**

Eligible employees of the Company hired before 2009 participate in a multiple-employer qualified noncontributory defined benefit retirement plan. This plan is accounted for as a multi-employer plan because assets contributed by an

employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer.

Citizens National had a qualified noncontributory, defined benefit pension plan, which has been assumed by the Company, that covers eligible employees hired before May 1, 2005. This is a single employer plan.

#### TREASURY STOCK

Common shares repurchased are recorded at cost. Cost of shares retired or reissued is determined using the weighted average method.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**STOCK OPTIONS AND RESTRICTED STOCK AWARD PLANS**

The cost of employee services received in exchange for stock option grants is the grant-date fair value of the award estimated using an option-pricing model. The compensation cost for restricted stock awards is based on the market price of the Company's common stock at the date of grant multiplied by the number of shares granted that are expected to vest. The estimated cost is recognized on a straight-line basis over the period the employee is required to provide services in exchange for the award, usually the vesting period. The Company uses a Black-Scholes pricing model and related assumptions for estimating the fair value of stock option grants and a five-year vesting period for stock options and restricted stock.

**INCOME TAXES**

Deferred income taxes are determined using the asset and liability method of accounting. Under this method, the net deferred tax asset or liability is determined based on the tax effects of temporary differences between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Management analyzes material tax positions taken in any income tax return for any tax jurisdiction and determines the likelihood of the positions being sustained in a tax examination. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

**EARNINGS PER SHARE**

Basic earnings per share allocated to common shareholders is calculated using the two-class method and is computed by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is adjusted for the dilutive effects of stock based compensation and warrants and is calculated using the two-class method or the treasury stock method. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock based compensation and warrants with the proceeds used to purchase treasury shares at the average market price for the period.

**RECENT ACCOUNTING PRONOUNCEMENTS**

From time to time the FASB issues an Accounting Standards Update ("ASU") to communicate changes to Generally Accepted Accounting Principles ("GAAP"). The following information provides brief summaries of newly issued but not yet effective ASUs that could have an effect on LCNB's financial position or results of operations:

ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"

ASU No. 2014-09 was issued in May 2014 and supersedes most current revenue recognition guidance for contracts to transfer goods or services or other nonfinancial assets. Lease contracts, insurance contracts, and most financial instruments are not included in the scope of this update. ASU No. 2014-09 provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance enumerates five steps that entities should follow in achieving this core principle. Additional disclosures providing information about contracts with customers are required.

Guidance in ASU No. 2014-09 has been clarified by the following ASUs:

• ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)"

• ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing"

• ASU No. 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients"

• ASU No. 2016-20, "Revenue from Contracts with Customers (Topic 606): Technical Corrections and Improvements"

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

As extended by ASU No. 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," ASU No. 2014-09 and the clarifying ASUs are effective for public companies for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Transitional guidance is included in the updates. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. LCNB's revenue is comprised of net interest income, which is explicitly excluded from the scope of ASU No. 2014-09, and non-interest income. LCNB management has finalized its assessment of the update's affect on non-interest income and has determined that the amendments in ASU No. 2014-09 will not result in a material change from current accounting. Changes to related disclosures are still being analyzed.

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

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

1. Requires most equity investments to be measured at fair value with changes in fair value recognized in net income. Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a
2. qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.
3. Eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.
4. Requires use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Requires an entity to present separately in other comprehensive income the portion of the total change in the fair
5. value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. Requires separate presentation of financial assets and financial liabilities by measurement category and form of
6. financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
7. Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

For public business entities, the new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. Adoption of ASU No. 2016-01 did not have a material impact on LCNB's results of operations or financial position.

ASU No. 2016-02, "Leases (Topic 842)"

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

A lessee shall classify a lease as a finance lease if it meets any of five listed criteria:

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

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

The amendments in this update are to be applied using a modified retrospective approach, as defined, and are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted. LCNB estimates that it will recognize discounted right of use assets and lease liabilities totaling approximately \$5 million for the leases disclosed in Note 8 - Leases. This projection is based on various assumptions, including the level of interest rates and no significant increases in leasing activity, that may change between now and the effective date.

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

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

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

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

ASU No. 2016-13 will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. While LCNB's Loan

Committee expects that the implementation of ASU No. 2016-13 will increase the balance of the allowance for loan losses, it is continuing to evaluate the potential impact on LCNB's results of operations and financial position. The Loan Committee is currently analyzing its data collection efforts, pool segmentation, and reporting mechanisms to prepare for adoption of this ASU. The financial statement impact of this new standard cannot be reasonably estimated at this time.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost"

ASU No. 2017-07 was issued in March 2017 and applies to all employers that offer to their employees defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715. The amendments in this update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost, as defined, are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in ASU No. 2017-07 are effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The amendments in this update are to be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement. Adoption of ASU No. 2017-07 did not have a material impact on LCNB's results of operations or financial position.

ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting"

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

ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities"

ASU No. 2017-12 was issued in August 2017 and applies to any entity that elects to apply hedge accounting in accordance with current generally accepted accounting principles. The amendments in this update better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components. The amendments are effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early application is permitted. LCNB does not currently own any instruments within the scope of ASU No. 2017-12 and its adoption is not expected to have a material impact on its results of operations or financial position.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ASU No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income"

ASU No. 2018-02 was issued in February 2018 and addresses a narrow-scope financial reporting issue that arose as a consequence of the passage of H.R. 1, originally known as the "Tax Cuts and Jobs Act." GAAP requires adjustment of deferred tax assets and liabilities for the effect of a change in tax laws or rates with the effect to be included in income from continuing operations in the reporting period that includes the enactment date. This guidance is applicable even in situations in which the related income tax effects of items in accumulated other comprehensive income were originally recognized in other comprehensive income rather than in income from continuing operations. As a consequence, the tax effects of items within accumulated other comprehensive income, referred to as stranded tax effects in the update, do not reflect the appropriate tax rate. The amendments in ASU No. 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings for the stranded tax effects resulting from the Tax Cuts and Jobs Act. Because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. ASU No. 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period. LCNB intends to early adopt ASU No. 2018-02 as of January 1, 2018 and reclassify its stranded tax effects totaling \$486,000 (credit) into retained earnings.

NOTE 2 – ACQUISITIONS (UNAUDITED)

On December 20, 2017, LCNB and Columbus First Bancorp, Inc. ("CFB") entered into an Agreement and Plan of Merger ("Merger Agreement") pursuant to which CFB will merge with and into LCNB in an all-stock transaction. Immediately following the merger of CFB into LCNB, Columbus First Bank, a wholly-owned subsidiary of CFB, will be merged into the Bank. Columbus First Bank operates from one full-service office located in Worthington, Ohio. Subject to customary regulatory approvals, LCNB and CFB shareholder approvals, and other conditions set forth in the definitive merger agreement, the transaction is anticipated to close in the second quarter of 2018. At that time, Columbus First Bank's office will become a branch of the Bank.

Under the terms of the Merger Agreement, which has been unanimously approved by the Board of Directors of each company, the shareholders of CFB will be entitled to receive two LCNB common shares for each outstanding CFB common share. Any unexercised stock options of CFB will be canceled in exchange for a cash payment. Based on LCNB's closing share price of \$18.50 as of February 28, 2018, the transaction is valued at \$37.00 for each CFB share or approximately \$58.8 million in aggregate. As of February 28, 2018, Columbus First has 1,589,516 shares outstanding, as well as 65,724 options with a weighted average strike price of \$14.06 per share.

The acquisition will be accounted for in accordance with applicable accounting guidance. Accordingly, the assets and liabilities

of CFB will be recorded at their estimated fair values at the acquisition date. The excess of the estimated fair value of LCNB common shares issued over the net fair values of the assets acquired, including identifiable intangible assets and liabilities assumed, will be recorded as goodwill. The results of operations will be included in the consolidated income statement from the date of the acquisition. Goodwill will be subject to an annual test for impairment and the amount impaired, if any, will be charged to expense at the time of impairment.

The estimated fair values of the assets and liabilities have not yet been determined. The recorded amounts reflected on the historic financial records of CFB as of December 31, 2017 include total assets of approximately \$330.4 million, consisting primarily of net loans of \$279.7 million and interest-bearing deposits of \$36.5 million. Recorded liabilities totaling approximately \$297.7 million consisted primarily of deposits totaling \$259.3 million.

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 3 - INVESTMENT SECURITIES

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
2017				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	\$ 2,283	—	24	2,259
U.S. Agency notes	84,837	57	1,633	83,261
U.S. Agency mortgage-backed securities	68,347	33	1,227	67,153
Municipal securities:				
Non-taxable	102,849	343	1,018	102,174
Taxable	20,313	175	122	20,366
Mutual funds	2,586	2	46	2,542
Trust preferred securities	49	1	—	50
Equity securities	574	97	4	667
	\$ 281,838	708	4,074	278,472
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$ 28,871	101	227	28,745
Taxable	3,700	—	95	3,605
	\$ 32,571	101	322	32,350
2016				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	\$ 28,180	41	76	28,145
U.S. Agency notes	87,098	150	1,848	85,400
U.S. Agency mortgage-backed securities	72,402	89	1,444	71,047
Municipal securities:				
Non-taxable	114,064	574	1,623	113,015
Taxable	19,710	220	85	19,845
Mutual funds	2,527	—	45	2,482
Trust preferred securities	49	—	1	48
Equity securities	632	55	10	677
	\$ 324,662	1,129	5,132	320,659
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$ 31,015	56	352	30,719
Taxable	9,988	—	217	9,771
	\$ 41,003	56	569	40,490



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 3 - INVESTMENT SECURITIES (Continued)

Information concerning securities with gross unrealized losses at December 31, 2017 and 2016, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	Less Than Twelve Months		Twelve Months or More	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2017				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	\$2,259	24	—	—
U.S. Agency notes	33,651	344	44,560	1,289
U.S. Agency mortgage-backed securities	24,433	142	41,080	1,085
Municipal securities:				
Non-taxable	36,348	315	24,197	703
Taxable	11,068	114	1,032	8
Mutual funds	—	—	1,519	46
Trust preferred securities	—	—	—	—
Equity securities	119	2	17	2
	\$107,878	941	112,405	3,133
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$9,824	133	3,542	94
Taxable	—	—	3,205	95
	\$9,824	133	6,747	189
2016				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	\$16,076	76	—	—
U.S. Agency notes	69,784	1,848	—	—
U.S. Agency mortgage-backed securities	64,564	1,310	3,518	134
Municipal securities:				
Non-taxable	72,867	1,621	451	2
Taxable	9,721	82	450	3
Mutual funds	1,205	37	277	8
Trust preferred securities	49	1	—	—
Equity securities	201	10	—	—
	\$234,467	4,985	4,696	147
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$20,429	251	2,564	101
Taxable	8,030	217	—	—
	\$28,459	468	2,564	101

Management has determined that the unrealized losses at December 31, 2017 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because the Company does not have the intent to sell the investments and it is more likely than not that the Company will not be required to sell the investments before recovery of their amortized cost, the Company does not consider these investments to be other-than-temporarily impaired.

-59-

---

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 3 - INVESTMENT SECURITIES (Continued)

Contractual maturities of investment securities at December 31, 2017 were as follows (in thousands). Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	\$ 11,222	11,267	4,043	4,047
Due from one to five years	92,900	92,453	4,128	4,045
Due from five to ten years	102,520	100,836	8,415	8,286
Due after ten years	3,640	3,504	15,985	15,972
	210,282	208,060	32,571	32,350
U.S. Agency mortgage-backed securities	68,347	67,153	—	—
Mutual funds	2,586	2,542	—	—
Trust preferred securities	49	50	—	—
Equity securities	574	667	—	—
	\$ 281,838	278,472	32,571	32,350

Investment securities with a market value of \$108,751,000 and \$149,990,000 at December 31, 2017 and 2016, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Certain information concerning the sale of investment securities available-for-sale for the years ended December 31 was as follows (in thousands):

	2017	2016	2015
Proceeds from sales	\$ 43,246	92,455	97,981
Gross realized gains	247	1,103	627
Gross realized losses	14	21	132

## NOTE 4 - LOANS

Major classifications of loans at December 31 were as follows (in thousands):

	2017	2016
Commercial and industrial	\$ 36,057	41,878
Commercial, secured by real estate	527,947	477,275
Residential real estate	251,582	265,788
Consumer	17,450	19,173
Agricultural	15,194	14,802
Other loans, including deposit overdrafts	539	633
	848,769	819,549
Deferred origination costs, net	291	254
	849,060	819,803
Less allowance for loan losses	3,403	3,575
Loans-net	\$ 845,657	816,228





Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

Non-accrual, past-due, and accruing restructured loans at December 31 were as follows (dollars in thousands):

	2017	2016
Non-accrual loans:		
Commercial and industrial	\$—	—
Commercial, secured by real estate	2,183	4,312
Agricultural	178	334
Residential real estate	604	1,079
Total non-accrual loans	2,965	5,725
Past-due 90 days or more and still accruing	—	23
Total non-accrual and past-due 90 days or more and still accruing	2,965	5,748
Accruing restructured loans	10,469	11,731
Total	\$13,434	17,479
Percentage of total non-accrual and past-due 90 days or more and still accruing to total loans	0.35	% 0.70 %
Percentage of total non-accrual, past-due 90 days or more and still accruing, and accruing restructured loans to total loans	1.58	% 2.13 %

Interest income that would have been recorded during 2017 and 2016 if loans on non-accrual status at December 31, 2017 and 2016 had been current and in accordance with their original terms was approximately \$202,000 and \$220,000, respectively.

The Company is not committed to lend additional funds to debtors whose loans have been modified to provide a reduction or deferral of principal or interest because of deterioration in the financial position of the borrower.

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

The allowance for loan losses and recorded investment in loans for the years ended December 31 were as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
December 31, 2017							
Allowance for loan losses:							
Balance, beginning of year	\$ 350	2,179	885	96	60	5	3,575
Provision charged to expenses	(71	) 348	(83	) (44	) (7	) 72	215
Losses charged off	—	(462	) (225	) (90	) —	(138)	(915
Recoveries	99	113	140	114	—	62	528
Balance, end of year	\$ 378	2,178	717	76	53	1	3,403
Individually evaluated for impairment	\$ 8	146	29	8	—	—	191
Collectively evaluated for impairment	370	2,032	688	68	53	1	3,212
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of year	\$ 378	2,178	717	76	53	1	3,403
Loans:							
Individually evaluated for impairment	\$ 303	11,289	1,351	47	177	—	13,167
Collectively evaluated for impairment	34,792	512,259	248,674	17,516	15,033	137	828,411
Acquired credit impaired loans	1,008	4,048	2,024	—	—	402	7,482
Balance, end of year	\$ 36,103	527,596	252,049	17,563	15,210	539	849,060
December 31, 2016							
Allowance for loan losses:							
Balance, beginning of year	\$ 244	1,908	854	54	66	3	3,129
Provision charged to expenses	314	358	106	74	(6	) 67	913
Losses charged off	(234	) (185	) (127	) (85	) —	(119)	(750
Recoveries	26	98	52	53	—	54	283
Balance, end of year	\$ 350	2,179	885	96	60	5	3,575
Individually evaluated for impairment	\$ 9	55	100	13	—	—	177
Collectively evaluated for impairment	341	1,832	785	83	60	5	3,106
Acquired credit impaired loans	—	292	—	—	—	—	292
Balance, end of year	\$ 350	2,179	885	96	60	5	3,575
Loans:							
Individually evaluated for impairment	\$ 337	12,580	1,518	52	334	—	14,821
Collectively evaluated for impairment	41,466	458,059	262,266	19,192	14,475	178	795,636
Acquired credit impaired loans	98	6,305	2,471	17	—	455	9,346
Balance, end of year	\$ 41,901	476,944	266,255	19,261	14,809	633	819,803



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
December 31, 2015							
Allowance for loan losses:							
Balance, beginning of year	\$ 129	1,990	926	63	11	2	3,121
Provision charged to expenses	208	955	125	(17 )	55	40	1,366
Losses charged off	(100 )	(1,133 )	(304 )	(52 )	(67 )	(74 )	(1,730)
Recoveries	7	96	107	60	67	35	372
Balance, end of year	\$ 244	1,908	854	54	66	3	3,129
Individually evaluated for impairment	\$ 9	306	48	—	—	—	363
Collectively evaluated for impairment	235	1,602	806	54	66	3	2,766
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of year	\$ 244	1,908	854	54	66	3	3,129

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

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

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

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

borrower occupancy.

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

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

-63-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 4 - LOANS (Continued)

Residential real estate loans are underwritten primarily based on the borrower's ability to repay, prior credit history, and the value of the collateral. LCNB requires private mortgage insurance for first mortgage loans that have a loan to appraised value ratio of greater than 80%.

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

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

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

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

Pass – loans categorized in this category are higher quality loans that do not fit any of the other categories described below.

Other Assets Especially Mentioned (OAEM) - loans in this category are currently protected but are potentially weak.

These loans constitute a risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an undue risk in light of the circumstances surrounding a specific asset.

Substandard – loans in this category are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – loans classified in this category have all the weaknesses inherent in loans classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

An analysis of the Company's loan portfolio by credit quality indicators at December 31 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
December 31, 2017					
Commercial & industrial	\$35,683	176	244	—	36,103
Commercial, secured by real estate	506,833	2,180	18,583	—	527,596
Residential real estate	250,039	—	2,010	—	252,049
Consumer	17,522	—	41	—	17,563
Agricultural	14,233	—	977	—	15,210
Other	539	—	—	—	539
Total	\$824,849	2,356	21,855	—	849,060
December 31, 2016					
Commercial & industrial	\$41,178	304	419	—	41,901
Commercial, secured by real estate	443,781	5,479	27,684	—	476,944
Residential real estate	261,839	442	3,974	—	266,255
Consumer	19,182	—	79	—	19,261
Agricultural	13,311	—	1,498	—	14,809
Other	633	—	—	—	633
Total	\$779,924	6,225	33,654	—	819,803

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis. No significant changes were made to either during the past year.

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

A loan portfolio aging analysis at December 31 is as follows (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans Greater Than 90 Days and Accruing
December 31, 2017							
Commercial & industrial	\$—	—	—	—	36,103	36,103	—
Commercial, secured by real estate	124	—	598	722	526,874	527,596	—
Residential real estate	362	135	496	993	251,056	252,049	—
Consumer	29	2	—	31	17,532	17,563	—
Agricultural	—	—	177	177	15,033	15,210	—
Other	82	—	—	82	457	539	—
Total	\$597	137	1,271	2,005	847,055	849,060	—
December 31, 2016							
Commercial & industrial	\$19	—	—	19	41,882	41,901	—
Commercial, secured by real estate	99	69	127	295	476,649	476,944	—
Residential real estate	686	80	727	1,493	264,762	266,255	20
Consumer	59	16	3	78	19,183	19,261	3
Agricultural	125	—	—	125	14,684	14,809	—
Other	115	—	—	115	518	633	—
Total	\$1,103	165	857	2,125	817,678	819,803	23



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

Impaired loans for the years ended December 31 were as follows (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2017					
With no related allowance recorded:					
Commercial & industrial	\$ 1,015	1,100	—	685	88
Commercial, secured by real estate	12,677	13,608	—	14,113	1,068
Residential real estate	2,822	3,516	—	3,216	546
Consumer	6	6	—	20	2
Agricultural	177	177	—	269	12
Other	402	554	—	441	55
Total	\$ 17,099	18,961	—	18,744	1,771
With an allowance recorded:					
Commercial & industrial	\$ 296	301	8	311	18
Commercial, secured by real estate	2,660	2,660	146	2,739	45
Residential real estate	553	572	29	596	19
Consumer	41	41	8	43	3
Agricultural	—	—	—	—	—
Other	—	—	—	—	—
Total	\$ 3,550	3,574	191	3,689	85
Total:					
Commercial & industrial	\$ 1,311	1,401	8	996	106
Commercial, secured by real estate	15,337	16,268	146	16,852	1,113
Residential real estate	3,375	4,088	29	3,812	565
Consumer	47	47	8	63	5
Agricultural	177	177	—	269	12
Other	402	554	—	441	55
Total	\$ 20,649	22,535	191	22,433	1,856

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2016					
With no related allowance recorded:					
Commercial & industrial	\$ 109	263	—	998	151
Commercial, secured by real estate	14,195	15,522	—	15,274	1,140
Residential real estate	3,238	4,286	—	3,736	369
Consumer	26	27	—	37	29
Agricultural	334	334	—	392	136
Other	455	629	—	481	77
Total	\$ 18,357	21,061	—	20,918	1,902
With an allowance recorded:					
Commercial & industrial	\$ 326	326	9	341	19
Commercial, secured by real estate	4,690	4,946	347	4,194	257
Residential real estate	751	751	100	651	36
Consumer	43	43	13	43	3
Agricultural	—	—	—	—	—
Other	—	—	—	—	—
Total	\$ 5,810	6,066	469	5,229	315
Total:					
Commercial & industrial	\$ 435	589	9	1,339	170
Commercial, secured by real estate	18,885	20,468	347	19,468	1,397
Residential real estate	3,989	5,037	100	4,387	405
Consumer	69	70	13	80	32
Agricultural	334	334	—	392	136
Other	455	629	—	481	77
Total	\$ 24,167	27,127	469	26,147	2,217

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

	Average Recorded Investment	Interest Income Recognized
December 31, 2015		
With no related allowance recorded:		
Commercial & industrial	\$ 1,467	206
Commercial, secured by real estate	18,575	2,229
Residential real estate	4,092	453
Consumer	106	25
Agricultural	81	487
Other	510	82
Total	\$ 24,831	3,482
With an allowance recorded:		
Commercial & industrial	\$ 370	21
Commercial, secured by real estate	4,007	114
Residential real estate	864	37
Consumer	—	—
Agricultural	—	—
Other	—	—
Total	\$ 5,241	172
Total:		
Commercial & industrial	\$ 1,837	227
Commercial, secured by real estate	22,582	2,343
Residential real estate	4,956	490
Consumer	106	25
Agricultural	81	487
Other	510	82
Total	\$ 30,072	3,654

Of the interest income recognized on impaired loans during 2017, 2016, and 2015, approximately \$28,000, \$51,000, and \$96,000, respectively, were recognized on a cash basis. The Company continued to accrue interest on certain loans classified as impaired during 2017, 2016, and 2015 because they were restructured or considered well secured and in the process of collection.



Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

Loan modifications that were classified as troubled debt restructurings during the years ended December 31 were as follows (dollars in thousands):

	2017		2016		2015	
	Number of Loans	Post-Modification Recorded Balance	Number of Loans	Post-Modification Recorded Balance	Number of Loans	Post-Modification Recorded Balance
Commercial and industrial	—	\$ —	—	\$ —	—	\$ —
Commercial, secured by real estate	—	—	4	2,142	1	75
Residential real estate	1	18	6	139	7	217
Consumer	1	14	3	39	2	9
	2	\$ 32	13	\$ 2,320	10	\$ 301

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

	Term Modification	Rate Modification	Interest Only	Principal Forgiveness	Combination	Total Modifications
December 31, 2017						
Commercial & industrial	\$ —	—	—	—	—	—
Commercial, secured by real estate	—	—	—	—	—	—
Residential real estate	—	—	—	9	—	9
Consumer	14	—	—	—	—	14
Total	\$ 14	—	—	9	—	23
December 31, 2016						
Commercial & industrial	\$ —	—	—	—	—	—
Commercial, secured by real estate	1,539	—	304	—	372	2,215
Residential real estate	38	47	—	—	54	139
Consumer	—	28	—	—	11	39
Total	\$ 1,577	75	304	—	437	2,393
December 31, 2015						
Commercial & industrial	\$ —	—	—	—	—	—
Commercial, secured by real estate	74	—	—	—	—	74
Residential real estate	221	—	—	—	—	221
Consumer	9	—	—	—	—	9
Total	\$ 304	—	—	—	—	304

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

-70-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 4 - LOANS (Continued)

There were no troubled debt restructurings that subsequently defaulted within twelve months of the restructuring date for the years ended December 31, 2016, and 2015. Two commercial, secured by real estate loans to the same borrower totaling \$1,236,000 that were modified during the fourth quarter 2016 subsequently defaulted in February 2017.

All troubled debt restructurings are considered impaired loans. The allowance for loan loss on such restructured loans is based on the present value of future expected cash flows.

Approximately \$21,000 of impaired loans without a valuation allowance at December 31, 2017 consisted of loans that were modified during 2017 and were determined to be troubled debt restructurings. None of the impaired loans restructured during 2017 had a valuation allowance at December 31, 2017. Approximately \$881,000 of impaired loans without a valuation allowance and \$1,168,000 of impaired loans with a valuation allowance at December 31, 2016 consisted of loans that were modified during 2016 and were determined to be troubled debt restructurings.

Mortgage loans sold to and serviced for the Federal Home Loan Mortgage Corporation and other investors are not included in the accompanying consolidated balance sheets. The unpaid principal balances of those loans at December 31, 2017, 2016 and 2015 were approximately \$92,818,000, \$100,982,000, and \$111,837,000, respectively.

Mortgage servicing right assets are included in core deposit and other intangibles in the consolidated balance sheets. Amortization of mortgage servicing rights is an adjustment to loan servicing income, which is included with other operating income in the consolidated statements of income. Activity in the mortgage servicing rights portfolio during the years ended December 31 was as follows (in thousands):

	2017	2016	2015
Balance, beginning of year	\$428	488	591
Amount capitalized to mortgage servicing rights	91	109	78
Amortization of mortgage servicing rights	(123 )	(169)	(181)
Balance, end of year	\$396	428	488

## NOTE 5 - ACQUIRED CREDIT IMPAIRED LOANS

The following table provides, as of December 31, the major classifications of loans acquired that are accounted for in accordance with FASB ASC 310-30 (in thousands):

	2017	2016
Commercial & industrial	\$1,008	98
Commercial, secured by real estate	4,048	6,305
Residential real estate	2,024	2,471
Consumer	—	17
Agricultural	—	—
Other loans, including deposit overdrafts	402	455
	7,482	9,346
Less allowance for loan losses	—	292
Loans, net	\$7,482	9,054





Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013

(Continued)

## NOTE 5 - ACQUIRED CREDIT IMPAIRED LOANS (continued)

The following table provides the outstanding balance and related carrying amount for acquired impaired loans at December 31 (in thousands):

	2017	2016
Outstanding balance	\$9,065	12,289
Carrying amount	7,482	9,346

Activity during 2017 and 2016 for the accretable discount related to acquired impaired loans is as follows (in thousands):

	2017	2016
Accretable discount, beginning of year	\$1,080	1,503
Accretable discount acquired during period	—	—
Reclass from nonaccretable discount to accretable discount	564	423
Less disposals	(170 )	(5 )
Less accretion	(805 )	(841 )
Accretable discount, end of year	\$669	1,080

## NOTE 6 – OTHER REAL ESTATE OWNED

Other real estate owned includes property acquired through foreclosure or deed-in-lieu of foreclosure and are included in other assets in the consolidated balance sheets. Changes in other real estate owned were as follows (in thousands):

	2017	2016
Balance, beginning of year	\$ —	846
Additions	974	214
Reductions due to sales	(974)	(484)
Reductions due to valuation write downs	—	(576)
Balance, end of year	\$ —	—

The total recorded investment in residential consumer mortgage loans secured by residential real estate that was in the process of foreclosure at December 31, 2017 was \$185,000.

## NOTE 7 - PREMISES AND EQUIPMENT

Premises and equipment at December 31 are summarized as follows (in thousands):

	2017	2016
Land	\$8,190	8,277
Buildings	31,965	21,400
Equipment	15,648	13,065
Construction in progress	120	7,362
Total	55,923	50,104
Less accumulated depreciation	20,996	19,860
Premises and equipment, net	\$34,927	30,244

Depreciation charged to expense was, \$1,549,000 in 2017, \$1,210,000 in 2016, and \$1,427,000 in 2015.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 8 - LEASES

Some of the Bank's branches, telephone equipment, and other equipment are leased under agreements expiring at various dates through 2050. These leases are accounted for as operating leases. The leases generally provide for renewal options and most require periodic changes in rental amounts based on various indices. Minimum annual rentals for non-cancelable leases at December 31, 2017 that have terms in excess of one year were as follows (in thousands):

2018	\$ 321
2019	243
2020	207
2021	161
2022	164
Thereafter	3,363
Total	\$4,459

Rental expense for all leased branches and equipment was approximately \$569,000 in 2017, \$545,000 in 2016, and \$542,000 in 2015.

## NOTE 9 - GOODWILL AND OTHER INTANGIBLE ASSETS

There were no changes in goodwill during 2017 and 2016.

Other intangible assets in the consolidated balance sheets at December 31, 2017 and 2016 were as follows (in thousands):

	2017			2016		
	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Core deposit intangibles	\$6,458	3,055	3,403	6,458	2,304	4,154
Mortgage servicing rights	1,279	883	396	1,188	760	428
Total	\$7,737	3,938	3,799	7,646	3,064	4,582

The estimated aggregate future amortization expense for each of the next five years for intangible assets remaining as of December 31, 2017 is as follows (in thousands):

2018	\$848
2019	829
2020	815
2021	800
2022	224

## NOTE 10 - AFFORDABLE HOUSING TAX CREDIT LIMITED PARTNERSHIPS

LCNB is a limited partner in limited partnerships that sponsor affordable housing projects utilizing the Low Income Housing Tax Credit (LIHTC) pursuant to Section 42 of the Internal Revenue Code. The purpose of the investments is

to achieve a satisfactory return on capital, to facilitate the sale of additional affordable housing product offerings, and to assist in achieving goals associated with the Community Reinvestment Act. The primary activities of the limited partnerships include the identification, development, and operation of multi-family housing that is leased to qualifying residential tenants.

-73-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 10 - AFFORDABLE HOUSING TAX CREDIT LIMITED PARTNERSHIPS (continued)

The following table presents the balances of LCNB's affordable housing tax credit investment and related unfunded commitment at December 31 (in thousands):

	2017	2016
Affordable housing tax credit investment	\$3,000	2,000
Less amortization	231	93
Net affordable housing tax credit investment	\$2,769	1,907
Unfunded commitment	\$2,257	1,617

The net affordable housing tax credit investment is included in other assets and the unfunded commitment is included in accrued interest and other liabilities in the Consolidated Balance Sheets.

LCNB expects to fund the unfunded commitment over ten years.

The following table presents other information relating to LCNB's affordable housing tax credit investment for the years indicated (in thousands):

	Year ended December 31,		
	2017	2016	2015
Tax credits and other tax benefits recognized	\$180	103	14
Tax credit amortization expense included in provision for income taxes	138	81	12

## NOTE 11 - TIME DEPOSITS

Contractual maturities of time deposits at December 31, 2017 were as follows (in thousands):

2018	\$64,454
2019	34,893
2020	49,289
2021	32,370
2022	8,667
Thereafter	2,226
	\$191,899

The aggregate amount of time deposits in denominations of \$250,000 or more at December 31, 2017 and 2016 was \$17,759,000 and \$22,410,000, respectively.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 12 - BORROWINGS

Funds borrowed from the FHLB at December 31 by year of maturity were as follows (dollars in thousands):

	Outstanding Balance	Average Rate
December 31, 2017		
2018	\$ 248	2.82 %
2019	55	2.82 %
Total	\$ 303	2.82 %
December 31, 2016		
2017	\$ 295	2.82 %
2018	248	2.82 %
2019	55	2.82 %
Total	\$ 598	2.82 %

All advances from the FHLB are secured by a blanket pledge of the Company's 1-4 family first lien mortgage loans in the amount of approximately \$217 million and \$229 million at December 31, 2017 and 2016, respectively. Additionally, the Company was required to hold minimum levels of FHLB stock, based on the outstanding borrowings. Total remaining borrowing capacity, including short-term borrowing arrangements, at December 31, 2017 was approximately \$56.3 million. One of the factors limiting remaining borrowing capacity is ownership of FHLB stock. The Company could increase its remaining borrowing capacity by purchasing additional FHLB stock.

Short-term borrowings at December 31 were as follows (dollars in thousands):

	2017		2016	
	Amount	Rate	Amount	Rate
Line of credit	\$—	— %	\$—	— %
FHLB short-term advance	47,000	1.43 %	25,000	0.63 %
Repurchase agreements	—	— %	17,040	0.10 %
	\$47,000	1.43 %	\$42,040	0.42 %

At December 31, 2017, the Company had short-term borrowing arrangements with three financial institutions and the Federal Home Loan Bank of Cincinnati ("FHLB"). The first arrangement is a short-term line of credit for a maximum amount of \$10 million at the interest rate in effect at the time of the borrowing. The second arrangement provides that the Company can borrow up to \$10 million in federal funds at the interest rate in effect at the time of the borrowing. The third arrangement is a short-term line of credit for a maximum amount of \$20 million at an interest rate equal to the lending institution's federal funds rate plus a spread of 50 basis points.

The Company has two short-term borrowing arrangements with the FHLB - a Cash Management Advance arrangement and a Repo Advance arrangement. Under the terms of the Cash Management Advance program, the Company can borrow up to \$65.3 million in short-term advances, subject to total remaining borrowing capacity limitations. The Company has the option of selecting a variable rate of interest for up to 90 days or a fixed rate of interest for up to 30 days. This agreement expires on August 24, 2018. Under the Repo Advance program, the

Company can borrow up to \$65.3 million in advances, subject to total remaining borrowing capacity limitations, with terms ranging from one day to one year. Prepayment is not permitted. This agreement expires on December 12, 2018. The interest rate for both the Cash Management Advance and Repo Advance programs is the published rate in effect at the time of the advance.

-75-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013

(Continued)

## NOTE 12 - BORROWINGS (continued)

The repurchase agreements product was discontinued in August 2017. Repurchase agreements were an option customers could use in managing their cash positions and matured the next business day after issuance. Repurchase agreements at December 31, 2016 were fully secured by U.S. Agency notes and such collateral securities were held by the Federal Reserve Bank. The maximum amount of outstanding agreements at any month-end during 2017 and 2016 totaled \$16,320,000 and \$18,715,000, respectively. The average balance through August 2017 was \$10,515,000 and the average balance for 2016 was \$13,891,000.

As of December 31, 2016, approximately \$3.1 million of the now discontinued repurchase agreements outstanding were held by a company owned by a member of the Company's Board of Directors.

## NOTE 13 - INCOME TAXES

The provision for federal income taxes consists of (in thousands):

	2017	2016	2015
Income taxes currently payable	\$3,018	3,515	4,280
Revaluation of net deferred tax liability (224 )	—	—	—
Deferred income tax provision (benefit) 1,478	928	(58 )	
Provision for income taxes	\$4,272	4,443	4,222

A reconciliation between the statutory income tax and the Company's effective tax rate follows:

	2017	2016	2015
Statutory tax rate	34.0 %	34.0 %	34.0 %
Increase (decrease) resulting from -			
Tax exempt interest	(6.0 )%	(6.3 )%	(6.0 )%
Tax exempt income on bank owned life insurance	(1.7 )%	(1.5 )%	(1.4 )%
Revaluation of net deferred tax liability	(1.3 )%	— %	— %
Captive insurance premium income	(0.9 )%	— %	— %
Other – net	0.7 %	0.1 %	0.3 %
Effective tax rate	24.8 %	26.3 %	26.9 %



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 13 - INCOME TAXES (continued)

Deferred tax assets and liabilities, included in the Consolidated Balance Sheets with accrued interest and other liabilities in 2017 and other assets in 2016, consist of the following at December 31 (in thousands):

	2017	2016
Deferred tax assets:		
Allowance for loan losses	\$715	1,223
Net unrealized losses on investment securities available-for-sale	707	1,369
Fair value adjustment on loans acquired from merger with First Capital	238	592
Pension and deferred compensation	760	1,157
Other	471	546
	2,891	4,887
Deferred tax liabilities:		
Depreciation of premises and equipment	(1,672)	(1,332)
Amortization of intangibles	(1,030)	(1,567)
Prepaid expenses	(210)	—
Deferred loan fees	(1)	(2)
FHLB stock dividends	(216)	(351)
Fair value adjustment on securities acquired from merger with First Capital	(9)	(19)
	(3,138)	(3,271)
Net deferred tax (liabilities) assets	\$(247)	1,616

As of December 31, 2017 and 2016 there were no unrecognized tax benefits and the Company does not anticipate the total amount of unrecognized tax benefits will significantly change within the next twelve months. There were no amounts recognized for interest and penalties in the consolidated statements of income for the three-year period ended December 31, 2017.

The Company is no longer subject to examination by federal tax authorities for years before 2014.

The Tax Cuts and Jobs Act ("Tax Act") was enacted on December 22, 2017. Among other changes, the Tax Act reduces the US Federal corporate tax rate from 35% to 21%. At December 31, 2017, the Company has substantially completed its accounting for the tax effects of enactment of the Tax Act. For deferred tax assets and liabilities, amounts were remeasured based on the rates expected to reverse in the future, which is now 21%. The Company continues to analyze certain aspects of the Tax Act and further refinements are possible, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts, although LCNB management does not expect these adjustments to materially impact its financial statements.

## NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES

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

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

-77-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES (continued)

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 December 31 were as follows (in thousands):

	2017	2016
Commitments to extend credit:		
Commercial loans	\$ 18,964	10,350
Other loans:		
Fixed rate	2,747	4,425
Adjustable rate	1,150	1,044
Unused lines of credit:		
Fixed rate	20,984	9,731
Adjustable rate	90,147	80,222
Unused overdraft protection amounts on demand and NOW accounts	16,441	17,123
Standby letters of credit	294	657
	\$ 150,727	123,552

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 or agreement. Unused lines of credit include amounts not drawn on line of credit loans. Commitments to extend credit and unused lines of credit generally have fixed expiration dates or other termination clauses.

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

The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, 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.

Capital expenditures include the construction or acquisition of new office buildings, improvements to LCNB's offices, purchases of furniture and equipment, and additions or improvements to LCNB's information technology system. Commitments outstanding for capital expenditures as of December 31, 2017 totaled approximately \$40,000.

The Company and the Bank 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 LCNB's consolidated financial position or results of operations.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 15 - REGULATORY MATTERS

The Federal Reserve Act requires depository institutions to maintain cash reserves with the Federal Reserve Bank. In 2017 and 2016, the Bank maintained average reserve balances of \$7,924,000 and \$10,903,000, respectively. The reserve balances at December 31, 2017 and 2016 were \$1,422,000 and \$4,313,000, respectively.

The principal source of income and funds for LCNB Corp. is dividends paid by the Bank. The payment of dividends is subject to restriction by regulatory authorities. For 2018, the restrictions generally limit dividends to the aggregate of net income for the year 2018 plus the net earnings retained for 2017 and 2016. In addition, dividend payments may not reduce capital levels below minimum regulatory guidelines. At December 31, 2017, approximately \$18,865,000 of the Bank's earnings retained was available for dividends in 2018 under this guideline. Dividends in excess of these limitations would require the prior approval of the Comptroller of the Currency.

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

A new rule requiring a Capital Conservation Buffer began phase-in on January 1, 2016 and will be fully implemented at the beginning of 2019. Under the fully-implemented rule, a financial institution will need to maintain a Capital Conservation Buffer composed of Common Equity Tier 1 Capital of at least 2.5% above its minimum risk-weighted capital requirements to avoid limitations on its ability to make capital distributions, including dividend payments to shareholders and certain discretionary bonus payments to executive officers. A financial institution with a buffer below 2.5% will be subject to increasingly stringent limitations on capital distributions as the buffer approaches zero.

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

	Minimum Requirement		Minimum Requirement with Capital Conservation Buffer for 2017		To Be Considered Well-Capitalized	
Ratio of Common Equity Tier 1 Capital to risk-weighted assets	4.5	%	5.75	%	6.5	%
Ratio of tier 1 capital to risk-weighted assets	6.0	%	7.25	%	8.0	%
Ratio of total capital (tier 1 capital plus tier 2 capital) to risk-weighted assets	8.0	%	9.25	%	10.0	%
Leverage ratio (tier 1 capital to adjusted quarterly average total assets)	4.0	%	N/A		5.0	%

As of the most recent notification from their regulators, the Company and Bank 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 category.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 15 - REGULATORY MATTERS (continued)

A summary of the regulatory capital of the Consolidated Company and Bank at December 31 follows (dollars in thousands):

	2017		2016	
	Consolidated Company	Bank	Consolidated Company	Bank
Regulatory Capital:				
Shareholders' equity	\$150,271	148,163	142,944	141,325
Goodwill and other intangible assets	(32,906 )	(32,906 )	(32,676 )	(32,676 )
Accumulated other comprehensive loss	2,828	2,859	2,617	2,605
Tier 1 risk-based capital	120,193	118,116	112,885	111,254
Eligible allowance for loan losses	3,403	3,403	3,575	3,575
Total risk-based capital	\$123,596	121,519	116,460	114,829
Capital Ratios:				
Common Equity Tier 1 Capital to risk-weighted assets	13.29	% 13.07	% 13.00	% 12.82
Tier 1 capital to risk-weighted assets	13.29	% 13.07	% 13.00	% 12.82
Total capital (tier 1 capital plus tier 2 capital) to risk-weighted assets	13.66	% 13.45	% 13.41	% 13.24
Leverage ratio (tier 1 capital to adjusted quarterly average total assets)	9.51	% 9.36	% 8.81	% 8.69

LCNB Corp. filed a Registration Statement on Form S-3 with the SEC on July 27, 2011 to register 400,000 shares for use in its Amended and Restated Dividend Reinvestment and Stock Purchase Plan (the "Amended Plan"). Formerly LCNB purchased the shares needed for its Dividend and Stock Purchase Plan in the secondary market. Under the Amended Plan, LCNB has the option of purchasing shares in the secondary market, using treasury shares, or issuing new shares.

## NOTE 16 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Changes in accumulated other comprehensive income (loss) for 2017 and 2016 were as follows (in thousands):

	2017			2016		
	Unrealized Gains and Losses on Available- for-Sale Securities	Changes in Pension Plan Assets and Benefit Provisions	Total	Unrealized Gains and Losses on Available- for-Sale Securities	Changes in Pension Plan Assets and Benefit Provisions	Total
Balance at beginning of year	\$(2,633)	16	(2,617)	469	(233 )	236
Before reclassifications	585	(158 )	427	(2,390)	249	(2,141)
Reclassifications	(152 )	—	(152 )	(712 )	—	(712 )
Balance at end of year	\$(2,200)	(142 )	(2,342)	(2,633)	16	(2,617)



LCNB CORP. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 December 31, 2016  
 (Continued)

## NOTE 16 - ACCUMULATED OTHER COMPREHENSIVE INCOME (continued)

Reclassifications out of accumulated other comprehensive income (loss) during 2017 and 2016 and the affected line items in the consolidated statements of income were as follows (in thousands):

	2017	2016	Affected Line Item in the Consolidated Statements of Income
Realized gain on sales of securities	\$233	1,082	Net gain on sale of securities
Less provision for income taxes	81	370	Provision for income taxes
Reclassification adjustment, net of taxes	\$152	712	

## NOTE 17 - RETIREMENT PLANS

Prior to January 1, 2009, the Company had a single-employer qualified noncontributory defined benefit retirement plan that covered substantially all regular full-time employees. Effective January 1, 2009, the Company redesigned the plan and merged it into a multiple-employer plan, which is accounted for as a multi-employer plan because assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer. Employees hired on or after January 1, 2009 are not eligible to participate in this plan.

Effective February 1, 2009, the Company amended the plan to reduce benefits for those whose age plus vesting service equaled less than 65 at that date. Also effective February 1, 2009, an enhanced 401(k) plan was made available to those hired on or after January 1, 2009 and to those who received benefit reductions from the amendments to the noncontributory defined benefit retirement plan. Employees hired on or after January 1, 2009 receive a 50% employer match on their contributions into the 401(k) plan, up to a maximum company contribution of 3% of each individual employee's annual compensation. Employees who received a benefit reduction under the retirement plan amendments receive an automatic contribution of 5% or 7% of annual compensation, depending on the sum of an employee's age and vesting service, into the 401(k) plan, regardless of the contributions made by the employees. This contribution is made annually and these employees will not receive any employer matches to their 401(k) contributions.

Certain information pertaining to the qualified noncontributory defined benefit retirement plan is as follows:

Legal name	Pentegra Defined Benefit Plan for Financial Institutions
Plan's employer identification number	13-5645888
Plan number	333

The plan is at least 80% funded as of July 1, 2017 and 2016. A funding improvement or rehabilitation plan has not been implemented, nor has a surcharge been paid to the plan. The Company's contributions to the qualified noncontributory defined benefit retirement plan do not represent more than 5% of total contributions to the plan.

Funding and administrative costs of the qualified noncontributory defined benefit retirement plan and 401(k) plan charged to salaries and employee benefits in the consolidated statements of income for the years ended December 31 were as follows (in thousands):

	2017	2016	2015
Qualified noncontributory defined benefit retirement plan	\$1,054	969	984
401(k) plan	374	359	346



The Company expects a minimum contribution of \$224,000 to the qualified noncontributory defined benefit retirement plan in 2018. The Company expects to contribute \$426,000 to the 401(k) plan in 2018.

-81-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 17 - RETIREMENT PLANS (continued)

Citizens National had a qualified noncontributory defined benefit pension plan which covered employees hired before May 1, 2005. The Company assumed this plan at the time of the merger. At December 31, 2017, the amount of the liability for this plan was \$128,000, representing the funded status of the plan.

The Bank has a benefit plan which permits eligible officers to defer a portion of their compensation. The deferred compensation balance, which accrues interest at 8% annually, is distributable in cash after retirement or termination of employment. The amount of such deferred compensation liability at December 31, 2017 and 2016 was \$3,406,000 and \$3,407,000, respectively.

The Bank also has supplemental income plans which provide certain employees an amount based on a percentage of average compensation, payable in accordance with individually defined schedules upon retirement. The projected benefit obligation included in other liabilities for the supplemental income plans at December 31, 2017 and 2016 is \$1,249,000 and \$1,284,000, respectively. The average discount rate used to determine the present value of the obligations was approximately 5.2% in 2017 and 5.2% in 2016. The service cost associated with the plans was \$0 for 2017, \$0 for 2016, and \$183,000 for 2015. Interest costs were \$62,000, \$63,000, and \$56,000 for 2017, 2016, and 2015, respectively.

The deferred compensation plan and supplemental income plans are nonqualified and unfunded. Participation in each plan is limited to a select group of management.

Effective February 1, 2009, the Company established a nonqualified defined benefit retirement plan, which is also unfunded, for certain highly compensated employees. The nonqualified plan ensures that participants receive the full amount of benefits to which they would have been entitled under the noncontributory defined benefit retirement plan in the absence of limits on benefit levels imposed by certain sections of the Internal Revenue Code.

The components of net periodic pension cost of the nonqualified defined benefit retirement plan for the years ended December 31 are summarized as follows (in thousands):

	2017	2016	2015
Service cost	\$ —	41	38
Interest cost	69	78	68
Amortization of unrecognized (gain) loss	16	168	171
Net periodic pension cost	\$ 85	287	277

A reconciliation of changes in the projected benefit obligation of the nonqualified defined benefit retirement plan at December 31 follows (in thousands):

	2017	2016	2015
Projected benefit obligation at beginning of year	\$1,727	1,843	1,741
Service cost	—	41	38
Interest cost	69	78	68
Actuarial (gain) or loss	238	(209 )	10
Benefits paid	(63 )	(26 )	(14 )
Projected benefit obligation at end of year	\$1,971	1,727	1,843

Amounts recognized in other liabilities in the consolidated balance sheets for the nonqualified defined benefit retirement plan at December 31, 2017 and 2016 were \$1,971,000 and \$1,727,000, respectively.

The accumulated benefit obligation for the nonqualified defined benefit retirement plan at December 31, 2017 and 2016 was \$1,971,000 and \$1,727,000, respectively.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 17 - RETIREMENT PLANS (continued)

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

	2017	2016	2015
Net actuarial (gain)/loss	\$141	(16)	233
Past service cost	—	—	—
	\$141	(16)	233

The estimated unrecognized net actuarial gain that will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2018 for the nonqualified defined benefit retirement plan is \$16,000.

Key weighted-average assumptions used to determine the benefit obligation and net periodic pension costs for the nonqualified defined benefit retirement plan for the years ended December 31 were as follows:

	2017	2016	2015
Benefit obligation:			
Discount rate	3.60%	4.14%	4.34%
Salary increase rate	2.00%	2.00%	2.00%
Net periodic pension cost:			
Discount rate	4.14%	4.34%	3.95%
Salary increase rate	2.00%	2.00%	2.00%
Amortization period in years	1.00	1.00	1.98

The nonqualified defined benefit retirement plan is not funded. Therefore no contributions will be made in 2018. Estimated future benefit payments reflecting expected future service for the years ended after December 31, 2017 are (in thousands):

2018	\$130
2019	130
2020	130
2021	130
2022	130
2023-2027	633

## NOTE 18 - STOCK-BASED COMPENSATION

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

The 2015 Ownership Incentive Plan (the "2015 Plan") was approved by LCNB's shareholders at the annual meeting on April 28, 2015 and allows for stock-based awards to eligible employees, as determined by the Compensation

Committee of the Board of Directors. Awards may be made in the form of stock options, appreciation rights, restricted shares, and/or restricted share units. The 2015 Plan provides for the issuance of up to 450,000 shares. The 2015 Plan will terminate on April 28, 2025 and is subject to earlier termination by the Compensation Committee.

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

-83-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 18 - STOCK-BASED COMPENSATION (continued)

LCNB has not granted stock options since 2012. Option awards granted to date under the 2002 Plan vest ratably over a five year period and expire ten years after the date of grant. Stock options outstanding at December 31, 2017 were as follows:

Exercise Price Range	Outstanding Stock Options			Exercisable Stock Options		
	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
\$9.00 - 10.99	4,356	\$ 9.00	1.1	4,356	\$ 9.00	1.1
\$11.00 - 12.99	15,909	12.08	2.6	15,909	12.08	2.6
\$17.00 - 18.99	—	—	0.0	—	—	0.0
	20,265	11.42	2.3	20,265	11.42	2.3

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

	2017		2016		2015	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at January 1,	24,669	12.17	83,861	\$ 12.39	99,810	\$ 12.16
Granted	—	—	—	—	—	—
Exercised	(3,398)	14.94	(51,390)	11.53	(13,449)	11.31
Expired	(1,006)	17.88	(7,802)	18.76	(2,500)	9.00
Outstanding at December 31,	20,265	11.42	24,669	12.17	83,861	12.39
Exercisable at December 31,	20,265	11.42	22,924	12.13	75,072	12.40

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

	2017	2016	2015
Intrinsic value of options exercised	\$ 25	288	67
Cash received from options exercised	51	592	152
Tax benefit realized from options exercised	5	59	13

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 December 31, 2017 that were “in the money” (market price greater than exercise price) was \$183,000. The aggregate intrinsic value at that date for only the options that were exercisable was \$183,000. The aggregate intrinsic value for options outstanding at December 31, 2016 that were in the money was \$273,000 and the aggregate intrinsic value at that date for only the options that were exercisable was \$255,000. The intrinsic value changes based on changes in the market value of the Company’s stock.

Total expense related to options included in salaries and wages in the consolidated statements of income for the years ended December 31, 2017, 2016, and 2015 was \$1,000, \$5,000, and \$19,000, respectively. The related tax benefit for

2017, 2016, and 2015 was \$0, \$2,000, and \$6,000, respectively. Compensation costs related to option awards were recognized in full during the first quarter 2017.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 18 - STOCK-BASED COMPENSATION (continued)

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

	2017		2016		2015	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1,	8,624	\$ 15.47	16,038	\$ 15.47	—	\$ —
Granted	4,027	22.60	—	—	16,038	15.47
Vested	(3,834)	16.73	(7,414 )	15.47	—	—
Forfeited	—	—	—	—	—	—
Outstanding at December 31,	8,817	\$ 16.44	8,624	\$ 15.47	16,038	\$ 15.47

Total expense related to restricted stock awards included in salaries and wages in the consolidated statements of income for the years ended December 31, 2017, 2016, and 2015 was \$75,000, \$90,000, and \$90,000 respectively. The related tax benefit for the years ended December 31, 2017, 2016, and 2015 was \$26,000, \$31,000, and \$31,000, respectively. Unrecognized compensation expense for restricted stock awards was \$84,000 at December 31, 2017 and is expected to be recognized over a period of 4.2 years.

## NOTE 19 - EARNINGS PER SHARE

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





Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 19 - EARNINGS PER SHARE (continued)

Earnings per share for the years ended December 31 were calculated as follows (in thousands, except share and per share data):

	2017	2016	2015
Net income	\$ 12,972	12,482	11,474
Less allocation of earnings and dividends to participating securities	7	13	—
Net income allocated to common shareholders	12,965	12,469	11,474
Weighted average common shares outstanding, gross	10,011,358	9,958,300	9,704,965
Less average participating securities	5,783	10,243	—
Weighted average number of shares outstanding used in the calculation of basic earnings per common share	10,005,575	9,948,057	9,704,965
Add dilutive effect of:			
Stock options	6,936	10,765	17,174
Stock warrants	—	17,548	89,328
Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share	10,012,511	9,976,370	9,811,467
Earnings per common share:			
Basic	\$ 1.30	1.26	1.18
Diluted	1.29	1.25	1.17

Options to purchase 12,962 shares of common stock at a weighted average price of \$18.41 per share were outstanding at December 31, 2015 and were not included in the computation of diluted earnings per common share because the exercise prices of the options were greater than the average market prices of the common shares. There were no such options at December 31, 2017 or 2016.

## NOTE 20 - RELATED PARTY TRANSACTIONS

LCNB has entered into related party transactions with various directors and executive officers. Management believes these transactions do not involve more than a normal risk of collectibility or present other unfavorable features. The following table provides a summary of the loan activity for these officers and directors for the years ended December 31 (in thousands):

	2017	2016
Beginning balance	\$1,447	1,091
New loans and advances	669	64
Change in composition of related parties	—	506
Reductions	(246 )	(214 )
Ending Balance	\$1,870	1,447

Deposits from executive officers, directors and related interests of such persons held by the Company at December 31, 2017 and 2016 amounted to \$5,698,000 and \$4,618,000, respectively.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 21 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The majority of LCNB's financial debt securities are classified as available-for-sale. The securities are reported at fair value with unrealized holding gains and losses reported net of income taxes in accumulated other comprehensive income.

LCNB utilizes a pricing service for determining the fair values of most of its investment securities. Methods and significant assumptions used to estimate fair value are as follows:

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

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

Fair value for trust preferred and equity securities are determined based on market quotations (level 1). These securities are not priced by the pricing service.

LCNB has investments in five mutual funds. These investments are not priced by the pricing service. Investments in two of the mutual funds are measured at fair value using net asset values ("NAV") per share as a practical expedient and are not required to be classified in the fair value hierarchy. These funds can be redeemed at any time at their current NAVs. Two other mutual funds are traded in active markets and their fair values are based on market quotations (level 1). The investment in the remaining mutual fund, which is not traded in an active market, is considered to have level 2 inputs because an investor can have its interest in the fund redeemed for the balance of its capital account at any quarter-end assuming the fund is given a 60 day notice. The investment in this fund is carried at fair value, which approximates cost.

Assets that may be recorded at fair value on a nonrecurring basis include impaired loans, other real estate owned, and other repossessed assets. A loan is considered impaired when management believes it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate or the fair value of collateral if the loan is collateral dependent, if this value is less than the loan balance. The inputs are considered to be level 3.

Other real estate owned is adjusted to fair value upon transfer of the loan to foreclosed assets, usually based on an appraisal of the property. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. These inputs are also considered to be level 3.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 21 - FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

Fair Value Measurements	Fair Value Measurements at the End of the Reporting Period Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017					
Recurring fair value measurements:					
Investment securities available-for-sale:					
U.S. Treasury notes	\$2,259	2,259	—	—	
U.S. Agency notes	83,261	—	83,261	—	
U.S. Agency mortgage-backed securities	67,153	—	67,153	—	
Municipal securities:					
Non-taxable	102,174	—	102,174	—	
Taxable	20,366	—	20,366	—	
Mutual funds	1,023	23	1,000	—	
Mutual funds measured	519				

at net asset value (a)				
Trust preferred securities	50	—	—	
Equity securities	667	—	—	
Total recurring fair value measurements	\$ 278,472	2,999	273,954	—
Nonrecurring fair value measurements:				
Impaired loans	\$ 3,359	—	—	3,359
December 31, 2016				
Recurring fair value measurement:				
Investment securities available-for-sale:				
U.S. Treasury notes	\$ 28,145	28,145	—	—
U.S. Agency notes	85,400	—	85,400	—
U.S. Agency mortgage-backed securities	71,047	—	71,047	—
Municipal securities:				
Non-taxable	113,015	—	113,015	—
Taxable	19,845	—	19,845	—
Mutual funds	1,000	—	1,000	—
Mutual funds measured	482			

at				
net				
asset				
value				
(a)				
Trust				
preferred	48	—	—	
securities				
Equity	677	—	—	
securities				
Total				
recurring				
fair value	\$ 320,659	28,870	290,307	—
measurements				
Nonrecurring				
fair				
value				
measurements:				
Impaired				
loans	\$ 5,340	—	—	5,340

In accordance with Subtopic 820-10, certain investments that are measured at fair value using the net asset value per share practical expedient have not been classified in the fair value hierarchy.

(a) The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Balance Sheets.



Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 21 - FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The following table presents quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements at December 31, 2017 and 2016 (dollars in thousands):

	Fair Value	Valuation Technique	Unobservable Inputs	Range		Weighted Average
				High	Low	
2017						
Impaired loans	\$3,359	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
		Discounted cash flows	Discount rate	8.25%	3.25%	6.27 %
2016						
Impaired loans	\$5,340	Estimated sales price	Adjustments for comparable properties, discounts to reflect current market conditions	Not applicable		
		Discounted cash flows	Discount rate	8.25%	4.50%	5.56 %

-89-

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 21 - FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Carrying amounts and estimated fair values of financial instruments as of December 31 were as follows (in thousands):

			Fair Value Measurements at the End of the Reporting Period Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Amount	Fair Value					
2017							
FINANCIAL ASSETS:							
Cash and cash equivalents	\$ 25,386	25,386	25,386	—	—		
Investment securities, held-to-maturity	32,571	32,350	—	—	32,350		
Federal Reserve Bank stock	2,732	2,732	2,732	—	—		
Federal Home Loan Bank stock	3,638	3,638	3,638	—	—		
Loans, net	845,657	813,368	—	—	813,368		
Accrued interest receivable	3,511	3,511	—	3,511	—		
FINANCIAL LIABILITIES:							
Deposits	1,085,821	1,087,086	894,046	193,040	—		
Short-term borrowings	47,000	47,000	47,000	—	—		
Long-term debt	303	307	—	307	—		
Accrued interest payable	329	329	—	329	—		
2016							
FINANCIAL ASSETS:							
Cash and cash equivalents	\$ 18,865	18,865	18,865	—	—		
Investment securities, held-to-maturity	41,003	40,490	—	—	40,490		
Federal Reserve Bank stock	2,732	2,732	2,732	—	—		
Federal Home Loan Bank stock	3,638	3,638	3,638	—	—		
Loans, net	816,228	799,791	—	—	799,791		
Accrued interest receivable	3,559	3,559	—	3,559	—		
FINANCIAL LIABILITIES:							
Deposits	1,110,905	1,113,187	896,147	217,040	—		
Short-term borrowings	42,040	42,040	42,040	—	—		
Long-term debt	598	614	—	614	—		

Edgar Filing: LCNB CORP - Form 10-K

Accrued interest payable	307	307	—	307	—
--------------------------	-----	-----	---	-----	---

The fair values of off-balance-sheet financial instruments such as loan commitments and letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements. The fair values of such instruments were not material at December 31, 2017 and 2016.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 21 - FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

Cash and cash equivalents

The carrying amounts presented are deemed to approximate fair value.

Investment securities, held-to-maturity

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

Federal Home Loan Bank and Federal Reserve Bank stock

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

Loans

Fair value is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, incorporating assumptions of current and projected prepayment speeds. These current rates approximate market rates.

Deposits

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

Borrowings

The carrying amounts of federal funds purchased, repurchase agreements, and U.S. Treasury demand note borrowings are deemed to approximate fair value of short-term borrowings. For long-term debt, fair values are estimated based on the discounted value of expected net cash flows using current interest rates.

Accrued interest receivable and Accrued interest payable

Carrying amount approximates fair value.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 22 – QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table sets forth certain quarterly results for the years ended December 31, 2017 and 2016 (dollars in thousands, except per share data):

	Three Months Ended			
	March 31	June 30	Sep. 30	Dec. 31
2017				
Interest income	\$ 10,864	10,934	11,055	11,610
Interest expense	877	861	908	953
Net interest income	9,987	10,073	10,147	10,657
Provision for loan losses	15	222	(12 )	(10 )
Net interest income after provision	9,972	9,851	10,159	10,667
Total non-interest income	2,430	2,790	2,659	2,579
Total non-interest expenses	7,968	8,611	8,672	8,612
Income before income taxes	4,434	4,030	4,146	4,634
Provision for income taxes	1,188	1,027	1,040	1,017
Net income	\$ 3,246	3,003	3,106	3,617
Earnings per common share:				
Basic	\$ 0.32	0.30	0.31	0.37
Diluted	0.32	0.30	0.31	0.36
2016				
Interest income	\$ 10,621	11,008	10,895	11,226
Interest expense	849	883	885	887
Net interest income	9,772	10,125	10,010	10,339
Provision for loan losses	90	396	372	55
Net interest income after provision	9,682	9,729	9,638	10,284
Total non-interest income	2,642	2,750	2,846	2,615
Total non-interest expenses	8,292	8,468	8,593	7,908
Income before income taxes	4,032	4,011	3,891	4,991
Provision for income taxes	1,068	1,043	995	1,337
Net income	\$ 2,964	2,968	2,896	3,654
Earnings per common share:				
Basic	\$ 0.30	0.30	0.29	0.37
Diluted	0.30	0.29	0.29	0.37

Table of Contents

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

## NOTE 23 - PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information for LCNB Corp., parent company only, follows (in thousands):

## Condensed Balance Sheets:

December 31,	2017	2016
Assets:		
Cash on deposit with subsidiary	\$308	491
Investment securities available-for-sale, at fair value	919	893
Investment in subsidiaries	148,850	141,325
Other assets	194	235
Total assets	\$150,271	142,944
Liabilities		
	\$—	—
Shareholders' equity		
Total liabilities and shareholders' equity	150,271	142,944

## Condensed Statements of Income

Year ended December 31,	2017	2016	2015
Income:			
Dividends from subsidiaries	\$6,800	7,300	5,400
Interest and dividends	36	38	58
Net gain on sales of securities	14	8	254
Total income	6,850	7,346	5,712
Total expenses			
	1,290	1,014	1,016
Income before income tax expense/benefit and equity in undistributed income of subsidiaries	5,560	6,332	4,696
Income tax benefit	380	336	250
Equity in undistributed income of subsidiaries	7,032	5,814	6,528
Net income	\$12,972	12,482	11,474

-93-

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017

(Continued)

NOTE 23 - PARENT COMPANY FINANCIAL INFORMATION (continued)

## Condensed Statements of Cash Flows

Year ended December 31,	2017	2016	2015
Cash flows from operating activities:			
Net income	\$12,972	12,482	11,474
Adjustments for non-cash items -			
Increase in undistributed income of subsidiaries	(7,032 )	(5,814 )	(6,528 )
Other, net	84	126	42
Net cash flows provided by operating activities	6,024	6,794	4,988
Cash flows from investing activities:			
Purchases of securities available-for-sale	(54 )	(177 )	(215 )
Proceeds from maturities of securities available-for-sale	50	55	—
Proceeds from sales of available-for-sale securities	43	173	1,217
Investments in subsidiaries	(250 )	—	—
Cash paid for business acquisition	—	—	(3,757 )
Net cash flows provided by (used in) investing activities	(211 )	51	(2,755 )
Cash flows from financing activities:			
Proceeds from issuance of common stock	360	379	390
Repurchase of stock warrants	—	(1,545 )	—
Cash dividends paid on common stock	(6,407 )	(6,375 )	(6,239 )
Other	51	653	165
Net cash flows used in financing activities	(5,996 )	(6,888 )	(5,684 )
Net change in cash	(183 )	(43 )	(3,451 )
Cash at beginning of year	491	534	3,985
Cash at end of year	\$308	491	534

-94-

Table of Contents

LCNB CORP. AND SUBSIDIARIES

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

An evaluation of the effectiveness of LCNB's internal controls over financial reporting was carried out under the supervision and with the participation of LCNB's management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that LCNB's disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Internal Control Over Financial Reporting

Information required by this item is set forth in the "Report of Management's Assessment of Internal Control over Financial Reporting" and the "Report of Independent Registered Public Accounting Firm" included in Item 8 of this 2017 Annual Report on Form 10-K.

Changes in Internal Control over Financial Reporting

During the fourth quarter 2017, 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.

Item 9B. Other Information

None.

-95-

---



Table of Contents

LCNB CORP. AND SUBSIDIARIES

PART III

Portions of the Company's Definitive Proxy Statement (the "Proxy Statement") included in the Notice of Annual Meeting of Shareholders to be held April 24, 2018, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2017, are incorporated by reference into Part III.

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item concerning the Executive Officers and Directors of the Registrant is incorporated herein by reference under the caption "Directors and Executive Officers" of the Proxy Statement.

The information required by this item concerning the Audit Committee and Code of Business Conduct and Ethics is incorporated herein by reference under the captions "Board of Directors Meetings and Committees," "Audit Committee Report," and "Code of Ethics" of the Proxy Statement.

The information required by this item concerning Section 16(a) Beneficial Ownership Reporting Compliance is incorporated herein by reference under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" of the proxy Statement.

Item 11. Executive Compensation

The information contained in the Proxy Statement under the captions "Board of Directors Meetings and Committees" "Compensation Committee Interlocks and Insider Participation" "Equity Compensation Plan Information," "Compensation of Executive Officers," and "Compensation Committee Report on Executive Compensation" is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information contained in the Proxy Statement under the captions "Market Price of Stock and Dividend Data" and "Voting Securities and Principal Holders" is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information contained in the Proxy Statement under the captions "Election of Directors," "Directors and Executive Officers," "Board of Directors Meetings and Committees," and "Certain Relationships and Related Transactions" is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information contained in the Proxy Statement under the captions "Independent Registered Accounting Firm" and "Board of Directors Meetings and Committees" is incorporated herein by reference.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)1. Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
FINANCIAL STATEMENTS

Consolidated Balance Sheets as of December 31, 2017 and 2016.

Consolidated Statements of Income for the Years Ended December 31, 2017, 2016, and 2015.

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2017, 2016, and 2015.

Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2017, 2016, and 2015.

Consolidated Statements of Cash Flows for the Years Ended December 31, 2017, 2016, and 2015.

Notes to Consolidated Financial Statements

2. Financial Statement Schedules – None

3. Exhibits required by Item 601 Regulation S-K.

(a)

Exhibit No.	Exhibit Description
2.1	<u>Agreement and Plan of Merger dated as of October 9, 2012 by and between LCNB Corp. and First Capital Bancshares, Inc. – incorporated by reference to the Registrant's Form 8-K filed on October 9, 2012, Exhibit 2.1.</u>
2.2	<u>Stock Purchase Agreement between LCNB Corp. and Colonial Banc Corp. dated as of October 28, 2013 - incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 28, 2013, Exhibit 2.1.</u>
2.3	<u>Agreement and Plan of Merger dated as of December 29, 2014 by and between LCNB Corp. and BNB Bancorp, Inc., - incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 2, 2015, Exhibit 2.1.</u>
2.4	<u>Agreement and Plan of Merger dated as of December 20, 2017 by and between LCNB Corp. and Columbus First Bancorp, Inc. - incorporated by reference to the Registrant's Current Report on Form 8-K filed on December 21, 2017, Exhibit 2.1.</u>
3.1	<u>Amended and Restated Articles of Incorporation of LCNB Corp., as amended – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010, Exhibit 3.1.</u>
3.2	<u>Code of Regulations of LCNB Corp. - Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005, Exhibit 3(ii).</u>
10.1	<u>LCNB Corp. Ownership Incentive Plan - incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 15, 2002, Exhibit A (000-26121).</u>
10.2	<u>LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 13, 2015, Exhibit A (001-35292).</u>
10.3	<u>Form of Option Grant Agreement under the LCNB Corp. Ownership Incentive Plan - incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2005, Exhibit 10.2.</u>
10.5	<u>Nonqualified Executive Retirement Plan – incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2009, Exhibit 10.4.</u>
10.7	

Edgar Filing: LCNB CORP - Form 10-K

Form of Restricted Share Grant Agreement under the LCNB Corp. 2015 Ownership Incentive Plan - incorporated by reference to Registrant's 2015 Form 10-K, Exhibit 10.7.

14.1 LCNB Corp. Code of Business Conduct and Ethics - incorporated by reference to Registrant's 2003 Form 10-K, Exhibit 14.1.

14.2 LCNB Corp. Code of Ethics for Senior Financial Officers - Incorporated by reference to Registrant's 2003 Form 10-K, Exhibit 14.2.

-97-

---

Table of Contents

LCNB CORP. AND SUBSIDIARIES

(a)	Exhibit	Exhibit Description
	No.	
	21	<u>LCNB Corp. subsidiaries.</u>
	23	<u>Consent of Independent Registered Public Accounting Firm.</u>
	31.1	<u>Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u>
	31.2	<u>Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.</u>
	32	<u>Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.</u>
		The following financial information from LCNB Corp.'s Annual Report on Form 10-K for the year ended December 31, 2017 is formatted in Extensible Business Reporting Language: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements, tagged as blocks of text.
	101	

Table of Contents

LCNB CORP. AND SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.  
(Registrant)

/s/ Steve P. Foster  
Steve P. Foster  
Chief Executive Officer & President  
March 9, 2018

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

/s/ Steve P. Foster  
Steve P. Foster  
Chief Executive Officer, President, & Director  
(Principal Executive Officer)  
March 9, 2018

/s/ William H. Kaufman  
William H. Kaufman  
Director  
March 9, 2018

/s/ Robert C. Haines II  
Robert C. Haines II  
Executive Vice President & Chief Financial  
Officer (Principal Financial and Accounting  
Officer)  
March 9, 2018

/s/ Anne E. Krehbiel  
Anne E. Krehbiel  
Director  
March 9, 2018

/s/ Stephen P. Wilson  
Stephen P. Wilson  
Chairman of the Board of Directors  
March 9, 2018

/s/ John H. Kochensparger III  
John H. Kochensparger III  
Director  
March 9, 2018

/s/ Spencer S. Cropper  
Spencer S. Cropper  
Director  
March 9, 2018

/s/ Valerie S. Krueckeberg  
Valerie S. Krueckeberg  
Director  
March 9, 2018

/s/ George L. Leasure  
George L. Leasure  
Director

March 9, 2018

-99-