

LCNB CORP
Form 10-Q
August 08, 2017

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

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 001-35292

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)

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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Edgar Filing: LCNB CORP - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The number of shares outstanding of the issuer's common stock, without par value, as of August 7, 2017 was 10,008,122 shares.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

TABLE OF CONTENTS

<u>PART I – FINANCIAL INFORMATION</u>	<u>2</u>
<u>Item 1. Financial Statements</u>	<u>2</u>
<u>CONSOLIDATED CONDENSED BALANCE SHEETS</u>	<u>2</u>
<u>CONSOLIDATED CONDENSED STATEMENTS OF INCOME</u>	<u>3</u>
<u>CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME</u>	<u>4</u>
<u>CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY</u>	<u>5</u>
<u>CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS</u>	<u>6</u>
<u>NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>37</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risks</u>	<u>48</u>
<u>Item 4. Controls and Procedures</u>	<u>49</u>
<u>PART II. OTHER INFORMATION</u>	<u>50</u>
<u>Item 1. Legal Proceedings</u>	<u>50</u>
<u>Item 1A. Risk Factors</u>	<u>50</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>50</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>50</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>50</u>
<u>Item 5. Other Information</u>	<u>50</u>
<u>Item 6. Exhibits</u>	<u>51</u>
<u>SIGNATURES</u>	<u>52</u>

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LCNB CORP. AND SUBSIDIARIES
 CONSOLIDATED CONDENSED BALANCE SHEETS
 (Dollars in thousands, except per share data)

	June 30, 2017 (Unaudited)	December 31, 2016
ASSETS:		
Cash and due from banks	\$19,399	\$ 18,378
Interest-bearing demand deposits	10,568	487
Total cash and cash equivalents	29,967	18,865
Investment securities:		
Available-for-sale, at fair value	328,788	320,659
Held-to-maturity, at cost	38,437	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	823,551	816,228
Premises and equipment, net	34,980	30,244
Goodwill	30,183	30,183
Core deposit and other intangibles	4,202	4,582
Bank owned life insurance	27,604	27,307
Other assets	11,489	11,358
TOTAL ASSETS	\$1,335,571	\$ 1,306,799
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$275,346	\$ 271,332
Interest-bearing	868,574	839,573
Total deposits	1,143,920	1,110,905
Short-term borrowings	31,712	42,040
Long-term debt	402	598
Accrued interest and other liabilities	11,610	10,312
TOTAL LIABILITIES	1,187,644	1,163,855
COMMITMENTS AND CONTINGENT LIABILITIES	—	—
SHAREHOLDERS' EQUITY:		
Preferred shares – no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares – no par value; authorized 19,000,000 shares; issued 10,767,631 and 10,751,652 shares at June 30, 2017 and December 31, 2016, respectively	76,785	76,490
Retained earnings	83,782	80,736
Treasury shares at cost, 753,627 shares at June 30, 2017 and December 31, 2016	(11,665)	(11,665)
Accumulated other comprehensive income (loss), net of taxes	(975)	(2,617)

TOTAL SHAREHOLDERS' EQUITY	147,927	142,944
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,335,571	\$ 1,306,799

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

The consolidated condensed balance sheet as of December 31, 2016 has been derived from the audited consolidated balance sheet as of that day.

Table of Contents

LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
INTEREST INCOME:				
Interest and fees on loans	\$8,823	\$ 8,892	\$17,738	\$ 17,519
Interest on investment securities:				
Taxable	1,149	1,187	2,242	2,376
Non-taxable	795	794	1,594	1,552
Other investments	167	135	224	182
TOTAL INTEREST INCOME	10,934	11,008	21,798	21,629
INTEREST EXPENSE:				
Interest on deposits	846	870	1,689	1,693
Interest on short-term borrowings	12	8	42	22
Interest on long-term debt	3	5	7	17
TOTAL INTEREST EXPENSE	861	883	1,738	1,732
NET INTEREST INCOME	10,073	10,125	20,060	19,897
PROVISION FOR LOAN LOSSES	222	396	237	486
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,851	9,729	19,823	19,411
NON-INTEREST INCOME:				
Trust income	881	837	1,733	1,600
Service charges and fees on deposit accounts	1,312	1,243	2,534	2,436
Net gain on sales of securities	140	279	140	650
Bank owned life insurance income	297	191	486	360
Gains from sales of loans	63	61	102	102
Other operating income	97	139	225	244
TOTAL NON-INTEREST INCOME	2,790	2,750	5,220	5,392
NON-INTEREST EXPENSE:				
Salaries and employee benefits	4,703	4,532	9,229	9,095
Equipment expenses	264	239	475	488
Occupancy expense, net	636	588	1,204	1,157
State franchise tax	286	276	570	557
Marketing	216	201	359	368
Amortization of intangibles	188	188	373	375
FDIC insurance premiums	108	162	212	327
Contracted services	375	223	623	450
Other real estate owned	—	356	5	385
Other non-interest expense	1,835	1,703	3,529	3,558
TOTAL NON-INTEREST EXPENSE	8,611	8,468	16,579	16,760
INCOME BEFORE INCOME TAXES	4,030	4,011	8,464	8,043
PROVISION FOR INCOME TAXES	1,027	1,043	2,215	2,111
NET INCOME	\$3,003	\$ 2,968	\$6,249	\$ 5,932

Edgar Filing: LCNB CORP - Form 10-Q

Dividends declared per common share	\$0.16	\$ 0.16	\$0.32	\$ 0.32
Earnings per common share:				
Basic	\$0.30	\$ 0.30	\$0.62	\$ 0.60
Diluted	0.30	0.29	0.62	0.59
Weighted average common shares outstanding:				
Basic	10,004,422	10,222,024	9,999,765	9,919,070
Diluted	10,011,311	9,940,323	10,007,192	9,969,302

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

Table of Contents

LCNB CORP. AND SUBSIDIARIES
 CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
 (In thousands)
 (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$3,003	\$2,968	\$6,249	\$5,932
Other comprehensive income:				
Net unrealized gain on available-for-sale securities (net of taxes of \$638 and \$742 for the three months ended June 30, 2017 and 2016, respectively, and \$894 and \$2,332 for the six months ended June 30, 2017 and 2016, respectively)	1,206	1,439	1,734	4,526
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of taxes of \$48 and \$95 for the three months ended June 30, 2017 and 2016, respectively, and \$48 and \$221 for the six months ended June 30, 2017 and 2016, respectively)	(92)	(184)	(92)	(429)
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of \$0 and \$14 for the three months ended June 30, 2017 and 2016, respectively, and \$0 and \$28 for the six months ended June 30, 2017 and 2016, respectively)	—	28	—	56
Other comprehensive income, net of tax	1,114	1,283	1,642	4,153
TOTAL COMPREHENSIVE INCOME	\$4,117	\$4,251	\$7,891	\$10,085

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

Table of Contents

LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars in thousands, except per share amounts)
(Unaudited)

	Common Shares Outstanding	Common Stock	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2015	9,925,547	\$76,908	\$74,629	\$(11,665)	\$ 236	\$ 140,108
Net income			5,932			5,932
Other comprehensive income, net of taxes					4,153	4,153
Dividend Reinvestment and Stock Purchase Plan	11,715	192				192
Repurchase of stock warrants		(1,545)				(1,545)
Compensation expense relating to stock options		2				2
Compensation expense relating to restricted stock		45				45
Common stock dividends, \$0.32 per share			(3,177)			(3,177)
Balance at June 30, 2016	9,937,262	\$75,602	\$77,384	\$(11,665)	\$ 4,389	\$ 145,710
Balance at December 31, 2016	9,998,025	\$76,490	\$80,736	\$(11,665)	\$ (2,617)	\$ 142,944
Net income			6,249			6,249
Other comprehensive income, net of taxes					1,642	1,642
Dividend Reinvestment and Stock Purchase Plan	8,554	180				180
Exercise of stock options	3,398	51				51
Compensation expense relating to stock options		1				1
Compensation expense relating to restricted stock	4,027	63				63
Common stock dividends, \$0.32 per share			(3,203)			(3,203)
Balance at June 30, 2017	10,014,004	\$76,785	\$83,782	\$(11,665)	\$ (975)	\$ 147,927

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

Table of Contents

LCNB CORP. AND SUBSIDIARIES
 CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$6,249	\$5,932
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization, and accretion	1,668	1,680
Provision for loan losses	237	486
Increase in cash surrender value of bank owned life insurance	(379)	(360)
Bank owned life insurance mortality benefits in excess of cash surrender value	(107)	—
Realized gain from sales of securities available-for-sale	(140)	(650)
Realized (gain) loss from sales of premises and equipment	(23)	35
Realized loss from sales and write-downs of other real estate owned and repossessed assets	3	346
Origination of mortgage loans for sale	(4,416)	(4,850)
Realized gains from sales of loans	(102)	(102)
Proceeds from sales of mortgage loans	4,464	4,907
Penalty for prepayment of long-term debt	—	251
Compensation expense related to stock options	1	2
Compensation expense related to restricted stock	63	45
Changes in:		
Accrued income receivable	63	(224)
Other assets	(1,039)	46
Other liabilities	1,297	(613)
TOTAL ADJUSTMENTS	1,590	999
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	7,839	6,931
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of investment securities available-for-sale	12,243	36,529
Proceeds from maturities and calls of investment securities:		
Available-for-sale	8,288	33,025
Held-to-maturity	7,941	3,342
Purchases of investment securities:		
Available-for-sale	(26,950)	(38,915)
Held-to-maturity	(5,375)	(20,156)
Net (increase) decrease in loans	(8,222)	(29,740)
Purchase of bank owned life insurance	—	(4,000)
Proceeds from bank owned life insurance mortality benefits	189	—
Proceeds from sale of other real estate owned and repossessed assets	971	—
Additions to other real estate owned	—	(182)
Purchases of premises and equipment	(5,561)	(3,565)
Proceeds from sale of premises and equipment	220	61
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(16,256)	(23,601)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	33,015	37,538

Edgar Filing: LCNB CORP - Form 10-Q

Net decrease in short-term borrowings	(10,328)	(6,846)
Principal payments on long-term debt	(196)	(5,221)
Penalty for prepayment of long-term debt	—	(251)
Proceeds from issuance of common stock	21	30
Repurchase of stock warrants	—	(1,545)
Proceeds from exercise of stock options	51	—
Cash dividends paid on common stock	(3,044)	(3,015)
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	19,519	20,690
NET CHANGE IN CASH AND CASH EQUIVALENTS	11,102	4,020
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	18,865	14,987
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$29,967	\$19,007
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$1,768	\$1,780
Income taxes paid	1,400	2,160
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Transfer from loans to other real estate owned and repossessed assets	974	—

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

Table of Contents

LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

The accompanying unaudited interim consolidated condensed financial statements include LCNB Corp. ("LCNB") and its wholly-owned subsidiaries: LCNB National Bank (the "Bank") and LCNB Risk Management, Inc., a captive insurance company which was incorporated in Nevada during the second quarter 2017. All material intercompany transactions and balances are eliminated in consolidation.

The unaudited interim consolidated condensed financial 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"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. 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.

The consolidated condensed balance sheet as of December 31, 2016 has been derived from the audited consolidated balance sheet as of that day.

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

Accounting Standards Update ("ASU") No. 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," was issued by the Financial Accounting Standards Board ("FASB") in March 2016 and affects all entities that issue share-based payment awards to their employees. The new guidance involves several aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Under ASU No. 2016-09, any excess tax benefits or tax deficiencies should be recognized as income tax expense or benefit in the income statement. Excess tax benefits are to be classified as an operating activity in the statement of cash flows. In accruing compensation cost, an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, as required under current guidance, or account for forfeitures when they occur. For an award to qualify for equity classification, an entity cannot partially settle the award in excess of the employer's maximum statutory withholding requirements. Such cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity in the statement of cash flows. The amendments in ASU No. 2016-09 were effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. Accordingly, LCNB adopted the update as of January 1, 2017. Adoption did not have a material impact on LCNB's results of operations or financial position.

ASU No. 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities," was issued by the FASB in March 2017 and applies to all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). The ASU requires the premium to be amortized to the earliest call date, not the maturity date. The amendments do not require an accounting change for securities held at a discount;

the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted and management elected to adopt the update as of January 1, 2017. Adoption did not have a material impact on LCNB's results of operations or financial position.

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, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. 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 2016 Annual Report on Form 10-K filed with the SEC.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities

The amortized cost and estimated fair value of investment securities at June 30, 2017 and December 31, 2016 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2017				
Available-for-Sale:				
U.S. Treasury notes	\$ 21,135	\$ 77	\$ 3	\$21,209
U.S. Agency notes	96,921	161	1,134	95,948
U.S. Agency mortgage-backed securities	74,949	73	1,061	73,961
Municipal securities:				
Non-taxable	111,651	902	758	111,795
Taxable	22,420	246	63	22,603
Mutual funds	2,546	—	39	2,507
Trust preferred securities	49	1	—	50
Equity securities	632	88	5	715
	\$ 330,303	\$ 1,548	\$ 3,063	\$328,788
Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$ 33,282	\$ 95	\$ 122	\$33,255
Taxable	5,155	—	124	5,031
	\$ 38,437	\$ 95	\$ 246	\$38,286
December 31, 2016				
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
Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$ 31,015	\$ 56	\$ 352	\$30,719
Taxable	9,988	—	217	9,771

Edgar Filing: LCNB CORP - Form 10-Q

\$ 41,003 \$ 56 \$ 569 \$ 40,490

8

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities (continued)

Information concerning investment securities with gross unrealized losses at June 30, 2017 and December 31, 2016, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (dollars in thousands):

	Less than Twelve Months		Twelve Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2017				
Available-for-Sale:				
U.S. Treasury notes	\$1,300	\$ 3	\$—	\$ —
U.S. Agency notes	78,483	1,134	—	—
U.S. Agency mortgage-backed securities	58,733	939	3,271	122
Municipal securities:				
Non-taxable	39,578	758	—	—
Taxable	10,833	62	450	1
Mutual funds	1,225	30	282	9
Trust preferred securities	—	—	—	—
Equity securities	24	1	29	4
	\$190,176	\$ 2,927	\$4,032	\$ 136
Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$19,188	78	2,622	44
Taxable	3,176	124	—	—
	\$22,364	\$ 202	\$2,622	\$ 44
December 31, 2016				
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
Held-to-Maturity:				
Municipal securities:				
Non-taxable	\$20,429	\$ 251	\$2,564	\$ 101

Edgar Filing: LCNB CORP - Form 10-Q

Taxable	8,030	217	—	—
	\$28,459	\$ 468	\$2,564	\$ 101

9

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities (continued)

Management has determined that the unrealized losses at June 30, 2017 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. 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 at maturity, LCNB does not consider these investments to be other-than-temporarily impaired.

Contractual maturities of investment securities at June 30, 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	\$12,940	\$12,981	\$6,191	\$6,221
Due from one to five years	110,596	111,142	4,082	4,064
Due from five to ten years	121,060	120,190	10,322	10,266
Due after ten years	7,531	7,242	17,842	17,735
	252,127	251,555	38,437	38,286
U.S. Agency mortgage-backed securities	74,949	73,961	—	—
Mutual funds	2,546	2,507	—	—
Trust preferred securities	49	50	—	—
Equity securities	632	715	—	—
	\$330,303	\$328,788	\$38,437	\$38,286

Investment securities with a market value of \$195,610,000 and \$149,990,000 at June 30, 2017 and December 31, 2016, respectively, were pledged to secure public deposits and for other purposes required or as permitted by law.

Certain information concerning the sale of investment securities available-for-sale for the three and six months ended June 30, 2017 and 2016 was as follows (in thousands):

	Three Months		Six Months	
	Ended June 30, 2017	Ended June 30, 2016	Ended June 30, 2017	Ended June 30, 2016
Proceeds from sales	\$12,243	\$16,100	\$12,243	\$36,529
Gross realized gains	140	300	140	671
Gross realized losses	—	21	—	21

Realized gains or losses from the sale of securities are computed using the specific identification method.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Loans

Major classifications of loans at June 30, 2017 and December 31, 2016 are as follows (in thousands):

	June 30, 2017	December 31, 2016
Commercial and industrial	\$38,651	\$ 41,878
Commercial, secured by real estate	495,255	477,275
Residential real estate	258,710	265,788
Consumer	17,475	19,173
Agricultural	16,014	14,802
Other loans, including deposit overdrafts	547	633
	826,652	819,549
Deferred origination costs (fees), net	281	254
	826,933	819,803
Less allowance for loan losses	3,382	3,575
Loans, net	\$823,551	\$ 816,228

Loans acquired through 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.

Impaired loans acquired are accounted for under FASB Accounting Standards Codification ("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 updated 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.

Non-accrual, past-due, and accruing restructured loans as of June 30, 2017 and December 31, 2016 are as follows (in thousands):

	June 30, 2017	December 31, 2016
Non-accrual loans:		
Commercial and industrial	\$—	\$—
Commercial, secured by real estate	2,493	4,312
Residential real estate	1,076	1,079

Edgar Filing: LCNB CORP - Form 10-Q

Consumer	—	—
Agricultural	178	334
Total non-accrual loans	3,747	5,725
Past-due 90 days or more and still accruing	141	23
Total non-accrual and past-due 90 days or more and still accruing	3,888	5,748
Accruing restructured loans	11,287	11,731
Total	\$15,175	\$ 17,479

11

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

The allowance for loan losses for the three and six months ended June 30, 2017 and 2016 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
Three Months Ended June 30, 2017							
Balance, beginning of period	\$ 353	\$ 2,007	\$ 809	\$ 91	\$ 66	\$ 2	\$3,328
Provision charged to expenses	(90)	206	109	(20)	(5)	22	222
Losses charged off	—	(82)	(118)	(9)	—	(31)	(240)
Recoveries	10	5	22	24	—	11	72
Balance, end of period	\$ 273	\$ 2,136	\$ 822	\$ 86	\$ 61	\$ 4	\$3,382
Six Months Ended June 30, 2017							
Allowance for loan losses:							
Balance, beginning of year	\$ 350	\$ 2,179	\$ 885	\$ 96	\$ 60	\$ 5	\$3,575
Provision charged to expenses	(92)	296	2	3	1	27	237
Losses charged off	—	(344)	(135)	(54)	—	(61)	(594)
Recoveries	15	5	70	41	—	33	164
Balance, end of period	\$ 273	\$ 2,136	\$ 822	\$ 86	\$ 61	\$ 4	\$3,382
Three Months Ended June 30, 2016							
Balance, beginning of period	\$ 247	\$ 1,868	\$ 896	\$ 81	\$ 56	\$ 2	\$3,150
Provision charged to expenses	74	320	(1)	(12)	6	9	396
Losses charged off	(49)	(117)	(14)	(9)	—	(19)	(208)
Recoveries	1	—	4	20	—	10	35
Balance, end of period	\$ 273	\$ 2,071	\$ 885	\$ 80	\$ 62	\$ 2	\$3,373
Six Months Ended June 30, 2016							
Allowance for loan losses:							
Balance, beginning of year	\$ 244	\$ 1,908	\$ 854	\$ 54	\$ 66	\$ 3	3,129
Provision charged to expenses	74	285	65	49	(4)	17	486
Losses charged off	(49)	(140)	(42)	(53)	—	(42)	(326)
Recoveries	4	18	8	30	—	24	84
Balance, end of period	\$ 273	\$ 2,071	\$ 885	\$ 80	\$ 62	\$ 2	\$3,373

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

A breakdown of the allowance for loan losses and the loan portfolio by loan segment at June 30, 2017 and December 31, 2016 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
June 30, 2017							
Allowance for loan losses:							
Individually evaluated for impairment	\$ 7	\$ 129	\$ 51	\$ 8	\$ —	\$ —	\$ 195
Collectively evaluated for impairment	266	2,007	771	78	61	4	3,187
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of period	\$ 273	\$ 2,136	\$ 822	\$ 86	\$ 61	\$ 4	\$ 3,382
Loans:							
Individually evaluated for impairment	\$ 320	\$ 12,005	\$ 1,428	\$ 61	\$ 177	\$ —	\$ 13,991
Collectively evaluated for impairment	37,504	478,574	255,360	17,513	15,851	114	804,916
Acquired credit impaired loans	865	4,331	2,392	5	—	433	8,026
Balance, end of period	\$ 38,689	\$ 494,910	\$ 259,180	\$ 17,579	\$ 16,028	\$ 547	\$ 826,933
December 31, 2016							
Allowance for loan losses:							
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 period	\$ 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 period	\$ 41,901	\$ 476,944	\$ 266,255	\$ 19,261	\$ 14,809	\$ 633	\$ 819,803

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

The risk characteristics of LCNB's material loan portfolio segments are 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 an 80% maximum loan to appraised value ratio.

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."

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 generally 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 84 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 collectability 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.

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

LCNB 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 LCNB will sustain some loss if the deficiencies are not corrected.

Doubtful – loans classified in this category have all the weaknesses inherent in loans classified as 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.

A breakdown of the loan portfolio by credit quality indicators at June 30, 2017 and December 31, 2016 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
June 30, 2017					
Commercial & industrial	\$37,988	\$218	\$483	\$	—\$38,689
Commercial, secured by real estate	467,419	4,497	22,994	—	494,910
Residential real estate	255,321	120	3,739	—	259,180
Consumer	17,490	—	89	—	17,579
Agricultural	14,710	—	1,318	—	16,028
Other	547	—	—	—	547
Total	\$793,475	\$4,835	\$28,623	\$	—\$826,933
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

Table of Contents

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 – Loans (continued)

A loan portfolio aging analysis at June 30, 2017 and December 31, 2016 is as follows (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans Greater Than 90 Days and Accruing
June 30, 2017							
Commercial & industrial	\$—	\$ —	\$—	\$—	\$38,689	\$ 38,689	\$ —
Commercial, secured by real estate	742	—	541	1,283	493,627	494,910	—
Residential real estate	518	28	1,093	1,639	257,541	259,180	118
Consumer	33	27	23	83	17,496	17,579	23
Agricultural	—	—	177	177	15,851	16,028	—
Other	55	—	—	55	492	547	—
Total	\$1,348	\$ 55	\$ 1,834	\$3,237	\$823,696	\$ 826,933	\$ 141
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		