

LCNB CORP  
Form 10-Q  
May 03, 2010

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

**FORM 10-Q**

(Mark One)

( X )

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

For the quarterly period ended March 31, 2010

( )

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

**2 North Broadway, Lebanon, Ohio 45036**

(Address of principal executive offices, including Zip Code)

**(513) 932-1414**

(Registrant's telephone number, including area code)

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

Yes       No

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

Yes       No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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

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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 number of shares outstanding of the issuer's common stock, without par value, as of May 3, 2010 was 6,687,232 shares.

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**LCNB Corp.**

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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****LCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

	March 31, 2010 (Unaudited)	December 31, 2009
<b>ASSETS:</b>		
Cash and due from banks	\$ 23,622	12,626
Federal funds sold and interest-bearing demand deposits	3,710	-
Total cash and cash equivalents	27,332	12,626
Investment securities:		
Available-for-sale, at fair value	184,946	201,578
Held-to-maturity, at cost	13,887	13,030
Federal Reserve Bank and Federal Home Loan Bank stock, at cost	3,031	3,031
Loans, net	456,769	457,418
Premises and equipment, net	15,558	15,722
Goodwill	5,915	5,915
Bank owned life insurance	14,275	14,122
Other assets	11,366	10,967
<b>TOTAL ASSETS</b>	<b>\$ 733,079</b>	<b>734,409</b>
<b>LIABILITIES:</b>		
Deposits:		
Noninterest-bearing	\$ 89,038	93,894
Interest-bearing	542,141	530,285
Total deposits	631,179	624,179
Short-term borrowings	5,108	14,265
Long-term debt	24,153	24,960
Accrued interest and other liabilities	5,573	5,390
<b>TOTAL LIABILITIES</b>	<b>666,013</b>	<b>668,794</b>
<b>SHAREHOLDERS' EQUITY:</b>		

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Preferred shares - no par value, authorized 1,000,000 shares,	-	-
none outstanding		
Common shares - no par value, authorized 8,000,000 shares,		
issued 7,445,514 shares at March 31, 2010 and December 31, 2009	11,068	11,068
Surplus	15,416	15,407
Retained earnings	50,104	48,962
Treasury shares at cost,		
758,282 shares at March 31, 2010 and December 31, 2009	(11,737)	(11,737)
Accumulated other comprehensive income, net of taxes	2,215	1,915
<b>TOTAL SHAREHOLDERS' EQUITY</b>	67,066	65,615
<b>TOTAL LIABILITES AND SHAREHOLDERS' EQUITY</b>	\$ 733,079	734,409

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



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

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,	
	2010	2009
<b>INTEREST INCOME:</b>		
Interest and fees on loans	\$ 6,822	6,876
Dividends on Federal Reserve Bank and Federal Home Loan Bank stock	24	24
Interest on investment securities-		
Taxable	931	1,071
Non-taxable	808	624
Other short-term investments	8	12
TOTAL INTEREST INCOME	8,593	8,607
<b>INTEREST EXPENSE:</b>		
Interest on deposits	1,976	2,621
Interest on short-term borrowings	9	-
Interest on long-term debt	177	107
TOTAL INTEREST EXPENSE	2,162	2,728
NET INTEREST INCOME	6,431	5,879
PROVISION FOR LOAN LOSSES	208	98
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,223	5,781
<b>NON-INTEREST INCOME:</b>		
Trust income	469	481
Service charges and fees	946	935
Net gain on sales of securities	77	-
Insurance agency income	419	366
Bank owned life insurance income	153	158
Gains from sales of mortgage loans	30	137
Other operating income	89	53
TOTAL NON-INTEREST INCOME	2,183	2,130
<b>NON-INTEREST EXPENSE:</b>		
Salaries and wages	2,401	2,352

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Pension and other employee benefits	631	662
Equipment expenses	209	244
Occupancy expense, net	524	482
State franchise tax	186	162
Marketing	79	113
Intangible amortization	27	28
FDIC insurance premiums	218	25
Write-off of pension asset	-	722
Other non-interest expense	1,245	1,127
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>5,520</b>	<b>5,917</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>2,886</b>	<b>1,994</b>
PROVISION FOR INCOME TAXES	674	431
<b>NET INCOME</b>	<b>2,212</b>	<b>1,563</b>
PREFERRED STOCK DIVIDENDS AND DISCOUNT ACCRETION	-	102
<b>NET INCOME AVAILABLE TO COMMON SHAREHOLDERS</b>	<b>\$ 2,212</b>	<b>1,461</b>
Dividends declared per common share	\$ 0.16	0.16
Earnings per common share:		
Basic	\$ 0.33	0.22
Diluted	0.33	0.22
Weighted average common shares outstanding:		
Basic	6,687,232	6,687,232
Diluted	6,729,790	6,687,232

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

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

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2010	2009
Net Income	\$ 2,212	1,563
Other comprehensive income:		
Net unrealized gain (loss) on available-for-sale securities (net of taxes of \$181 and \$53 for the three months ended March 31, 2010 and 2009, respectively)	351	(102)
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of taxes of \$26)	(51)	-
Reversal of pension plan unrecognized net loss (net of taxes of \$1,564)	-	3,037
Total comprehensive income	\$ 2,512	4,498

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



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

(Dollars in thousands, except per share amounts)

(Unaudited)

	Common Shares Outstanding	Preferred Stock	Common Stock	Surplus	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance January 1, 2010	6,687,232	-	11,068	15,407	48,962	(11,737)	1,915	65,615
Net income					2,212			2,212
Net unrealized gain on available-for-sale securities, net of tax							300	300
Compensation expense relating to stock options				9				9
Common stock dividends, \$0.16 per share					(1,070)			(1,070)
Balance March 31, 2010	6,687,232	-	11,068	15,416	50,104	(11,737)	2,215	67,066
Balance January 1, 2009	6,687,232	-	11,068	14,792	46,584	(11,737)	(2,591)	58,116
Net income					1,563			1,563
Issuance of preferred stock and related warrant		12,817		583				13,400
Net unrealized loss on available-for-sale securities, net of tax							(102)	(102)
Reversal of pension plan unrecognized net loss, net of tax							3,037	3,037

Compensation expense relating to								
stock options				6				6
Preferred stock dividends and								
discount accretion	35			(102)				(67)
Common stock dividends, \$0.16 per share				(1,069)				(1,069)
Balance March 31, 2009	6,687,232	\$ 12,852	11,068	15,381	46,976	(11,737)	344	74,884

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

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

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 2,212	1,563
Adjustments to reconcile net income to net cash flows from operating activities-		
Depreciation, amortization and accretion	631	482
Provision for loan losses	208	98
Increase in cash surrender value of bank owned life insurance	(153)	(158)
Realized (gain) loss on sales of securities available-for-sale	(77)	-
Realized (gain) loss on sales of premises and equipment	(4)	(18)
Origination of mortgage loans for sale	(1,600)	(10,034)
Realized gains from sales of mortgage loans	(30)	(137)
Proceeds from sales of mortgage loans	1,613	10,070
Compensation expense related to stock options	9	6
Increase (decrease) due to changes in assets and liabilities:		
Income receivable	(149)	(373)
Other assets	(221)	(1,106)
Other liabilities	28	1,360
NET CASH FLOWS FROM OPERATING ACTIVITIES	2,467	1,753
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sales of investment securities available-for-sale	5,342	-
Proceeds from maturities of investment securities:		
Available-for-sale	16,875	30,764
Held-to-maturity	516	80

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Purchases of investment securities:		
Available-for-sale	(5,324)	(68,560)
Held-to-maturity	(1,373)	(2,849)
Net decrease in loans	259	7,423
Proceeds from sale of repossessed assets	61	59
Purchases of premises and equipment	(87)	(292)
Proceeds from sales of premises and equipment	4	18
<b>NET CASH FLOWS FROM INVESTING</b>	<b>16,273</b>	<b>(33,357)</b>
<b>ACTIVITIES</b>		

**CASH FLOWS FROM FINANCING**  
**ACTIVITIES:**

Net increase in deposits	7,000	12,647
Net decrease in short-term borrowings	(9,157)	(1,443)
Proceeds from long-term debt	-	15,000
Principal payments on long-term debt	(807)	-
Proceeds from issuance of preferred stock	-	13,400
Cash dividends paid on common stock	(1,070)	(1,069)
Cash dividends paid on preferred stock	-	(67)
<b>NET CASH FLOWS FROM FINANCING</b>	<b>(4,034)</b>	<b>38,468</b>
<b>ACTIVITIES</b>		

<b>NET CHANGE IN CASH AND CASH</b>	<b>14,706</b>	<b>6,864</b>
<b>EQUIVALENTS</b>		

<b>CASH AND CASH EQUIVALENTS AT</b>	<b>12,626</b>	<b>18,020</b>
<b>BEGINNING OF PERIOD</b>		

<b>CASH AND CASH EQUIVALENTS AT END OF</b>	<b>\$ 27,332</b>	<b>24,884</b>
<b>PERIOD</b>		

**SUPPLEMENTAL CASH FLOW**  
**INFORMATION:**

**CASH PAID DURING THE YEAR FOR:**

Interest	\$ 2,186	2,787
Income taxes	315	-

**SUPPLEMENTAL DISCLOSURE OF**  
**NONCASH INVESTING ACTIVITIES:**

Investment securities transferred from available-for-sale to held-to-maturity	-	1,944
Transfer from loans to other real estate owned and repossessed assets	125	7



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

**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1 - Basis of Presentation**

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

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

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

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

Results of operations for the three months ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year ending December 31, 2010. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, accounting policies and financial notes thereto included in LCNB's 2009 Annual Report on Form 10-K filed with the SEC.



## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 2 - Investment Securities**

The amortized cost and fair value of available-for-sale investment securities at March 31, 2010 and December 31, 2009 are summarized as follows (in thousands):

	March 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury notes	\$ 13,248	10	20	13,238
U.S. Agency notes	35,828	238	-	36,066
U.S. Agency mortgage-backed securities	45,590	1,245	30	46,805
Corporate securities	5,931	60	-	5,991
Municipal securities:				
Non-taxable	70,632	1,931	38	72,525
Taxable	9,127	227	-	9,354
Other debt securities	547	-	-	547
Trust preferred securities	298	52	-	350
Equity securities	63	7	-	70
	\$ 181,264	3,770	88	184,946

	December 31, 2009			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury notes	\$ 13,288	49	29	13,308
U.S. Agency notes	45,931	207	250	45,888
U.S. Agency mortgage-backed securities	48,650	1,093	119	49,624

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Corporate securities	8,450	64	26	8,488
Municipal securities:				
Non-taxable	72,002	2,056	36	74,022
Taxable	9,127	176	2	9,301
Other debt securities	542	-	4	538
Trust preferred securities	298	46	-	344
Equity securities	62	3	-	65
	\$ 198,350	3,694	466	201,578

The fair value of held-to-maturity investment securities, consisting of non-taxable municipal securities, approximates amortized cost at March 31, 2010 and December 31, 2009.

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 2 - Investment Securities (continued)**

Information concerning securities with gross unrealized losses at March 31, 2010, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	<u>March 31, 2010</u>			
	Less than Twelve Months		Twelve Months or Greater	
	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses
U.S. Treasury notes	\$ 10,564	20	-	-
U.S. Agency mortgage-				
backed securities	7,243	30	42	-
Municipal securities	2,941	33	435	5
	\$ 20,748	83	477	5

The unrealized losses at March 31, 2010 are primarily due to increases in market interest rates. Because LCNB does not have the intent to sell the investments and it is more likely than not that LCNB will not be required to sell the investments before recovery of their amortized cost bases, which may be maturity, LCNB does not consider these investments to be other-than-temporarily impaired.

**Note 3 - Loans**

Major classifications of loans at March 31, 2010 and December 31, 2009 are as follows (in thousands):

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	March 31, 2010	December 31, 2009
Commercial and industrial	\$ 44,092	42,807
Commercial, secured by real estate	187,593	185,024
Residential real estate	191,771	193,293
Consumer	23,792	26,185
Agricultural	2,648	3,125
Other loans, including deposit overdrafts	9,441	9,422
	459,337	459,856
Deferred net origination costs	492	560
	459,829	460,416
Less allowance for loan losses	3,060	2,998
Loans, net	\$ 456,769	457,418

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 3 Loans (continued)**

Changes in the allowance for loan losses for the three months ended March 31, 2010 and 2009 were as follows (in thousands):

	Three Months Ended March 31,	
	2010	2009
Balance, beginning of year	\$ 2,998	2,468
Provision for loan losses	208	98
Charge-offs	(205)	(197)
Recoveries	59	99
Net charge-offs	(146)	(98)
Balance, end of period	\$ 3,060	2,468

Charge-offs for the three months ended March 31, 2010 and 2009 primarily consisted of consumer loans and checking and NOW account overdrafts.

Non-accrual, past-due, and restructured loans as of March 31, 2010 and December 31, 2009 were as follows (in thousands):

March 31, 2010	December 31, 2009
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Non-accrual loans	\$ 3,370	2,939
Past-due 90 days or more and still accruing	547	924
Restructured loans	7,120	7,173
Total	\$ 11,037	11,036
Percent to total loans	2.40%	2.40%

Non-accrual loans at March 31, 2010 were \$431,000 greater than at December 31, 2009 and loans past-due 90 days or more and still accruing decreased \$377,000 primarily due to the reclassification of three loans to the same borrower from past-due 90 days or more and still accruing at December 31, 2009 to non-accrual at March 31, 2010.

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 3 Loans (continued)**

The following is a summary of information pertaining to loans considered to be impaired at March 31, 2010 and December 31, 2009 (in thousands):

		March 31, 2010	December 31, 2009
Impaired loans without a valuation allowance	\$	7,728	6,927
Impaired loans with a valuation allowance		3,225	3,249
Total impaired loans		10,953	10,176
Valuation allowance related to impaired loans	\$	944	858

Other real estate owned (which includes property acquired through foreclosure or deed-in-lieu of foreclosure and also includes property deemed to be in-substance foreclosed) and other repossessed assets, which are included in other assets in the consolidated balance sheets, totaled approximately \$2,554,000 at March 31, 2010, compared to \$2,470,000 at December 31, 2009. Other real estate owned increased primarily due to the transfer of a residential real estate property into this category during the first quarter 2010.

Loans sold to and serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of those loans at March 31, 2010 and December 31, 2009 were \$57,196,000 and \$57,369,000, respectively. Loans sold to the Federal Home Loan Mortgage Corporation during the three months ended March 31, 2010 and 2009 totaled \$1,600,000 and \$10,034,000, respectively. The decrease in the amount of mortgage loans sold is primarily due to an above average number of refinanced loans during the first quarter 2009 resulting from a general decline in market interest rates during that period.



## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 4 Borrowings**

Funds borrowed from the Federal Home Loan Bank of Cincinnati at March 31, 2010 and December 31, 2009 are as follows (in thousands):

	Current Interest Rate	March 31, 2010	December 31, 2009
Fixed Rate Advances, due at maturity:			
Advance due February 2011	2.10%	\$ 5,000	5,000
Advance due August 2012	1.99%	6,000	6,000
Advance due March 2017	5.25%	5,000	5,000
Fixed Rate Advances, with monthly principal and interest payments:			
Advance due March 2014	2.45%	4,048	4,288
Advance due March 2019	2.82%	4,105	4,672
		\$ 24,153	24,960

All advances from the Federal Home Loan Bank of Cincinnati are secured by a blanket pledge of LCNB's 1-4 family first lien mortgage loans in the amount of approximately \$148 million and \$149 million at March 31, 2010 and December 31, 2009, respectively. Additionally, LCNB was required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

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

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	March 31, 2010		December 31, 2009	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
U.S. Treasury demand note	\$ 601	-%	457	-%
Federal funds purchased	-	-%	7,000	0.50%
Line of credit	-	-%	3,173	1.00%
Repurchase agreements	4,507	0.40%	3,635	0.40%
	\$ 5,108	0.35%	14,265	0.57%

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 5 - Commitments and Contingent Liabilities**

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

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

LCNB uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Financial instruments whose contract amounts represent off-balance-sheet credit risk at March 31, 2010 and December 31, 2009 were as follows (in thousands):

	March 31, 2010	December 31, 2009
Commitments to extend credit:		
Commercial loans	\$ 3,830	10,020
Other loans:		
Fixed rate	1,246	359
Adjustable rate	1,265	537
Unused lines of credit:		
Fixed rate	4,144	4,168
Adjustable rate	70,787	69,974
Unused overdraft protection amounts on		
demand and NOW accounts	10,174	10,205
Standby letters of credit	7,096	7,273
	\$ 98,542	102,536

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Unused lines of credit include amounts not drawn in line of credit loans. Commitments to extend credit and unused lines of credit generally have fixed expiration dates or other termination clauses.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. At March 31, 2010 and December 31, 2009, outstanding guarantees of approximately \$1,566,000 and \$1,744,000, respectively, were issued to developers and contractors. These guarantees generally are fully secured and have varying maturities. In addition, LCNB has a participation in a letter of credit securing payment of principal and interest on a bond issue. The participation amount at March 31, 2010 and December 31, 2009 was approximately \$5.5 million. The agreement has a final maturity date of January 2012.

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

**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**Note 5 - Commitments and Contingent Liabilities (continued)**

Commitments for capital expenditures outstanding as of March 31, 2010 totaled approximately \$120,000.

Management believes that LCNB has sufficient liquidity to fund its lending and capital expenditure commitments.

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

**Note 6 Regulatory Capital**

On January 9, 2009, LCNB received \$13.4 million of new equity capital from the U.S. Department of the Treasury's Capital Purchase Program (the CPP) established under the Emergency Economic Stabilization Act of 2008. The investment by the Treasury Department was comprised of \$13.4 million in preferred shares, with a warrant to purchase 217,063 common shares of LCNB at an exercise price of \$9.26, with a term of ten years. The preferred shares were scheduled to pay a dividend of 5% per year for the first five years and 9% thereafter. Participation in the CPP was voluntary and participating institutions were required to comply with a number of restrictions and provisions, including, but not limited to, restrictions on compensation of certain executive officers and limitations on stock repurchase activities and dividend payments.

On October 21, 2009, LCNB entered into a repurchase agreement with the Treasury Department pursuant to which it redeemed all 13,400 shares of its preferred shares. In connection with this redemption, LCNB paid approximately \$13.5 million to the Treasury Department, which included the original investment amount of \$13.4 million plus accrued and unpaid dividends of approximately \$123,000.



LCNB did not repurchase the warrant issued to the Treasury Department as part of the CPP. Pursuant to the terms of the repurchase agreement, the warrant has been cancelled and LCNB has issued a substitute warrant to the Treasury Department with the same terms as the original warrant, except that Section 13(H) of the original warrant, which related to the reduction of shares subject to the warrant in the event that LCNB raised \$13.4 million in a qualified stock offering prior to December 31, 2009, has been removed. The substitute warrant remains outstanding at March 31, 2010.

On April 20, 2010, LCNB obtained shareholder approval to increase the number of authorized common shares to 12,000,000.

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 6 Regulatory Capital (continued)**

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

For various regulatory purposes, financial institutions are classified into categories based upon capital adequacy. The highest "well-capitalized" category requires capital ratios of at least 10% for total risk-based, 6% for Tier 1 risk-based, and 5% for leverage. As of the most recent notification from their regulators, the Bank and LCNB were categorized as "well-capitalized" under the regulatory framework for prompt corrective action. Management believes that no conditions or events have occurred since the last notification that would change the Bank's or LCNB's category. A summary of the regulatory capital and capital ratios of LCNB follows (dollars in thousands):

	At March 31, 2010	At December 31, 2009
Regulatory Capital:		
Shareholders' equity	\$ 67,066	65,615
Goodwill and other intangibles	(6,479)	(6,507)
Accumulated other comprehensive income	(2,215)	(1,915)
Tier 1 risk-based capital	58,372	57,193
Eligible allowance for loan losses	3,060	2,998
Total risk-based capital	\$ 61,432	60,191

Capital ratios:

Total risk-based (8% required)	13.01%	12.68%
Tier 1 risk-based (4% required)	12.36%	12.04%
Leverage (3% required)	7.95%	7.77%

**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**Note 7 Employee Benefits**

LCNB has a noncontributory defined benefit retirement plan that covers substantially all regular full-time employees hired before January 1, 2009. Effective January 1, 2009, LCNB redesigned its noncontributory defined benefit retirement plan and merged its single-employer plan 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. Accordingly, the assets and obligations of the single-employer plan were transferred to the multiple-employer plan in January 2009. At that time, the pension plan related balance sheet accounts were adjusted resulting in an approximate \$3.0 million increase in other comprehensive income and a \$722,000 charge to non-interest expense in the consolidated statements of income. Employees hired on or after January 1, 2009 are not eligible to participate in this plan.

Effective February 1, 2009, LCNB 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 Internal Revenue Code 401(k) plan (the 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 LCNB 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 do not receive any employer matches to their 401(k) contributions.

Funding and administrative costs of the qualified noncontributory defined benefit retirement plan charged to pension and other employee benefits in the consolidated statements of income for the three months ended March 31, 2010 and 2009 were \$60,000 and \$64,000, respectively. Employer expense incurred in connection with the 401(k) plan during the three months ended March 31, 2010 and 2009 were \$74,000 and \$60,000 respectively.

Effective February 1, 2009, LCNB established a nonqualified defined benefit retirement plan 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 three months ended March 31, 2010 are summarized as follows (000 s):

Service cost	\$	43
Interest cost		8
Amortization of unrecognized prior service cost		12
Net periodic pension cost	\$	63

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## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 8 - Stock Based Compensation**

Under the Ownership Incentive Plan (the "Plan"), LCNB may grant stock-based awards to eligible employees. The awards may be in the form of stock options, share awards, and/or appreciation rights. The Plan provides for the issuance of up to 200,000 common shares.

Options granted to date vest ratably over a five year period and expire ten years after the date of grant. Stock options outstanding at March 31, 2010 were as follows:

Expiration <u>Date</u>	<u>Number</u>	Outstanding		Exercisable		<u>Number Exercised</u>
		<u>Weighted Average Exercise Price</u>		<u>Weighted Average Exercise Price</u>		
Feb 2013	11,056	\$ 13.09		11,056	\$ 13.09	-
Jan 2014	8,108	17.66		8,108	17.66	-
Jan 2016	7,934	18.95		6,347	18.95	-
Feb 2017	8,116	17.88		4,870	17.88	-
Feb 2018	13,918	12.55		5,567	12.55	-
Jan 2019	29,110	9.00		5,822	9.00	-
Feb 2020	20,798	11.50		-	11.50	-
	99,040	12.71		41,770	14.78	-

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

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	Three Months ended March 31,			
	2010		2009	
		Weighted Average Exercise <u>Price</u>		Weighted Average Exercise <u>Price</u>
	<u>Options</u>		<u>Options</u>	
Outstanding, January 1,	78,242	\$13.04	49,132	\$15.43
Granted	20,798	11.50	29,110	9.00
Exercised	-	-	-	-
Outstanding, March 31,	99,040	12.71	78,242	13.04
Exercisable, March 31,	41,770	14.78	29,954	15.73

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 March 31, 2010 that were in the money (market price greater than exercise price) was \$98,000. The aggregate intrinsic value at that date for only the options that were exercisable was \$17,000. The intrinsic value changes based on changes in the market value of LCNB's stock.

**LCNB CORP. AND SUBSIDIARIES**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 8 - Stock Based Compensation (continued)**

The estimated weighted-average fair value of the options granted in the first quarter of 2010 and 2009 were \$2.27 and \$1.89 per option, respectively. The fair value was estimated at the dates of grant using the Black-Scholes option-pricing model and the following assumptions:

	<u>2010</u>	<u>2009</u>
Risk-free interest rate	3.34%	3.49%
Average dividend yield	4.31%	4.04%
Volatility factor of the expected market price of LCNB's common stock	28.32%	27.54%
Average life in years	7.0	9.0

Total expense related to options included in salaries and wages in the consolidated statements of income for the three months ended March 31, 2010 and 2009 was \$9,000 and \$6,000, respectively.

A total of 2,511 restricted shares were granted in February 2010. These shares will vest in November 2010. Until they vest, they are restricted from sale, transfer, or assignment in accordance with the terms of the agreement under which they were issued. Compensation cost for restricted stock grants are calculated using the fair value of LCNB's common stock and the number of shares issued. No restricted shares were granted prior to February 2010.



## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 9 - Earnings Per Common Share**

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is adjusted for the dilutive effects of stock options, warrant, and restricted stock. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock options, warrant, and restricted stock with proceeds used to purchase treasury shares at the average market price for the period. The computations were as follows for the three months ended March 31, 2010 and 2009 (dollars in thousands, except share and per share data):

	For the Three Months Ended March 31,	
	2010	2009
Net income available to common shareholders	\$ 2,212	1,461
Weighted average number of shares outstanding used in the calculation of basic earnings per common share	6,687,232	6,687,232
Add dilutive effect of:		
Stock options	2,207	-
Restricted stock	1,060	-
Stock warrant	39,291	-
	42,558	-
Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share	6,729,790	6,687,232
Basic earnings per common share	\$ 0.33	0.22
Diluted earnings per common share	\$ 0.33	0.22



**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**Note 10- Fair Value of Financial Instruments**

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

•

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

•

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

•

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

The majority of LCNB's 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. Fair value for U.S. Treasury notes and corporate securities are determined based on market quotations (level 1). Fair value for most of the other investment securities is 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. In addition, approximately \$547,000 is invested in a mutual fund. LCNB uses the fair value estimate provided by the mutual fund company, which uses market quotations when such quotes are available and good faith judgment when market quotations are not available. Because LCNB does not know the portion of the mutual fund valued using market quotations and the portion valued using good faith judgment, the entire investment in the mutual fund has been measured using level 3 inputs. Additionally, Dakin owns stock in an insurance company and LCNB Corp. owns trust preferred securities in various financial institutions. Market quotations (level 1) are used to determine fair value for these investments. Dakin also owns stock in another insurance agency. A market does not exist for the other insurance agency's stock. This stock is considered to have level 3 inputs.

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 10- Fair Value of Financial Instruments (continued)**

The following table summarizes the valuation of LCNB's available-for-sale securities by input levels as of March 31, 2010 and December 31, 2009 (in thousands):

	Fair Value Measurements	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>March 31, 2010</u>				
Available-for-sale securities:				
U.S. Treasury notes	\$ 13,238	13,238	-	-
U.S. Agency notes	36,066	-	36,066	-
U.S. Agency mortgage-				
backed securities	46,805	-	46,805	-
Corporate securities	5,991	5,991	-	-
Municipal securities:				
Non-taxable	72,525	-	72,525	-
Taxable	9,354	-	9,354	-
Other debt securities	547	-	-	547
Trust preferred securities	350	350	-	-
Equity securities	70	47	-	23
Totals	\$ 184,946	19,626	164,750	570

December 31, 2009

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Available-for-sale  
securities:

U.S. Treasury notes	\$ 13,308	13,308	-	-
U.S. Agency notes	45,888	-	45,888	-
U.S. Agency mortgage-				
backed securities	49,624	-	49,624	-
Corporate securities	8,488	8,488	-	-
Municipal securities:				
Non-taxable	74,022	-	74,022	-
Taxable	9,301	-	9,301	-
Other debt securities	538	-	-	538
Trust preferred securities	344	344	-	-
Equity securities	65	42	-	23
Totals	\$ 201,578	22,182	178,835	561

## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 10- Fair Value of Financial Instruments (continued)**

The following table is a reconciliation of the beginning and ending balances of recurring fair value measurements that use significant unobservable inputs (level 3) for the three months ended March 31, 2010 (in thousands):

	<u>Total</u>	Other Debt <u>Securities</u>	Equity <u>Securities</u>
Beginning balance	\$ 561	538	23
Purchases	-	-	-
Dividends reinvested	5	5	-
Net change in unrealized gains (losses)			
included in other comprehensive income	4	4	-
Ending balance	\$ 570	547	23

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. When the fair value of the collateral is based on an observable market price or current appraised value, the inputs are considered to be level 2.

When an appraised value is not available and there is not an observable market price, 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. The inputs for a valuation based on current appraised value are considered to be level 2.





## LCNB CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

**Note 10- Fair Value of Financial Instruments (continued)**

The table below presents LCNB's impaired loans, other real estate owned, and repossessed assets measured at fair value on a nonrecurring basis as of March 31, 2010 and December 31, 2009 by the level in the fair value hierarchy within which those measurements fall (in thousands):

	Fair Value Measurements	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>March 31, 2010</u>				
Impaired loans	\$ 2,281	-	83	2,198
Other real estate owned	2,513	-	2,513	-
Repossessed assets	41	-	-	41
Totals	\$ 4,835	-	2,596	2,239
<u>December 31, 2009</u>				
Impaired loans	\$ 2,391	-	-	2,391
Other real estate owned	2,424	-	2,424	-
Repossessed assets	46	-	-	46
Totals	\$ 4,861	-	2,424	2,437

Carrying amounts and estimated fair values of financial instruments as of March 31, 2010 and December 31, 2009 were as follows (in thousands):

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	March 31, 2010		December 31, 2009	
	Carrying	Fair	Carrying	Fair
	<u>Amount</u>	<u>Value</u>	<u>Amount</u>	<u>Value</u>
<b>FINANCIAL ASSETS:</b>				
Cash and cash equivalents	\$ 27,332	27,332	12,626	12,626
Securities available-for-sale	184,946	184,946	201,578	201,578
Securities held-to-maturity	13,887	13,887	13,030	13,030
Federal Reserve Bank and				
Federal Home Loan Bank stock	3,031	3,031	3,031	3,031
Loans, net	456,769	466,693	457,418	467,226
<b>FINANCIAL LIABILITIES:</b>				
Deposits	631,179	633,762	624,179	627,536
Short-term borrowings	5,108	5,108	14,265	14,265
Long-term debt	24,153	25,392	24,960	26,266

**LCNB CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**Note 10- Fair Value of Financial Instruments (continued)**

The fair value of off-balance-sheet financial instruments at March 31, 2010 and December 31, 2009 was not material.

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

*Cash and cash equivalents*

The carrying amounts presented are deemed to approximate fair value.

*Investment securities*

Fair values for securities, excluding Federal Home Loan Bank and Federal Reserve Bank stock, are based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities and/or discounted cash flow analyses or other methods. 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.

*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.

*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.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

LCNB Corp. and subsidiaries

Lebanon, Ohio

We have reviewed the accompanying consolidated balance sheet of LCNB Corp. and subsidiaries as of March 31, 2010, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the three-month periods ended March 31, 2010 and 2009. These interim financial statements are the responsibility of the Company's management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of LCNB Corp. and subsidiaries as of December 31, 2009, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated February 22, 2010, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2009, is fairly stated in all material respects, in relation to the consolidated balance sheet from which it has been derived.

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

Cincinnati, Ohio

May 3, 2010

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**LCNB CORP. AND SUBSIDIARIES**

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

**Forward Looking Statements**

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

**Results of Operations**

LCNB's net income available to common shareholders for the three months ended March 31, 2010 was \$2,212,000 or \$0.33 basic and diluted earnings per common share, compared to \$1,461,000 or \$0.22 basic and diluted earnings per common share for the three months ended March 31, 2009. Affecting net income to common shareholders and earnings per common share was an increase in net interest income and a decrease in non-interest expense, offset by an increase in the provision for loan losses. Negatively affecting net income available to common shareholders during 2009 were preferred stock dividends paid and related discount accretion recorded in connection with the preferred shares and warrant issued under the U.S. Department of the Treasury's Capital Purchase Program (the CPP) on January 9, 2009. LCNB did not have these costs during 2010 because the preferred stock was redeemed from the U.S. Department of the Treasury in October 2009.

Net interest income increased during the three month period in 2010 compared to 2009 primarily because of growth in interest earning assets and a general decline in market interest rates. Non-interest expense during the three month period in 2010 was less than the comparable period in 2009 because of the absence of a pension-related charge recognized by LCNB during the first quarter 2009. This decrease was partially offset by increases in FDIC insurance expense and other smaller miscellaneous increases.

Current economic conditions have contributed to an increase in loan delinquencies, but LCNB's loan portfolio continues to benefit from responsible underwriting and lending practices. Net charge-offs for the first quarter of 2010 and 2009 totaled \$146,000 and \$98,000, respectively. Non-accrual loans and loans past due 90 days or more and still

accruing interest totaled \$3,917,000 or 0.85% of total loans at March 31, 2010, compared to \$3,863,000 or 0.84% of total loans at December 31, 2009. Other real estate owned (which includes property acquired through foreclosure or deed-in-lieu of foreclosure and also includes property deemed to be in-substance foreclosed) and other repossessed assets totaled approximately \$2,554,000 at March 31, 2010, compared to \$2,470,000 at December 31, 2009.

**Net Interest Income**

LCNB's primary source of earnings is net interest income, which is the difference between earnings from loans and other investments and interest paid on deposits and other liabilities. The following table presents, for the three months ended March 31, 2010 and 2009, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resultant average yields earned or rates paid.



## LCNB CORP. AND SUBSIDIARIES

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

## Operations (continued)

	Three Months Ended March 31,					
	Average Outstanding Balance	2010 Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	2009 Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Loans (1)	\$ 458,503	6,822	6.03%	\$ 450,065	\$ 6,876	6.20%
Federal funds sold and interest-bearing						
demand deposits	10,105	8	0.32%	19,184	12	0.25%
Federal Reserve Bank stock	940	-	-%	937	-	-%
Federal Home Loan Bank stock	2,091	24	4.65%	2,091	24	4.65%
Investment securities:						
Taxable	118,537	931	3.19%	101,365	1,071	4.29%
Non-taxable (2)	86,068	1,224	5.77%	65,649	945	5.84%
Total	676,244	9,009	5.40%	639,291	8,928	5.66%
interest-earning assets						
Non-earning assets	70,885			54,929		
Allowance for loan losses	(3,003)			(2,477)		
Total assets	\$ 744,126			\$ 691,743		
Interest-bearing deposits	\$ 547,394	1,976	1.46%	515,996	2,621	2.06%
Short-term borrowings	8,000	9	0.46%	746	-	-%
Long-term debt	24,574	177	2.92%	12,167	107	3.57%
Total	579,968	2,162	1.51%	528,909	2,728	2.09%
interest-bearing liabilities						
Demand deposits	91,687			84,144		

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Other liabilities	5,356			3,893
Capital	67,115			74,797
Total liabilities and capital	\$ 744,126			\$ 691,743
Net interest rate spread (3)		3.89%		3.57%
Net interest income and net interest margin on a tax-equivalent basis (4)		6,847	4.11%	\$ 6,200
				3.93%
Ratio of interest-earning assets to interest-bearing liabilities	116.60%			120.87%

(1)

Includes nonaccrual loans if any.

(2)

Income from tax-exempt securities is included in interest income on a tax-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 rate spread is the difference between the average rate on total interest-earning assets and interest-bearing liabilities.

(4)

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

## LCNB CORP. AND SUBSIDIARIES

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

The following table presents the changes in tax-equivalent interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the three months ended March 31, 2010 as compared to the same period in 2009. Changes not solely attributable to rate or volume have been allocated to volume and rate changes in proportion to the relationship of absolute dollar amounts of the changes in each.

	Three Months Ended March 31, 2010 vs. 2009 Increase (decrease) due to:		
	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
	(In thousands)		
<b>Interest-earning Assets:</b>			
Loans	\$ 128	(182)	(54)
Federal funds sold and interest-			
bearing demand deposits	(7)	3	(4)
Investment securities:			
Taxable	163	(303)	(140)
Nontaxable	291	(12)	279
Total interest income	575	(494)	81
<b>Interest-bearing Liabilities:</b>			
Deposits	151	(796)	(645)
Short-term borrowings	-	9	9
Long-term debt	92	(22)	70
Total interest expense	243	(809)	(566)
Net interest income	\$ 332	315	647

Net interest income on a tax-equivalent basis for the three months ended March 31, 2010 totaled \$6,847,000, an increase of \$647,000 from the comparable period in 2009. Total tax-equivalent interest income increased \$81,000 and total interest expense decreased \$566,000.

The increase in total interest income was primarily due to a \$37.0 million increase in average total earning assets, partially offset by a 26 basis point (a basis point equals 0.01%) decrease in the average rate earned on earning assets. The increase in average interest earning assets was primarily due to a \$37.6 million increase in average investment securities. The decrease in the average rate earned reflects a general decrease in market rates.

The decrease in total interest expense was primarily due to a 58 basis point decrease in the average rate paid on interest-bearing liabilities, partially offset by a \$51.1 million increase in average interest-bearing liabilities. The increase in average interest-bearing liabilities was primarily due to a \$31.4 million increase in average interest-bearing deposits and a \$12.4 million increase in average long-term borrowings. The decrease in the average rate paid also reflects a general decrease in market rates.

**LCNB CORP. AND SUBSIDIARIES**

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

**Operations (continued)**

**Provision and Allowance for Loan Losses**

The total provision for loan losses is determined based upon management's evaluation as to the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, and current economic conditions that may affect borrowers' ability to pay. The provision for loan losses for the three months ended March 31, 2010 and 2009 was \$208,000 and \$98,000, respectively. The increase in the provision reflects an increase in non-accrual and delinquent loans, the net charge-off trend, and current economic conditions.

**Non-Interest Income**

Total non-interest income for the first quarter 2010 was \$53,000 greater than for the first quarter 2009. This increase is primarily due to a \$53,000 increase in insurance agency income, a \$77,000 increase in gains from sales of securities, and a \$65,000 increase in check card income (included with service charges and fees). These increases were partially offset by \$107,000 decrease in gains from sales of mortgage loans and a \$67,000 decrease in overdraft fees (included with service charges and fees). Insurance agency income increased due to a \$23,000 increase in contingency commissions and an increase in commission income reflecting the sales of new policies. Contingency commissions are profit-sharing arrangements on property and casualty policies between the originating agency and the underwriter and are generally based on underwriting results and written premium. As such, the amount received each year can vary significantly depending on loss experience. Gains from the sale of mortgage loans decreased due to a lesser volume of loans sold during the first quarter 2010 as compared to the first quarter 2009. A general decline in market interest rates created an increased demand for refinanced loans during 2009. Loans sold during the first quarter 2010 totaled \$1,600,000 compared to \$10.0 million of loan sales during the 2009 period. The increase in check card income and the decrease in overdraft fees both reflect continuing historical trends.

**Non-Interest Expense**

Non-interest expense for the first quarter 2010 was \$397,000 less than for the first quarter 2009 due to a \$722,000 one-time pension plan related charge recognized during the first quarter 2009. The remaining \$325,000 increase was largely due to a \$193,000 increase in FDIC insurance premium expense and other smaller miscellaneous increases.

During the first quarter 2009, LCNB redesigned its retirement program to provide competitive benefits to employees and provide more predictable and lower retirement plan costs over the long term. Retirement plan changes include an

enhanced 401(k) plan, reduced pension plan benefits for employees whose age and vesting service do not meet certain thresholds, and merging LCNB's single-employer pension plan into a multiple-employer plan. At the time the single-employer pension plan was merged into the multiple-employer plan, pension plan related balance sheet accounts were adjusted, resulting in an approximate \$3.0 million after-tax increase in other comprehensive income and a \$722,000 charge to non-interest expense (\$477,000 on an after-tax basis).

**LCNB CORP. AND SUBSIDIARIES**

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

**Operations (continued)**

**Income Taxes**

LCNB's effective tax rates for the three months ended March 31, 2010 and 2009 were 23.4% and 21.6%, respectively. The difference between the statutory rate of 34.0% and the effective tax rate is primarily due to tax-exempt interest income from municipal securities and tax-exempt income from bank owned life insurance.

**Financial Condition**

Total assets at March 31, 2010 were \$1.3 million less than at December 31, 2009. The decrease in total assets is primarily due to the decrease of investment securities of \$15.8 million, which was partially offset by an increase in cash and cash equivalents of \$14.7 million. Proceeds received from maturities and calls of investment securities were not replaced with new securities in order to build liquidity for anticipated future needs.

Net loans decreased \$739,000 primarily due to a \$2.4 million decrease in consumer loans and a \$1.5 million decrease in residential real estate loans. These decreases were largely offset by a total increase of \$3.9 million in commercial real estate and commercial and industrial loans. Consumer loans decreased due to weak demand for new loans and residential real estate loans decreased because the majority of loans originated during the first quarter were sold to the Federal Home Loan Mortgage Corporation. Residential mortgage loan sales for the first quarter 2010 totaled \$1.6 million. In an effort to increase the volume of residential mortgage loans originated, management initiated a no closing costs special promotion in April 2010.

Total deposits were \$7.0 million greater at March 31, 2010 than at December 31, 2009, primarily due to a \$5.7 million increase in public fund deposits by local government entities. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities. LCNB believes that much of the increase during the first quarter was due to seasonal property and other tax receipts. The remaining deposit growth resulted from increases in NOW, money fund deposit, and savings account product balances, while time deposits decreased by \$2.3 million during this time period. The deposit growth was used to reduce short-term borrowings, which decreased \$9.2 million between March 31, 2010 and December 31, 2009.

**Liquidity**

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



**LCNB CORP. AND SUBSIDIARIES**

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

**Operations (continued)**

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. Asset liquidity is provided by cash and assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash and cash equivalents, interest-bearing deposits in other banks, and securities available for sale. At March 31, 2010, LCNB's liquid assets amounted to \$212.3 million or 29.0% of total assets, a slight decrease from \$214.2 million or 29.2% of total assets at December 31, 2009.

Liquidity is also provided by access to core funding sources, primarily core deposits in the bank's market area. Approximately 79.2% of total deposits at March 31, 2010 were core deposits, compared to 79.8% of deposits at December 31, 2009. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit equal to or greater than \$100,000.

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

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

## LCNB CORP. AND SUBSIDIARIES

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

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

The Bank's Asset and Liability Management Committee ("ALCO") primarily uses a combination of Interest Rate Sensitivity Analysis ( IRSA ) and Economic Value of Equity ( EVE ) analysis for measuring and managing interest rate risk. IRSA is used to estimate the effect on net interest income 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 the down-300 basis points scenario to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the March 31, 2010 IRSA indicates that an increase in interest rates would have a positive effect on net interest income ( NII ), and a decrease in rates would have a negative effect on NII. The changes in NII for all rate assumptions are within LCNB's acceptable ranges.

Rate Shock Scenario in <u>Basis Points</u>		\$ Change in NII (Dollars in thousands)	% Change in NII
	<u>Amount</u>		
Up 300	\$ 26,953	589	2.23%
Up 200	26,679	315	1.19%
Up 100	26,448	84	0.32%
Base	26,364	-	-%
Down 100	26,276	(88)	-0.33%
Down 200	26,321	(43)	-0.16%

IRSA shows the effect on NII during a one-year period only. A long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. The EVE analysis at March 31, 2010 is shown below. It shows a negative effect on the EVE for increases in interest rates and a positive effect for decreases in interest rates. The changes in EVE are within LCNB's acceptable ranges.

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Rate Shock Scenario in <u>Basis Points</u>		\$ Change in	% Change in
	<u>Amount</u>	<u>EVE</u>	<u>EVE</u>
		(Dollars in thousands)	
Up 300	\$ 64,527	(14,474)	-18.32%
Up 200	69,417	(9,584)	-12.13%
Up 100	74,039	(4,962)	-6.28%
Base	79,001	-	-%
Down 100	83,505	4,504	5.70%
Down 200	88,256	9,255	11.72%

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**LCNB CORP. AND SUBSIDIARIES**

**Item 3. Quantitative and Qualitative Disclosures about Market Risks (continued)**

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.

**Item 4. Controls and Procedures**

**a) Disclosure controls and procedures.** The Chief Executive Officer and the Chief Financial Officer have carried out an evaluation of the effectiveness of LCNB's disclosure controls and procedures that ensure that information relating to LCNB required to be disclosed by LCNB in the reports that it files or submits under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based upon this evaluation, these officers have concluded, that as of March 31, 2010, LCNB's disclosure controls and procedures were effective.

**b) Changes in internal control over financial reporting.** During the period covered by this report, there were no changes in LCNB's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, LCNB's internal control over financial reporting.

**Item 4T. Controls and Procedures**

Not applicable; the registrant is an accelerated filer.



**LCNB CORP. AND SUBSIDIARIES**

**PART II -- OTHER INFORMATION**

**Item 1. Legal Proceedings**

Not Applicable

**Item 1A. Risk Factors**

No material changes

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

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

During the period covered by this report, LCNB did not purchase any shares of its equity securities.

**Item 3. Defaults Upon Senior Securities**

Not Applicable

**Item 4. (Removed and Reserved).**

**Item 5. Other Information**

Not Applicable

**LCNB CORP. AND SUBSIDIARIES**

**Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Exhibit Description</u>
3.1	Amended and Restated Articles of Incorporation of LCNB Corp., as amended.
3.2	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).
4.1	Warrant to Purchase Shares of Common Stock of the Registrant, dated January 9, 2009 incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 9, 2009, Exhibit 4.1.
4.2	Letter Agreement, dated as of January 9, 2009 between the Registrant and the U.S. Department of the Treasury, which includes the Securities Purchase Agreement Standard Terms incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 9, 2009, Exhibit 10.1.
4.3	Substitute Warrant to Purchase Shares of Common Stock of the Registrant, dated January 9, 2009 - incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009, Exhibit 4.3.
4.4	Repurchase Letter Agreement, dated as of October 21, 2009 between the Registrant and the U.S. Department of the Treasury incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 21, 2009, Exhibit 10.1.
10.1	LCNB Corp. Ownership Incentive Plan incorporated by reference to Registrant's Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 15, 2002, Exhibit A (000-26121).
10.2	Form of Option Grant Agreement under the LCNB Corp. Ownership Incentive Plan incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, Exhibit 10.2.
10.3	Letter Agreement, dated as of January 9, 2009 between the Registrant and the U.S. Department of the Treasury, which includes the Securities Purchase Agreement Standard Terms incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 9, 2009, Exhibit 10.1.
10.4	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.



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- 10.5 Repurchase Letter Agreement, dated as of October 21, 2009 between the Registrant and the U.S. Department of the Treasury incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 21, 2009, Exhibit 10.1.
- 10.6 Restricted Stock Grant Agreement, dated as of February 22, 2010, between the Registrant and Stephen P. Wilson.

**LCNB CORP. AND SUBSIDIARIES**

**Item 6. Exhibits (continued)**

<u>Exhibit No.</u>	<u>Exhibit Description</u>
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

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

LCNB Corp.

May 3, 2010

/s/ Stephen P. Wilson

Stephen P. Wilson, CEO &

Chairman of the Board of Directors

May 3, 2010

/s/ Robert C. Haines, II

Robert C. Haines, II, Executive Vice President

and Chief Financial Officer