LCNB CORP
Form 10-K
March 09, 2016

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

FORM 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______________________ to _____________________

Commission File Number 000-26121

LCNB Corp.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

COMMON STOCK, NO PAR VALUE
(Title of Class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.   x Yes   o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
x Yes o No

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

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.

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

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

The aggregate market value of the registrant's outstanding voting common stock held by nonaffiliates on June 30, 2015, determined using a per share closing price on that date of $16.20 as quoted on the NASDAQ Capital Market, was $154,224,000.

As of March 8, 2016, 9,905,147 common shares were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement included in the Notice of Annual Meeting of Shareholders to be held April 26, 2016, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2015 are incorporated by reference into Part III.

LCNB CORP.
For the Year Ended December 31, 2015

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

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

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

1. the success, impact, and timing of the implementation of LCNB's business strategies, including the successful integration of recently completed and pending acquisitions;
2. LCNB may incur increased charge-offs in the future;
3. LCNB may face competitive loss of customers;
4. changes in the interest rate environment may have results on LCNB's operations materially different from those anticipated by LCNB's market risk management functions;
5. changes in general economic conditions and increased competition could adversely affect LCNB's operating results;
6. changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact LCNB's operating results;
7. LCNB may experience difficulties growing loan and deposit balances;
8. the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations;
9. deterioration in the financial condition of the U.S. banking system may impact the valuations of investments LCNB has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; and
10. the effects of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the regulations promulgated and to be promulgated thereunder, which may subject LCNB and its subsidiaries to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses.

Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist shareholders and potential investors in understanding current and anticipated financial operations of LCNB and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. LCNB undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

DESCRIPTION OF LCNB CORP.'S BUSINESS

General Description

LCNB Corp., an Ohio corporation formed in December 1998, is a financial holding company headquartered in Lebanon, Ohio. Substantially all of the assets, liabilities and operations of LCNB Corp. are attributable to its wholly-owned subsidiary, LCNB National Bank (the "Bank"). LCNB Corp. and its subsidiary are herein collectively referred to as “LCNB.” The predecessor of LCNB Corp., the Bank, was formed as a national banking association in 1877. On May 19, 1999, the Bank became a wholly-owned subsidiary of LCNB Corp.

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

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

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

At February 29, 2016, the Bank had 36 offices, including a main office in Warren County, Ohio and branch offices in Warren, Butler, Clinton, Clermont, Hamilton, Montgomery, Preble, Ross, and Fayette Counties, Ohio, and 40 automated teller machines ("ATMs").

The Bank is a full service community bank offering a wide range of commercial and personal banking services. Deposit services include checking accounts, NOW accounts, savings accounts, Christmas and vacation club accounts, money market deposit accounts, Lifetime Checking accounts (a senior citizen program), individual retirement accounts, and certificates of deposit. Additional supportive services include online banking, bill pay, mobile banking and telephone banking. Commercial customers also have both cash management and remote deposit capture products as potential options. Deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation (the “FDIC”).

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

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

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

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

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

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

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LCNB CORP. AND SUBSIDIARIES

Market Area

LCNB's primary market area consists of Warren, Butler, Clinton, Preble, Ross, and Fayette Counties and portions of Hamilton, Clermont, and Montgomery Counties in Southwestern and South Central Ohio. Certain demographic information is as follows:

	Warren	Butler	Clinton	Preble	Ross	Fayette	Hamilton	Montgomery
Population:								
2000 census	158,383	332,807	40,543	42,337	73,345	28,433	845,303	559,062
2010 census	212,693	368,130	42,040	42,270	78,064	29,030	802,374	535,153
Percentage increase/decrease in population	34.3 %	10.6 %	3.0 %	(0.2)%	6.4 %	2.1 %	(5.1)%	(4.3)%
Estimated percentage of persons below poverty level	5.9 %	12.8 %	14.0 %	10.7 %	17.5 %	18.5 %	15.4 %	15.7 %
Estimated median household income	$71,274	$54,788	$46,261	$48,899	$42,626	$39,599	$48,234	$43,965
Median age	37.0	35.7	37.7	41.0	39.5	39.3	36.9	38.7
Unemployment rate:								
December 2015	3.9 %	4.2 %	5.7 %	4.6 %	5.4 %	4.7 %	4.1 %	4.7 %
December 2014	3.9 %	4.3 %	6.3 %	4.5 %	5.4 %	4.5 %	4.3 %	4.8 %
December 2013	5.5 %	6.2 %	8.8 %	6.4 %	7.6 %	5.9 %	6.0 %	7.0 %

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

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

Most of the growth in Butler County has occurred in West Chester, Liberty, and Fairfield Townships. Many of the people living in these townships are employed by companies located in the Cincinnati metropolitan area. Not including local government entities and school districts, the top five major employers in Butler County are Miami University, AK Steel, Cincinnati Financial Corp. (insurance), GE Aviation, and Liberty Mutual Group (insurance). Fort Hamilton Hospital, Mercy Hospital Fairfield, McCullough-Hyde Memorial Hospital, West Chester Hospital, Cincinnati Children's Hospital Liberty Campus, Cincinnati Children's Hospital Fairfield, and Bethesda Butler Hospital are located in Butler County and collectively are a significant source of health-related employment.

Clinton County remains mostly rural. Wilmington, with a 2010 census population of 12,520, is the largest city. The next largest is Blanchester, with a 2010 census population of 4,243. The unemployment rates for December 2013 through December 2015 are unusually high because of the loss of a dominant employer. DHL, an overnight shipping company, owned the Wilmington Air Park, a decommissioned air force base, and maintained hub operations at this location. In 2008, Wilmington Air Park discontinued operations, resulting in the direct loss of approximately 8,000 jobs, not including job losses sustained by other businesses dependent on the air park operations. Certain services subcontracted to ABX Air and ASTAR Air Cargo continue, but with greatly diminished work forces.

Preble County is mostly rural. Eaton, with a 2010 census population of 8,407, is the only city in the county. Major employers are Neaton Auto Products Manufacturing Inc., Henny Penny Corporation, Parker-Hannifin Corporation, SILFEX, a division of Lam Research Corp., and Wal-Mart.

Ross and Fayette Counties are both primarily rural. Chillicothe, with a 2010 census population of 21,901, is the largest city in Ross County and Washington Court House, with a 2010 census population of 14,192, is the largest city in Fayette County. Not including local government entities and school districts, major employers in Ross County include Adena Regional Medical Center, Kenworth Truck Company (assembler of heavy trucks), Veterans Affairs Medical Center, P.H. Glatfelter Company (formerly Mead Corp.), the Ross Correctional Institution, and the Chillicothe Correctional Institution.

Hamilton County’s economics are dominated by Cincinnati. Fortune 500 companies with their headquarters in Hamilton County include American Financial Group, Macy's, Inc., Fifth Third Bank, The Kroger Company, The Procter & Gamble Company, and Western & Southern Financial Group. The five largest employers are The Kroger Company, The University of Cincinnati, The Procter & Gamble Company, Cincinnati Children’s Hospital Medical Center, and TriHealth Inc.

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

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

Competition

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

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

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

Supervision and Regulation

LCNB Corp., as a financial holding company, is regulated under the Bank Holding Company Act of 1956, as amended (the "Act"), and is subject to the supervision and examination of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board").

The Bank is subject to the provisions of the National Bank Act. The Bank is subject to primary supervision, regulation and examination by the Office of the Comptroller of the Currency (the "OCC"). The Bank is also subject to the rules and regulations of the Board of Governors of the Federal Reserve System and the FDIC.

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LCNB CORP. AND SUBSIDIARIES

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

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

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

1. Required regulatory agencies to take "prompt corrective action" with financial institutions that do not meet minimum capital requirements;

2. Established five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized;

3. Imposed significant restrictions on the operations of a financial institution that is not rated well-capitalized or adequately capitalized;

4. Prohibited a depository institution from making any capital distributions, including payments of dividends or paying any management fee to its holding company, if the institution would be undercapitalized as a result;

5. Implemented a risk-based premium system;

6. Required an audit committee to be comprised of outside directors;

7. Required a financial institution with more than $1 billion in total assets to issue annual, audited financial statements prepared in conformity with U.S. generally accepted accounting principles; and

8. Required a financial institution with more than $1 billion in total assets to document, evaluate, and report on the effectiveness of the entity's internal control system and required an independent public accountant to attest to management's assertions concerning the bank's internal control system.

The members of an audit committee for banks with more than $1 billion in total assets must be independent of management. Only a majority, rather than all, of the members of an audit committee for banks with total assets between $500 million and $1 billion must be independent. FDICIA does not relieve financial institutions that are public companies, such as LCNB, from internal control reporting and attestation requirements or audit committee independence requirements prescribed by the Sarbanes-Oxley Act of 2002 (see below).
The Gramm-Leach-Bliley Act, which amended the Bank Holding Company Act of 1956 and other banking related laws, was signed into law on November 12, 1999. The Gramm-Leach-Bliley Act repealed certain sections of the

Glass-Steagall Act and substantially eliminated the barriers separating the banking, insurance, and securities industries. Effective March 11, 2000, qualifying bank holding companies could elect to become financial holding companies. Financial holding companies have expanded investment powers, including affiliating with securities and insurance firms and engaging in other activities that are "financial in nature or incidental to such financial activity," as defined in the act, or "complementary to a financial activity."

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

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1. Certification of financial reports by the chief executive officer ("CEO") and the chief financial officer ("CFO"), who are responsible for designing and monitoring internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to the certifying officers by others within the company;

2. Inclusion of an internal control report in annual reports that include management's assessment of the effectiveness of a company's internal control over financial reporting and a report by the company's independent registered public accounting firm attesting to the effectiveness of internal control over financial reporting;

3. Accelerated reporting of stock trades on Form 4 by directors and executive officers;

4. Disgorgement requirements of incentive pay or stock-based compensation profits received within twelve months of the release of financial statements if the company is later required to restate those financial statements due to material noncompliance with any financial reporting requirement that resulted from misconduct;

5. Disclosure in a company's periodic reports stating if it has adopted a code of ethics for its CFO and principal accounting officer or controller and, if such code of ethics has been implemented, immediate disclosure of any change in or waiver of the code of ethics;
6. Disclosure in a company's periodic reports stating if at least one member of the audit committee is a "financial expert," as that term is defined by the Securities and Exchange Commission (the "SEC"); and

7. Implementation of new duties and responsibilities for a company's audit committee, including independence requirements, the direct responsibility to appoint the outside auditing firm and to provide oversight of the auditing firm's work, and a requirement to establish procedures for the receipt, retention, and treatment of complaints from a company's employees regarding questionable accounting, internal control, or auditing matters.

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

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

1. Merging the Bank Insurance Fund and the Savings Association Insurance Fund into a new fund called the Deposit Insurance Fund, effective March 31, 2006;

2. Increasing insurance coverage for retirement accounts from $100,000 to $250,000, effective April 1, 2006; and

3.

Eliminating a 1.25% hard target Designated Reserve Ratio, as defined, and giving the FDIC discretion to set the Designated Reserve Ratio within a range of 1.15% to 1.50% for any given year.

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

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

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

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

General corporate governance provisions included in the Dodd-Frank Act include expanding executive compensation disclosures to be included in the annual proxy statement, requiring non-binding shareholder advisory votes on executive compensation at annual meetings, enhancing independence requirements for compensation committee members and any advisers used by the compensation committee, and requiring the adoption of certain compensation policies including the recovery of executive compensation in the event of a financial statement restatement.
Noncompliance with laws and regulations by bank holding companies and banks can lead to monetary penalties and/or an increased level of supervision or a combination of these two items. Management is not aware of any current significant instances of noncompliance with laws and regulations and does not anticipate any problems maintaining compliance on a prospective basis. Recent regulatory inspections and examinations of LCNB and the Bank have not disclosed any significant instances of noncompliance.
The earnings and growth of LCNB are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government and its agencies, particularly the Federal Reserve Board. Its policies influence the amount of bank loans and deposits and the interest rates charged and paid thereon and thus have an effect on earnings. The nature of future monetary policies and the effect of such policies on the future business and earnings of LCNB and the Bank cannot be predicted.

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

Employees

As of December 31, 2015, LCNB employed 280 full-time equivalent employees. LCNB is not a party to any collective bargaining agreement. Management considers its relationship with its employees to be very good. Employee benefit programs are considered by management to be competitive with benefit programs provided by other financial institutions and major employers within LCNB's market area.

Divestitures

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

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LCNB CORP. AND SUBSIDIARIES

Availability of Financial Information

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

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

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

FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

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

STATISTICAL INFORMATION

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

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

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

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

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Investment Portfolio

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

	At December 31,		
	2015	2014	2013
	(Dollars in thousands)		
Securities available-for-sale:			
U.S. Treasury notes	$72,846	62,560	12,894
U.S. Agency notes	139,889	83,637	106,675
U.S. Agency mortgage-backed securities	29,378	38,032	40,309
Certificates of deposit	249	3,086	1,501
Municipal securities	132,420	93,790	92,642
Mutual funds	2,466	2,461	2,380
Trust preferred securities	50	50	147
Equity securities	680	1,749	1,693
Total securities available-for-sale	377,978	285,365	258,241
Securities held-to-maturity:			
Municipal securities	22,633	22,725	16,323
Federal Reserve Bank stock	2,732	2,346	1,603
Federal Home Loan Bank stock	3,638	3,638	2,854
Total securities	$406,981	314,074	279,021

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LCNB CORP. AND SUBSIDIARIES

Contractual maturities of securities at December 31, 2015, were as follows. Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale				Held-to-Maturity			
	Amortized Cost	Fair Value	Yield		Amortized Cost	Fair Value	Yield	
	(Dollars in thousands)							
U.S. Treasury notes:								
Within one year	$9,091	9,081	0.67	%	$—	—	—	%
One to five years	36,725	36,923	1.60	%	—	—	—	%
Five to ten years	26,856	26,842	1.94	%	—	—	—	%
After ten years	—	—	—	%	—	—	—	%
Total U.S. Treasury notes	72,672	72,846	1.61	%	—	—	—	%
U.S. Agency notes:								
Within one year	—	—	—	%	—	—	—	%
One to five years	83,404	83,085	1.48	%	—	—	—	%
Five to ten years	57,472	56,804	2.06	%	—	—	—	%
After ten years	—	—	—	%	—	—	—	%
Total U.S. Agency notes	140,876	139,889	1.72	%	—	—	—	%
Certificates of deposit								
Within one year	248	249	1.16	%	—	—	—	%
One to five years	—	—	—	%	—	—	—	%
Five to ten years	—	—	—	%	—	—	—	%
After ten years	—	—	—	%	—	—	—	%
Total certificates of deposit	248	249	1.16	%	—	—	—	%
Municipal securities (1):								
Within one year	13,672	13,829	3.28	%	3,819	3,831	2.43	%
One to five years	62,645	63,589	3.03	%	3,904	3,882	3.04	%
Five to ten years	54,321	55,002	3.26	%	3,168	3,107	3.40	%
After ten years	—	—	—	%	11,742	11,810	6.31	%
Total Municipal securities	130,638	132,420	3.15	%	22,633	22,630	4.68	%
U.S. Agency mortgage-backed securities	29,608	29,378	2.39	%	—	—	—	%
Mutual funds	2,517	2,466	1.92	%	—	—	—	%
Trust preferred securities	49	50	7.78	%	—	—	—	%
Equity securities	659	680	4.57	%	—	—	—	%
Totals	$377,267	377,978	2.25	%	22,633	22,630	4.68	%

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

Excluding holdings in U.S. Treasury securities and U.S. Government Agencies, there were no investments in securities of any issuer that exceeded 10% of LCNB's consolidated shareholders' equity at December 31, 2015.

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LCNB CORP. AND SUBSIDIARIES

Loan Portfolio

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

Employees authorized to accept loan applications have various, designated lending limits for the approval of loans. A loan application for an amount outside a particular employee's lending limit needs to be approved by an employee with a lending limit sufficient for that loan. Residential and commercial real estate loans of any amount require the approval of two of the following designated officers: Chief Executive Officer, President, Chief Lending Officer, Chief Credit Officer, and the officers in charge of commercial, real estate, and consumer lending. Any loan in excess of $3.0 million or with policy exceptions needs the approval of the Board of Directors.

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

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

	At December 31,									
	2015		2014		2013		2012		2011	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Commercial and industrial	$45,275	5.9 %	$35,424	5.1 %	$29,337	5.1 %	$26,236	5.8 %	$30,990	6.7 %
Commercial, secured by real estate	419,633	54.5 %	379,141	54.3 %	314,252	54.7 %	230,256	50.7 %	219,188	47.6 %
Residential real estate	273,139	35.4 %	254,087	36.4 %	215,587	37.6 %	183,132	40.4 %	186,904	40.5 %
Consumer	18,510	2.4 %	18,006	2.5 %	12,643	2.2 %	10,554	2.3 %	14,562	3.2 %
Agricultural	13,479	1.7 %	11,472	1.6 %	2,472	0.4 %	1,668	0.4 %	2,835	0.6 %
Other loans, including deposit overdrafts	665	0.1 %	680	0.1 %	91	— %	1,875	0.4 %	6,554	1.4 %
	770,701	100.0 %	698,810	100.0 %	574,382	100.0 %	453,721	100.0 %	461,033	100.0 %
Deferred origination costs (fees), net	237		146		(28)		62		229	
Total loans	770,938		698,956		574,354		453,783		461,262	
Less allowance for loan losses	3,129		3,121		3,588		3,437		2,931	
Loans, net	$767,809		$695,835		$570,766		$450,346		$458,331	

As of December 31, 2015, there were no concentrations of loans exceeding 10% of total loans that are not already disclosed as a category of loans in the above table.

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The following table summarizes the commercial and agricultural loan maturities and sensitivities to interest rate change at December 31, 2015:

	(In thousands)
Maturing in one year or less	$33,115
Maturing after one year, but within five years	63,883
Maturing beyond five years	381,389
Total commercial and agricultural loans	$478,387
Loans maturing beyond one year:	
Fixed rate	$155,886
Variable rate	289,386
Total	$445,272

Risk Elements

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

	At December 31,				
	2015	2014	2013	2012	2011
	(Dollars in thousands)				
Non-accrual loans	$1,723	5,599	2,961	2,283	3,668
Past-due 90 days or more and still accruing	559	203	250	128	39
Accruing restructured loans	13,723	14,269	15,151	13,343	14,739
Total	$16,005	20,071	18,362	15,754	18,446
Percent to total loans	2.08 %	2.87 %	3.20 %	3.47 %	4.00 %

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

At December 31, 2015, there were no material additional loans not classified as acquired credit impaired or already disclosed as non-accrual, accruing restructured, or accruing past due 90 days or more where known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with present loan repayment terms.

Summary of Loan Loss Experience

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

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LCNB CORP. AND SUBSIDIARIES

Allocation of the Allowance for Loan Losses

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

	At December 31,														
	2015			2014			2013			2012			2011		
	Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans	
	(Dollars in thousands)														
Commercial and industrial	$244	5.9	%	$129	5.1	%	$175	5.1	%	$320	5.8	%	$162	6.7	%
Commercial, secured by real estate	1,908	54.5	%	1,990	54.3	%	2,520	54.7	%	2,296	50.7	%	1,941	47.6	%
Residential real estate	854	35.4	%	926	36.4	%	826	37.6	%	712	40.4	%	656	40.5	%
Consumer	54	2.4	%	63	2.5	%	66	2.2	%	108	2.3	%	166	3.2	%
Agricultural	66	1.7	%	11	1.6	%	—	0.4	%	—	0.4	%	—	0.6	%
Other loans, including deposit overdrafts	3	0.1	%	2	0.1	%	1	—	%	1	0.4	%	6	1.4	%
Unallocated	—	—		—	—		—	—		—	—		—	—	
Total	$3,129	100.0	%	$3,121	100.0	%	$3,588	100.0	%	$3,437	100.0	%	$2,931	100.0	%

Deposits

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

The following table presents the contractual maturity of time deposits of $100,000 or more at December 31, 2015:

	(In thousands)
Maturity within 3 months	$7,297
After 3 but within 6 months	5,137
After 6 but within 12 months	11,265
After 12 months	50,356
	$74,055

Return on Equity and Assets

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

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Item 1A. Risk Factors

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

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

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

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

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

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

Gains from sales of mortgage loans may experience significant volatility.

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

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

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

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

Economic conditions in Southwestern and South Central Ohio could adversely affect LCNB's financial condition and results of operations.
LCNB conducts its operations from offices that are located in nine Southwestern and South Central Ohio counties, from which substantially all of its customer base is drawn. Because of this geographic concentration of operations and customer base, LCNB's financial performance is heavily influenced by economic conditions in these areas. LCNB's financial performance could be negatively affected to the extent that business and economic conditions in these areas do not continue to recover from the recent recession. Any material deterioration in economic conditions in these markets could have material direct or indirect adverse impacts on LCNB's customers and on LCNB. Such deterioration could increase the number of customers experiencing financial distress, negatively impacting their ability to obtain new loans or to repay existing loans. As a result, LCNB may experience increases in the levels of impaired loans, increased charge-offs, and increased provisions for loan losses. Deteriorating economic conditions may also effect the ability of depositors to maintain or add to deposit balances and may effect the demand for loans, trust, brokerage, and other products and services offered by LCNB. Such losses and decreased demand could have material adverse effects on LCNB's financial position, results of operations, and cash flows.

The allowance for loan losses may be inadequate.
The provision for loan losses is determined by management based upon its evaluation of the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, the fair value of any underlying collateral, borrowers' cash flows, and current economic conditions that may affect borrowers' ability to make payments. Increases in the allowance result in an expense for the period. By its nature, the evaluation is imprecise and requires significant judgment. Actual results may vary significantly from management's assumptions. If, as a result of general economic conditions or a decrease in asset quality, management determines that additional increases in the allowance for loan

losses are necessary, LCNB will incur additional expenses.

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

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

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

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

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

Changes in income tax laws or interpretations or in accounting standards could materially affect LCNB's financial condition or results of operations.
Changes in income tax laws could be enacted, or interpretations of existing income tax laws could change, causing an adverse effect to LCNB's financial condition or results of operations. Similarly, new accounting standards may be issued by the Financial Accounting Standards Board (the "FASB") or existing standards revised, changing the methods for preparing financial statements. These changes are not within LCNB's control and may significantly impact its reported financial condition and results of operations. FASB is currently working on various projects, including accounting for impaired financial instruments and accounting for leases.
LCNB is subject to environmental liability risk associated with lending activities.
A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Bank to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Bank's exposure to environmental liability. Although the Bank has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on LCNB's financial

condition and results of operations.

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

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LCNB CORP. AND SUBSIDIARIES

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

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

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

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

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

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

LCNB continually encounters technological change.

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

Risk factors related to LCNB's trust business.
Competition for trust business is intense. Competitors include other commercial bank and trust companies, brokerage firms, investment advisory firms, mutual fund companies, accountants, and attorneys.

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LCNB CORP. AND SUBSIDIARIES

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

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

LCNB's ability to pay cash dividends is limited.

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

Item 1B. Unresolved Staff Comments

Not applicable

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LCNB CORP. AND SUBSIDIARIES

Item 2. Properties

The Bank conducts its business from the following offices:

	Name of Office	Address	
1.	Main Office	2 North Broadway Lebanon, Ohio 45036	Owned
2.	Auto Bank	Silver and Mechanic Streets Lebanon, Ohio 45036	Owned
3.	Barron Street Office	1697 North Barron Street Eaton, Ohio 45320	Leased
4.	Bridge Street Office	1240 North Bridge Street Chillicothe, Ohio 45601	Owned
5.	Brookville Office	225 West Upper Lewisburg Salem Road Brookville, Ohio 45309	Owned
6.	Centerville Office	9605 Dayton-Lebanon Pike Centerville, Ohio 45458	Owned
7.	Chillicothe Office	33 West Main Street Chillicothe, Ohio 45601	Owned
8.	Clarksburg Office	10820 Main Street Clarksburg, Ohio 43115	Owned
9.	Colerain Township Office	3209 West Galbraith Road Cincinnati, Ohio 45239	Owned
10.	Columbus Avenue Office	730 Columbus Avenue Lebanon, Ohio 45036	Owned
11.	Eaton Office	110 West Main Street Eaton, Ohio 45320	Owned
12.	Fairfield Office	765 Nilles Road Fairfield, Ohio 45014	Leased
13.	Frankfort Office	Springfield and Main Streets Frankfort, Ohio 45628	Owned
14.	Goshen Office	6726 Dick Flynn Blvd.	Owned

		Goshen, Ohio 45122	
15.	Hamilton Office	794 NW Washington Blvd. Hamilton, Ohio 45013	Owned
16.	Hay Avenue Office	121 Hay Avenue Brookville, Ohio 45309	Owned
17.	Hunter Office	3878 State Route 122 Franklin, Ohio 45005	Owned
18.	Lewisburg Office	522 South Commerce Street Lewisburg, Ohio 45338	Owned

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LCNB CORP. AND SUBSIDIARIES

	Name of Office	Address	
19.	Loveland Office	500 Loveland-Madeira Road Loveland, OH 45140	Owned
20.	Maineville Office	7795 South State Route 48 Maineville, Ohio 45039	Owned
21.	Mason/West Chester Office	1050 Reading Road Mason, Ohio 45040	Owned
22.	Middletown Office	4441 Marie Drive Middletown, Ohio 45044	Owned
23.	Monroe Office	101 Clarence F. Warner Drive Monroe, Ohio 45050	Owned
24.	New Paris Office	201 South Washington Street New Paris, Ohio 45347	Owned
25.	Oakwood Office	2705 Far Hills Avenue Oakwood, Ohio 45419	(2)
26.	Okeana Office (closed February 12, 2016)	6225 Cincinnati-Brookville Road Okeana, Ohio 45053	Owned
27.	Otterbein Office	Otterbein Retirement Community State Route 741 Lebanon, Ohio 45036	Leased
28.	Oxford Office (1)	30 West Park Place Oxford, Ohio 45056	(2)
29.	Rochester/Morrow Office	Route 22-3 at 123 Morrow, Ohio 45152	Owned
30.	South Lebanon Office	603 Corwin Nixon Blvd. South Lebanon, Ohio 45065	Owned
31.	Springboro/Franklin Office	525 West Central Avenue Springboro, Ohio 45066	Owned
32.	Warrior Office	Lebanon High School 1916 Drake Road Lebanon, Ohio 45036	Leased

33.	Washington Court House Office	100 Crossings Drive Washington Court House, Ohio 43160	Owned
34.	Waynesville Office	9 North Main Street Waynesville, Ohio 45068	Owned
35.	West Alexandria Office	55 East Dayton Street West Alexandria, Ohio 45381	Owned
36.	Western Avenue Office	1006 Western Avenue Chillicothe, Ohio 45601	Owned

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LCNB CORP. AND SUBSIDIARIES

	Name of Office	Address	
37.	Wilmington Office	1243 Rombach Avenue Wilmington, Ohio 45177	Owned
38.	Operations Center (under construction)	105 North Broadway Lebanon, Ohio 45036	Owned

(1) Excess space in this office is leased to third parties.
(2) The Bank owns the Oakwood and Oxford office buildings and leases the land.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not Applicable

LCNB CORP. AND SUBSIDIARIES

PART II

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

LCNB had approximately 1,026 registered holders of its common stock as of December 31, 2015. The number of shareholders includes banks and brokers who act as nominees, each of whom may represent more than one shareholder. LCNB's stock trades on the NASDAQ Capital Market exchange under the symbol "LCNB."

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

	2015			2014		
	High	Low	Dividends Declared	High	Low	Dividends Declared
First Quarter	$16.40	13.95	0.16	18.24	17.25	0.16
Second Quarter	17.88	15.01	0.16	18.89	14.67	0.16
Third Quarter	16.40	15.26	0.16	17.14	14.84	0.16
Fourth Quarter	17.18	15.07	0.16	15.43	13.83	0.16
Total dividends declared			0.64			0.64

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

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

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

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

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares. Through December 31, 2015, 290,444 shares have been purchased under this program. No shares were purchased under the Market Repurchase Program during 2015.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. There is no limit to the number of shares that may be purchased under this program. A total of 466,018 shares have been purchased under this program since its inception through December 31, 2015. No shares were purchased under the Private Sale Repurchase Program during 2015.

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

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

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

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance
Equity compensation plans approved by security holders	83,861	$12.39	433,962
Equity compensation plans not approved by security holders	—	—	—
Total	83,861	$12.39	433,962

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LCNB CORP. AND SUBSIDIARIES

The graph below provides an indicator of cumulative total shareholder returns for LCNB as compared with the NASDAQ Composite, the SNL Midwest OTC-BB and Pink Sheet Banks, and the SNL Midwest Bank indexes. This graph covers the period from December 31, 2010 through December 31, 2015. The cumulative total shareholder returns included in the graph reflect the returns for the shares of common stock of LCNB. The information provided in the graph assumes that $100 was invested on December 31, 2010 in LCNB common stock, the NASDAQ Composite, and the SNL Midwest Bank Index and that all dividends were reinvested.

	Period Ending					
Index	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
LCNB Corp.	$100.00	114.16	126.65	171.16	150.37	169.90
NASDAQ Composite	$100.00	99.21	116.82	163.75	188.03	201.40
SNL Midwest Bank index	$100.00	94.46	113.69	155.65	169.21	171.78

Source : SNL Financial LC, Charlottesville, VA

www.snl.com

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LCNB CORP. AND SUBSIDIARIES

Item 6. Selected Financial Data

The following represents selected consolidated financial data of LCNB for the years ended December 31, 2011 through 2015 and are derived from LCNB's consolidated financial statements. Certain prior year data presented in this table have been reclassified to conform with the current year presentation. This data should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 8 of this Form 10-K and Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures about Market Risk included in Items 7 and 7A, respectively, of this Form 10-K, and are qualified in their entirety thereby and by other detailed information elsewhere in this Form 10-K.

	For the Years Ended December 31,				
	2015	2014	2013	2012	2011
	(Dollars in thousands, except ratios and per share data)				
Income Statement:					
Interest income	$42,659	39,477	33,497	29,938	32,093
Interest expense	3,328	3,590	4,065	4,889	6,387
Net interest income	39,331	35,887	29,432	25,049	25,706
Provision for loan losses	1,366	930	588	1,351	2,089
Net interest income after provision for loan losses	37,965	34,957	28,844	23,698	23,617
Non-interest income	10,123	9,142	9,090	9,049	7,764
Non-interest expenses	32,392	30,844	26,212	21,682	21,849
Income before income taxes	15,696	13,255	11,722	11,065	9,532
Provision for income taxes	4,222	3,386	2,942	2,795	2,210
Net income from continuing operations	11,474	9,869	8,780	8,270	7,322
Income from discontinued operations, net of tax	—	—	—	—	793
Net income	$11,474	9,869	8,780	8,270	8,115
Dividends per common share	$0.64	0.64	0.64	0.64	0.64
Basic earnings per common share:					
Continuing operations	1.18	1.06	1.12	1.23	1.09
Discontinued operations	—	—	—	—	0.12
Diluted earnings per common share:					
Continuing operations	1.17	1.05	1.10	1.22	1.08
Discontinued operations	—	—	—	—	0.12
Balance Sheet:					
Securities	$406,981	314,074	279,021	276,970	267,771
Loans, net	767,809	695,835	570,766	450,346	458,331
Total assets	1,280,531	1,108,066	932,338	788,637	791,570
Total deposits	1,087,160	946,205	785,761	671,471	663,562
Short-term borrowings	37,387	16,645	8,655	13,756	21,596
Long-term debt	5,947	11,357	12,102	13,705	21,373
Total shareholders' equity	140,108	125,695	118,873	82,006	77,960

Selected Financial Ratios and Other Data:

Return on average assets	0.94	%	0.88	%	0.93	%	1.02	%	1.02	%
Return on average equity	8.43	%	8.04	%	9.02	%	10.22	%	10.89	%
Equity-to-assets ratio	10.94	%	11.34	%	12.75	%	10.40	%	9.85	%
Dividend payout ratio	54.24	%	60.38	%	57.14	%	52.03	%	52.89	%
Net interest margin, fully taxable equivalent	3.64	%	3.66	%	3.57	%	3.52	%	3.70	%

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Dakin Insurance Agency, Inc. ("Dakin") was sold during the first quarter 2011 and therefore the net gain on the sale and Dakin’s financial operating results are reported in the income statements as income from discontinued operations, net of tax.
First Capital merged with and into LCNB as of the close of business on January 11, 2013. As of the date of the merger, LCNB recorded additional loans of $98.9 million and additional deposits of $136.8 million.
An underwritten public offering of common stock was conducted during the fourth quarter 2013. The offering increased shareholders' equity by $26.9 million, which was the net proceeds LCNB received after deducting offering expenses. The proceeds were used to fund the acquisition of Eaton National on January 24, 2014 and the remainder was used for general corporate purposes.
Eaton National merged with and into LCNB as of the close of business on January 24, 2014. As of the date of the merger, LCNB recorded additional loans of $115.9 million and additional deposits of $165.3 million.
BNB merged with and into LCNB as of the close of business on April 30, 2015. As of the date of the merger, LCNB recorded additional loans of $34.7 million and additional deposits of $99.1 million.

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

Introduction

The following is management's discussion and analysis of the consolidated financial condition and consolidated results of operations of LCNB. It is intended to amplify certain financial information regarding LCNB and should be read in conjunction with the Consolidated Financial Statements and related Notes and the Financial Highlights contained in the 2015 Annual Report to Shareholders.

Forward-Looking Statements

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

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

1. the success, impact, and timing of the implementation of LCNB's business strategies, including the successful integration of recently completed acquisitions;
2. LCNB may incur increased charge-offs in the future;
3. LCNB may face competitive loss of customers;
4. changes in the interest rate environment may have results on LCNB's operations materially different from those anticipated by LCNB's market risk management functions;
5. changes in general economic conditions and increased competition could adversely affect LCNB's operating results;
6. changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact LCNB's operating results;
7. LCNB may experience difficulties growing loan and deposit balances;
8. the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations;
9. deterioration in the financial condition of the U.S. banking system may impact the valuations of investments LCNB has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; and
10. the effects of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the regulations promulgated and to be promulgated thereunder, which may subject LCNB and its subsidiaries to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses.

Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist shareholders and potential investors in understanding current and anticipated financial operations of LCNB and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. LCNB undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

Overview

Net income for 2015 was $11,474,000 (basic and diluted earnings per share of $1.18 and $1.17, respectively), compared to $9,869,000 (basic and diluted earnings per share of $1.06 and $1.05) in 2014 and $8,780,000 (total basic and diluted earnings per share of $1.12 and $1.10) in 2013.

The following items significantly affected earnings for the years indicated:
1. The completion of a merger with BNB Bancorp, Inc. on April 30, 2015.
2. The completion of a merger with Eaton National Bank & Trust Co. on January 24, 2014.

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3. The completion of a merger with First Capital Bancshares, Inc. and its subsidiary, Citizens National Bank of Chillicothe, on January 11, 2013.
4. Net gains on sales of securities were significantly greater in 2013 when compared to 2015 and 2014.
5. Other real estate owned expense was significantly less in 2013 as compared to 2015 and 2014 because of decreases in valuation write-downs and a gain recognized during the first quarter 2013 on the sale of commercial real estate property.
6. Impaired loans with a carrying value of approximately $4.5 million were sold during the second second quarter 2015, significantly improving LCNB's loan quality metrics.

Net Interest Income

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

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LCNB CORP. AND SUBSIDIARIES

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

	Years ended December 31,								
	2015			2014			2013		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
Loans (1)	$740,626	35,285	4.76%	$679,223	32,706	4.82%	$555,602	27,325	4.92%
Federal funds sold	452	1	0.22%	—	—	— %	768	1	0.13%
Interest-bearing demand deposits	12,245	30	0.24%	12,450	29	0.23%	9,908	24	0.24%
Federal Reserve Bank stock	2,495	152	6.09%	2,100	126	6.00%	1,436	86	5.99%
Federal Home Loan Bank stock	3,638	146	4.01%	3,571	146	4.09%	2,826	119	4.21%
Investment securities:									
Taxable	245,410	4,197	1.71%	219,131	3,757	1.71%	192,983	3,369	1.75%
Non-taxable (2)	115,215	4,315	3.75%	102,902	4,111	4.00%	98,567	3,898	3.95%
Total earning assets	1,120,081	44,126	3.94%	1,019,377	40,875	4.01%	862,090	34,822	4.04%
Non-earning assets	107,919			104,413			85,970		
Allowance for loan losses	(2,888)			(3,275)			(3,401)		
Total assets	$1,225,112			$1,120,515			$944,659		
Savings deposits	$608,925	545	0.09%	$544,698	474	0.09%	$454,265	407	0.09%
IRA and time certificates	219,562	2,464	1.12%	223,555	2,687	1.20%	197,302	3,195	1.62%
Short-term borrowings	15,105	24	0.16%	14,820	22	0.15%	16,912	25	0.15%
Long-term debt	6,177	295	4.78%	11,546	407	3.53%	12,768	438	3.43%
Total interest-bearing liabilities	849,769	3,328	0.39%	794,619	3,590	0.45%	681,247	4,065	0.60%
Demand deposits	230,608			196,273			160,470		
Other liabilities	8,590			6,908			5,593		
Capital	136,145			122,716			97,349		
Total liabilities and capital	$1,225,112			$1,120,516			$944,659		
Net interest rate spread (3)			3.55%			3.56%			3.44%
Net interest income and net interest margin on a tax equivalent basis (4)		40,798	3.64%		37,285	3.66%		30,757	3.57%
Ratio of interest-earning assets to interest-bearing liabilities	131.81 %			128.29 %			126.55 %		

(1) Includes non-accrual loans if any.
(2) Income from tax-exempt securities is included in interest income on a taxable-equivalent basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34%.
(3) The net interest spread is the difference between the average rate on total interest-earning assets and interest-bearing liabilities.
(4) The net interest margin is the taxable-equivalent net interest income divided by average interest-earning assets.

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LCNB CORP. AND SUBSIDIARIES

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

The following table presents the changes in interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the years indicated. Changes not solely attributable to rate or volume have been allocated to volume and rate changes in proportion to the relationship of absolute dollar amounts of the changes in each.

	For the years ended December 31,					
	2015 vs. 2014			2014 vs. 2013		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income attributable to:						
Loans (1)	$2,929	(350)	2,579	5,964	(583)	5,381
Federal funds sold	1	—	1	(1)	—	(1)
Interest-bearing demand deposits	—	1	1	6	(1)	5
Federal Reserve Bank stock	24	2	26	40	—	40
Federal Home Loan Bank stock	3	(3)	—	31	(4)	27
Investment securities:						
Taxable	449	(9)	440	449	(61)	388
Non-taxable (2)	472	(268)	204	173	40	213
Total interest income	3,878	(627)	3,251	6,662	(609)	6,053
Interest expense attributable to:						
Savings deposits	57	14	71	80	(13)	67
IRA and time certificates	(47)	(176)	(223)	388	(896)	(508)
Short-term borrowings	—	2	2	(3)	—	(3)
Long-term debt	(227)	115	(112)	(43)	12	(31)
Total interest expense	(217)	(45)	(262)	422	(897)	(475)
Net interest income	$4,095	(582)	3,513	6,240	288	6,528

(1) Non-accrual loans, if any, are included in average loan balances.
(2) Change in interest income from non-taxable investment securities is computed based on interest income determined on a taxable-equivalent yield basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34%.

2015 vs. 2014. Net interest income on a fully tax-equivalent basis for 2015 totaled $40,798,000, an increase of $3,513,000 from 2014. The increase resulted from an increase in total taxable-equivalent interest income of $3,251,000 and a decrease in total interest expense of $262,000.

The increase in taxable-equivalent interest income was due to a $100.7 million increase in total average interest-earning assets, slightly offset by a 7 basis point (a basis point equals 0.01%) decrease in the average rate earned on interest-earning assets. The increase in total average interest-earning assets reflects an increase of $61.4 million in average loans, partially from the BNB merger and partially from organic growth, and a $38.6 million increase in investment securities. The decrease in the average rate earned was primarily due to general decreases in market rates.

Interest expense decreased primarily due to a $5.4 million decrease in average long term debt, primarily due the payment in full of a $5.0 million advance from the Federal Home Loan Bank of Cincinnati during the first quarter 2015, and to a 1 basis point decrease in the average rate paid on total interest-bearing liabilities.

2014 vs. 2013. Net interest income on a fully tax-equivalent basis for 2014 totaled $37,285,000, an increase of $6,528,000 from 2013. The increase resulted from an increase in total taxable-equivalent interest income of $6,053,000 and a decrease in total interest expense of $475,000.

The increase in taxable-equivalent interest income was due to a $157.3 million increase in total average interest-earning assets, slightly offset by a 3 basis point decrease in the average rate earned on interest-earning assets. The increase in total average interest-earning assets reflects an increase of $123.6 million in average loans, primarily from the Eaton National merger, and a $30.5 million increase in investment securities. The decrease in the average rate earned was primarily due to general decreases in market rates.

Interest expense decreased primarily due to a 15 basis point decrease in the average rate paid on interest-bearing liabilities, partially offset by a $113.4 million increase in total average interest-bearing liabilities. Deposit accounts (savings deposits, NOW and money fund deposits, and IRA and time certificates) grew a combined total of $116.7 million on an average basis, while average short-term borrowings decreased $2.1 million, while average long-term debt decreased $1.2 million. The growth in deposits was primarily due to the Eaton National merger. The decrease in average rates paid was primarily due to general decreases in market rates.

The net interest margin, on a taxable-equivalent basis, increased from 3.57% for 2013 to 3.66% for 2014, the net effect of declines in both yields on earning assets and rates paid on liabilities, as indicated above.

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

Provisions and Allowance for Loan Losses

The following table presents the total loan loss provision and the other changes in the allowance for loan losses for the years 2011 through 2015:

	2015	2014	2013	2012	2011
	(Dollars in thousands)				
Balance – Beginning of year	$3,121	3,588	3,437	2,931	2,641
Loans charged off:					
Commercial and industrial	100	261	119	159	581
Commercial, secured by real estate	1,133	573	58	234	598
Residential real estate	304	652	244	486	512
Consumer	52	129	181	134	252
Agricultural	67	—	—	—	—
Other loans, including deposit overdrafts	74	79	67	85	127
Total loans charged off	1,730	1,694	669	1,098	2,070
Recoveries:					
Commercial and industrial	7	42	4	—	—
Commercial, secured by real estate	96	63	26	71	30
Residential real estate	107	40	31	7	31
Consumer	60	108	127	123	122
Agricultural	67	—	—	—	—
Other loans, including deposit overdrafts	35	44	44	52	88
Total recoveries	372	297	232	253	271
Net charge offs	1,358	1,397	437	845	1,799
Provision charged to operations	1,366	930	588	1,351	2,089
Balance - End of year	$3,129	3,121	3,588	3,437	2,931
Ratio of net charge-offs during the period to average loans outstanding	0.18 %	0.21 %	0.08 %	0.18 %	0.39 %
Ratio of allowance for loan losses to total loans at year-end	0.41 %	0.45 %	0.62 %	0.76 %	0.64 %

Charge-offs for the commercial, secured by real estate category had an elevated balance during 2015 due to the sale of impaired loans. Charge-offs for the commercial and industrial loan category for 2014 included a charge-off of $222,000 on one loan and charge-offs in the commercial, secured by real estate category for the same year included charge-offs totaling $469,000 on three loans. The $581,000 of charge-offs in the commercial and industrial loan category for 2011 is comprised of a $251,000 charge-off connected to a retail business that ceased operations during that year and the remaining $330,000 is due to one borrower. Commercial real estate charge-offs for 2011 consisted of loans to five different borrowers.

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

LCNB continuously reviews the loan portfolio for credit risk through the use of its lending and loan review functions. Independent loan reviews analyze specific loans, providing validation that credit risks are appropriately identified and reported to the Loan Committee and Board of Directors. In addition, the Board of Directors' Audit Committee receives loan review reports throughout each year. New credits meeting specific criteria are analyzed prior to origination and are reviewed by the Loan Committee and Board of Directors.
Inputs from all of the Bank's credit risk identification processes are used by management to analyze and validate the adequacy and methodology of the allowance quarterly. The analysis includes two basic components: specific allocations for individual loans and general loss allocations for pools of loans based on average historic loss ratios for the thirty-six preceding months adjusted for identified economic and other risk factors. Due to the number, size, and complexity of loans within the loan portfolio, there is always a possibility of inherent undetected losses.

The following table presents the components of the allowance for loan losses on the dates specified:

	At December 31,								
	2015			2014			2013		
	Amount	Percent		Amount	Percent		Amount	Percent	
	(Dollars in thousands)								
Specific allocations	$363	11.6	%	$817	26.2	%	$1,032	28.8	%
General allocations:									
Historical loss	1,044	33.4	%	943	30.2	%	982	27.4	%
Adjustments to historical loss	1,722	55.0	%	1,361	43.6	%	1,574	43.8	%
Total	$3,129	100.0	%	$3,121	100.0	%	$3,588	100.0	%

Non-Interest Income

2015 vs. 2014. Total non-interest income for 2015 was $981,000 greater than for 2014 primarily due to increases in trust income, net gains on sales of securities, and gains from sales of mortgage loans. Trust income increased $359,000 primarily due to an increase in the fair value of trust assets and brokerage accounts managed. Net gains from sales of securities increased $346,000 and gains from sales of mortgage loans increased $196,000 primarily due to higher sales volumes.

2014 vs. 2013. Total non-interest income for 2014 was $52,000 greater than for 2013 primarily due to increases in trust income, service charges and fees on deposit accounts, and other operating income. Trust income increased $385,000 primarily due to an increase in the fair value of trust assets and brokerage accounts managed along with fee adjustments that became effective July 1, 2013. Service charges and fees on deposit accounts increased $683,000 primarily due to a greater number of deposit accounts resulting from the merger with Eaton National. Contributing to the increase in other operating income was a $78,000 increase in fee income from loans serviced for others, primarily due to increases in the servicing portfolio from the merger with Eaton National. These favorable increases were largely offset by a $911,000 decrease in net gains from sales of securities and a $192,000 decrease in gains from sales of mortgage loans primarily due to lower volumes of sales.

Non-Interest Expense

2015 vs. 2014. Total non-interest expense was $1,548,000 greater in 2015 than in 2014 primarily due to a $1,831,000 increase in salaries and employee benefits, partially offset by a $757,000 decrease in merger related expenses (consisting primarily of professional fees, data system conversion costs, and employee severance payments). Salaries and employee benefits and occupancy expenses increased due to salary and wage increases, employees retained from the BNB and Eaton National acquisitions, an increase in the number of employees outside of the acquisitions, and increased retirement plan expenses. Costs related to the acquisition of BNB in April 2015 were less than the costs associated with the acquisition of Eaton National in January 2014.

Amortization of intangibles increased $126,000 due to amortization of BNB's core deposit intangible. Other real estate owned expenses increased $204,000 primarily due to impairment charges recognized on a commercial property.

2014 vs. 2013. Total non-interest expense was $4,632,000 greater in 2014 than in 2013 largely due to a $2,275,000 increase in salaries and employee benefits and smaller increases in other line items. Salaries and employee benefits, as well as a variety of other expense items, increased due to the increased number of employees and offices resulting from the Eaton National merger. Occupancy expenses increased $190,000 due to increased real estate taxes, utilities, rental, and maintenance and repair costs, primarily reflecting costs required by the additional offices from the Eaton National merger. Marketing costs increased $142,000 primarily due to greater usage of television and print advertising during 2014. Amortization of intangibles increased $240,000 due to amortization of Eaton National's core deposit intangible, partially offset by the amortization in full of Sycamore National Bank's ("Sycamore") core deposit intangible during 2013. Other real estate owned expenses increased $315,000 primarily due to the absence of a gain recognized on the sale of commercial property during the first quarter 2013.

Income Taxes

LCNB's effective tax rates for the years ended December 31, 2015, 2014, and 2013 were 26.9%, 25.5%, and 25.1%, respectively. The difference between the statutory rate of 34.0% and the effective tax rate is primarily due to tax-exempt interest income and tax-exempt earnings from bank owned life insurance.

Assets

The carrying values of loans, premises and equipment, and deposits were greatly influenced by the merger with BNB. See Note 2 - Acquisition to the Consolidated Financial Statements for a description of the merger and a summary of the fair values of BNB's assets and liabilities added to LCNB's consolidated balance sheet.

Available-for-sale investment securities increased $92.6 million during 2015. Included in the increase were $58.2 million in investment securities obtained through the acquisition of BNB. During 2015, LCNB purchased $163.9 million in new securities. These additions were partially offset by sales, maturities, and calls of investment securities.

Net loans increased $72.0 million during 2015. The BNB merger added $34.7 million of net loans to LCNB's loan portfolio as of the merger date. The remainder of the net increase was due to new loan origination. The increase in the loan portfolio does not reflect $7.7 million of residential fixed-rate real estate loans that were originated and sold to the Federal Home Loan Mortgage Corporation during 2015.

Deposits

Total deposits at December 31, 2015 were $141.0 million greater than at December 31, 2014, including $99.1 million of new deposits obtained through the BNB acquisition and and a $24.0 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.

Liquidity

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. These commitments may include paying dividends to shareholders, funding new loans for borrowers, funding withdrawals by depositors, paying general and administrative expenses, and funding capital expenditures. Sources of liquidity include growth in deposits, principal payments received on loans, proceeds from the sale of loans, the sale or maturation of investment securities, cash generated by operating activities, and the ability to borrow funds. Management closely monitors the level of liquid assets available to meet ongoing funding requirements. It is management's intent to maintain adequate liquidity so that sufficient funds are readily available at a reasonable cost. LCNB experienced no liquidity or operational problems during the past year as a result of current liquidity levels.

The liquidity of LCNB is enhanced by the fact that 84.3% of total deposits at December 31, 2015 were "core" deposits. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than $100,000.

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

Liquid assets include cash and cash equivalents, federal funds sold and securities available-for-sale. Except for investments in the stock of the Federal Reserve Bank and the Federal Home Loan Bank of Cincinnati ("FHLB") and certain local municipal securities, all of LCNB's investment portfolio is classified as "available-for-sale" and can be readily sold to meet liquidity needs, subject to certain pledging commitments for public funds, repurchase agreements, and other requirements. At December 31, 2015, LCNB's liquid assets amounted to $393.0 million or 30.7% of total assets, compared to $301.2 million or 27.2% of total assets at December 31, 2014. The ratio for 2015 is larger because of an increase in securities available-for-sale.

An additional source of funding is borrowings from the FHLB. Long-term advances totaling $5.9 million were outstanding at December 31, 2015. LCNB is approved to borrow up to $55.3 million in short-term advances through the FHLB's Cash Management Advance program. Total remaining available borrowing capacity, including short-term advances, with the FHLB at December 31, 2015 was approximately $99.6 million. One of the factors limiting availability of FHLB borrowings is a bank's ownership of FHLB stock. LCNB could increase its available borrowing capacity by purchasing more FHLB stock.

Besides short-term FHLB advances, short-term borrowings may include repurchase agreements, federal funds purchased, and advances from a line of credit with another financial institution. At December 31, 2015, LCNB could borrow up to $20 million through the line of credit and up to $17 million under federal funds arrangements with two other financial institutions.
Commitments to extend credit at December 31, 2015 totaled $118.9 million, including standby letters of credit totaling $0.5 million, and are more fully described in Note 14 - Commitments and Contingent Liabilities to LCNB's Financial Statements. Since many commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The following table provides information concerning LCNB's contractual obligations at December 31, 2015:

	Payments due by period				
	Total	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years
	(In thousands)				
Short-term borrowings	$37,387	37,387	—	—	—
Long-term debt obligations	5,947	349	5,543	55	—
Operating lease obligations	5,206	479	634	259	3,834
Estimated pension plan contribution for 2016	200	200	—	—	—
Commitment to purchase municipal security when issued	7,630	7,630	—	—	—
Funding commitment for affordable housing tax credit limited partnership	907	291	326	91	199
Estimated capital expenditure obligations	11,026	11,026	—	—	—
Certificates of deposit:					
$100,000 and over	74,055	23,699	20,578	28,042	1,736
Other time certificates	143,900	62,205	36,914	42,275	2,506
Total	$286,258	143,266	63,995	70,722	8,275

During January 2016, LCNB prepaid in full a $5.0 million advance from the FHLB, which is included in the table above in the long-term debt obligations line, over 1 through 3 years. Since the prepaid advance had an interest rate of 5.25%, the average rate on remaining advances will decrease significantly.

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

The following table provides information concerning LCNB's commitments at December 31, 2015:

		Amount of Commitment Expiration Per Period			
	Total Amounts Committed	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years
	(In thousands)				
Commitments to extend credit	$11,815	11,815	—	—	—
Unused lines of credit	106,588	52,035	22,312	19,462	12,779
Standby letters of credit	457	453	4	—	—
Total	$118,860	64,303	22,316	19,462	12,779

Capital Resources

LCNB and the Bank are required by banking regulators to meet certain minimum levels of capital adequacy. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on LCNB's and the Bank's financial statements. These minimum levels are expressed in the form of certain ratios. Capital is separated into Tier 1 capital (essentially shareholders' equity less goodwill and other intangibles) and Tier 2 capital (essentially the allowance for loan losses limited to 1.25% of risk-weighted assets). Common Equity Tier 1 Capital is the sum of common stock, related surplus, and retained earnings, net of treasury stock, accumulated other comprehensive income, and other adjustments. The first three ratios, which are based on the degree of credit risk in the Bank's assets, provide for weighting assets based on assigned risk factors and include off-balance sheet items such as loan commitments and stand-by letters of credit. The ratio of Common Equity Tier 1 Capital to risk weighted assets must be at least 4.50%. The ratio of Tier 1 capital to risk-weighted assets must be at least 6.00% and the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8.00%. 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 4.00%. A table summarizing the regulatory capital of LCNB and the Bank at December 31, 2015 and 2014 is included in Note 15 - Regulatory Matters of the consolidated financial statements.

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

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

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock, as restated for a 100% stock dividend issued in May, 2007, through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares, as restated for a stock dividend. Through December 31, 2015, 290,444 shares, as restated for the stock dividend, had been purchased under this program. No shares were purchased under this program during 2015.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. A total of 466,018 shares, as restated for the stock dividend, had been purchased under this program at December 31, 2015. No shares were purchased under this program during 2015.

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

On January 9, 2009, LCNB issued 13,400 shares of Fixed Rate Cumulative Preferred Stock, Series A and a warrant for the purchase of 217,063 common shares of LCNB stock at an exercise price of $9.26 per share to the U.S. Treasury Department. LCNB allocated $583,000 of the proceeds from the preferred stock issuance to the warrant. The warrant carries a ten year term and was 100% vested at grant. On October 21, 2009, LCNB redeemed the preferred stock that had been issued under the Capital Purchase Program agreement, but did not redeem the warrant. The Treasury Department sold the warrant to an investor during the fourth quarter 2011.

Critical Accounting Policies

Allowance for Loan Losses. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb inherent losses in the loan portfolio, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrowers' ability to pay. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.
The allowance consists of specific and general components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans an allowance is established when the discounted cash flows or collateral value is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors, which include trends in underperforming loans, trends in the volume and terms of loans, economic trends and conditions, concentrations of credit, trends in the quality of loans, and borrower financial statement exceptions.

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

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

Accounting for Intangibles. LCNB’s intangible assets at December 31, 2015 are composed primarily of goodwill and core deposit intangibles related to the acquisitions of Sycamore during the fourth quarter 2007, First Capital during the first quarter 2013, Eaton National during the first quarter 2014, and BNB during the second quarter 2015. It also includes mortgage servicing rights recorded from sales of fixed-rate mortgage loans. Goodwill is not subject to amortization, but is reviewed annually for impairment. The core deposit intangible for Sycamore was amortized on a straight line basis over six years. The core deposit intangible for First Capital and BNB is being amortized on a straight line basis over nine years. The core deposit intangible for Eaton National is being amortized on a straight line basis over eight years. Mortgage servicing rights are capitalized by allocating the total cost of loans between mortgage servicing rights and the loans based on their estimated fair values. Capitalized mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income, subject to periodic review for impairment.

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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

The Bank's Asset and Liability Management Committee ("ALCO") primarily uses a combination of Interest Rate Sensitivity Analysis (IRSA) and Economic Value of Equity (EVE) analysis for measuring and managing interest rate risk. The IRSA model is used to estimate the effect on net interest income during a one-year period of instantaneous and sustained movements in interest rates, also called interest rate shocks, of 100, 200, and 300 basis points. Management considers the results of any significant downward scenarios to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the December 31, 2015 IRSA indicates that an increase in interest rates at all shock levels will have a positive effect on net interest income. The changes in net interest income for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in Net Interest Income	% Change in Net Interest Income
Up 300	$42,163	3,074	7.86 %
Up 200	41,110	2,021	5.17 %
Up 100	40,089	1,000	2.56 %
Base	39,089	—	— %

IRSA shows the effect on net interest income during a one-year period only. A more long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. As shown below, the December 31, 2015 EVE analysis indicates that an increase in interest rates would have a negative effect on the EVE for all shock levels. The changes in the EVE for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in EVE	% Change in EVE
Up 300	$135,725	(3,473)	(2.50)%
Up 200	136,319	(2,879)	(2.07)%
Up 100	137,176	(2,022)	(1.45)%
Base	139,198	—	— %

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.

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LCNB CORP. AND SUBSIDIARIES

Item 8. Financial Statements and Supplementary Data

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

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

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

Management assessed LCNB's internal controls as of December 31, 2015, in relation to criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2015, LCNB's internal control over financial reporting met the criteria.

BKD LLP, an independent registered public accounting firm, has issued an attestation report on the effectiveness of LCNB's internal control over financial reporting as of December 31, 2015.

Submitted by:

LCNB Corp.

/s/ Steve P. Foster	/s/ Robert C. Haines II
Steve P. Foster	Robert C. Haines II
Chief Executive Officer & President	Executive Vice President &
March 9, 2016	Chief Financial Officer
	March 9, 2016

LCNB CORP. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

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

We have audited LCNB Corp. and subsidiaries' (Company) internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Companying management's assessment of internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because management's assessment and our audit were also conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our examination of LCNB Corp.'s internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). A Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

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

In our opinion, LCNB Corp. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of LCNB Corp. and subsidiaries and our report dated March 9, 2016, expressed an unqualified opinion thereon.

/s/ BKD, LLP
BKD, LLP

Cincinnati, Ohio
March 9, 2016

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LCNB CORP. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of LCNB Corp. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2015. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LCNB Corp. and subsidiaries as of December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), LCNB Corp. and subsidiaries' internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 9, 2016, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ BKD, LLP
BKD, LLP

Cincinnati, Ohio
March 9, 2016

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LCNB CORP. AND SUBSIDIARIES

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated statements of income, comprehensive income, shareholders' equity, and cash flows of LCNB Corp. and Subsidiaries ("LCNB") for the year ended December 31, 2013. LCNB's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated results of operations and cash flows for LCNB for the year ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

/s/ Clark, Schaefer, Hackett & Co. (successor of J. D. Cloud & Co. L.L.P., through merger)
Clark, Schaefer, Hackett & Co. (successor of J. D. Cloud & Co. L.L.P., through merger)

Cincinnati, Ohio
March 3, 2014

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LCNB CORP. AND SUBSIDIARIES

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
At December 31,
(Dollars in thousands)

	2015	2014
ASSETS:		
Cash and due from banks	$14,155	14,235
Interest-bearing demand deposits	832	1,610
Total cash and cash equivalents	14,987	15,845
Investment securities:		
Available-for-sale, at fair value	377,978	285,365
Held-to-maturity, at cost	22,633	22,725
Federal Reserve Bank stock, at cost	2,732	2,346
Federal Home Loan Bank stock, at cost	3,638	3,638
Loans, net	767,809	695,835
Premises and equipment, net	22,100	20,733
Goodwill	30,183	27,638
Core deposit and other intangibles	5,396	4,780
Bank owned life insurance	22,561	21,936
Other assets	10,514	7,225
TOTAL ASSETS	$1,280,531	1,108,066
LIABILITIES:		
Deposits:		
Noninterest-bearing	$250,306	213,303
Interest-bearing	836,854	732,902
Total deposits	1,087,160	946,205
Short-term borrowings	37,387	16,645
Long-term debt	5,947	11,357
Accrued interest and other liabilities	9,929	8,164
TOTAL LIABILITIES	1,140,423	982,371
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Preferred shares - no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares - no par value, authorized 12,000,000 shares, issued 10,679,174 and 10,064,945 shares at December 31, 2015 and 2014, respectively	76,908	67,181
Retained earnings	74,629	69,394
Treasury shares at cost, 753,627 shares at December 31, 2015 and 2014	(11,665)	(11,665)
Accumulated other comprehensive income (loss), net of taxes	236	785
TOTAL SHAREHOLDERS' EQUITY	140,108	125,695

TOTAL LIABILITES AND SHAREHOLDERS' EQUITY	$1,280,531	1,108,066

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

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

	2015	2014	2013
INTEREST INCOME:			
Interest and fees on loans	$35,285	32,706	27,325
Interest on investment securities:			
Taxable	4,197	3,757	3,369
Non-taxable	2,848	2,713	2,573
Other investments	329	301	230
TOTAL INTEREST INCOME	42,659	39,477	33,497
INTEREST EXPENSE:			
Interest on deposits	3,009	3,161	3,602
Interest on short-term borrowings	24	22	25
Interest on long-term debt	295	407	438
TOTAL INTEREST EXPENSE	3,328	3,590	4,065
NET INTEREST INCOME	39,331	35,887	29,432
PROVISION FOR LOAN LOSSES	1,366	930	588
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	37,965	34,957	28,844
NON-INTEREST INCOME:			
Trust income	3,262	2,903	2,518
Service charges and fees on deposit accounts	4,920	4,838	4,155
Net gain on sales of securities	495	149	1,060
Bank owned life insurance income	625	671	678
Gains from sales of mortgage loans	343	147	339
Other operating income	478	434	340
TOTAL NON-INTEREST INCOME	10,123	9,142	9,090
NON-INTEREST EXPENSE:			
Salaries and employee benefits	17,593	15,762	13,487
Equipment expenses	1,257	1,316	1,232
Occupancy expense, net	2,307	2,232	2,042
State franchise tax	1,001	955	846
Marketing	720	703	561
Amortization of intangibles	700	574	334
FDIC premiums	598	660	499
ATM expense	698	624	534
Computer maintenance and supplies	782	794	616
Telephone expense	707	690	566
Contracted services	842	880	568
Other real estate owned	489	285	(30)
Merger-related expenses	643	1,400	1,433
Other non-interest expense	4,055	3,969	3,524
TOTAL NON-INTEREST EXPENSE	32,392	30,844	26,212

INCOME BEFORE INCOME TAXES	15,696	13,255	11,722
PROVISION FOR INCOME TAXES	4,222	3,386	2,942
NET INCOME	$11,474	9,869	8,780
Earnings per common share:			
Basic	$1.18	1.06	1.12
Diluted	1.17	1.05	1.10
Weighted average shares outstanding:			
Basic	9,704,965	9,297,019	7,852,514
Diluted	9,811,476	9,406,346	7,982,997

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

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

	2015	2014	2013
Net income	$11,474	9,869	8,780
Other comprehensive income (loss):			
Net unrealized gain (loss) on available-for-sale securities (net of taxes of $169, $1,476, and $2,940 for 2015, 2014, and 2013, respectively)	(329)	2,865	(5,706)
Change in nonqualified pension plan unrecognized net gain (loss) and unrecognized prior service cost (net of taxes of $55, $133, and $38 for 2015, 2014, and 2013, respectively)	107	(260)	73
Reclassification adjustment for:			
Net realized gain on sale of available-for-sale securities included in net income (net of taxes of $168, $51, and $418 for 2015, 2014 and 2013, respectively)	(327)	(98)	(810)
Other comprehensive income (loss)	(549)	2,507	(6,443)
TOTAL COMPREHENSIVE INCOME	$10,925	12,376	2,337

SUPPLEMENTAL INFORMATION: COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX, AS OF YEAR-END:			
Net unrealized gain (loss) on securities available-for-sale	$469	1,125	(1,642)
Net unfunded liability for nonqualified pension plan	(233)	(340)	(80)
Balance at year-end	$236	785	(1,722)

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

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the years ended December 31,
(Dollars in thousands, except share data)

	Common Shares Outstanding	Common Shares	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2012	6,731,900	$27,107	61,843	(11,665)	4,721	82,006
Net income			8,780			8,780
Other comprehensive gain (loss), net of taxes					(6,443)	(6,443)
Issuance of common stock	1,642,857	26,909				26,909
Dividend Reinvestment and Stock Purchase Plan	18,348	329				329
Acquisition of First Capital Bancshares, Inc.	888,811	12,321				12,321
Exercise of stock options	5,620	70				70
Excess tax benefit on exercise and forfeiture of stock options		12				12
Compensation expense relating to stock options		37				37
Common stock dividends, $0.64 per share			(5,148)			(5,148)
Balance, December 31, 2013	9,287,536	66,785	65,475	(11,665)	(1,722)	118,873
Net income			9,869			9,869
Other comprehensive gain (loss), net of taxes					2,507	2,507
Dividend Reinvestment and Stock Purchase Plan	23,782	372				372
Compensation expense relating to stock options		24				24
Common stock dividends, $0.64 per share			(5,950)			(5,950)
Balance, December 31, 2014	9,311,318	67,181	69,394	(11,665)	785	125,695
Net income			11,474			11,474
Other comprehensive gain (loss), net of taxes					(549)	(549)
Dividend Reinvestment and Stock Purchase Plan	24,610	390				390
Acquisition of BNB Bancorp, Inc.	560,132	9,063				9,063
Exercise of stock options	13,449	152				152
Excess tax benefit on exercise and forfeiture of stock options		13				13
Compensation expense relating to stock options		19				19
	16,038	90				90

Compensation expense relating to restricted stock							
Common stock dividends, $0.64 per share			(6,239	)			(6,239	)
Balance, December 31, 2015	9,925,547	$76,908	74,629	(11,665	) 236		140,108

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

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

	2015	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$11,474	9,869	8,780
Adjustments to reconcile net income to net cash flows from operating activities-			
Depreciation, amortization and accretion	2,997	2,991	2,212
Provision for loan losses	1,366	930	588
Deferred income tax provision (benefit)	(58)	192	192
Increase in cash surrender value of bank owned life insurance	(625)		