LCNB CORP
Form 10-Q
November 04, 2015

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

¨	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)

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 ¨ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The number of shares outstanding of the issuer's common stock, without par value, as of October 30, 2015 was 9,903,736 shares.

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LCNB CORP. AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS:		
Cash and due from banks	$18,844	14,235
Interest-bearing demand deposits	14,367	1,610
Total cash and cash equivalents	33,211	15,845
Investment securities:		
Available-for-sale, at fair value	360,741	285,365
Held-to-maturity, at cost	24,575	22,725
Federal Reserve Bank stock, at cost	2,476	2,346
Federal Home Loan Bank stock, at cost	3,638	3,638
Loans, net	759,875	695,835
Premises and equipment, net	22,434	20,733
Goodwill	30,187	27,638
Core deposit and other intangibles	5,601	4,780
Bank owned life insurance	22,406	21,936
Other assets	10,027	7,225
TOTAL ASSETS	$1,275,171	1,108,066
LIABILITIES:		
Deposits:		
Noninterest-bearing	$238,796	213,303
Interest-bearing	864,717	732,902
Total deposits	1,103,513	946,205
Short-term borrowings	14,931	16,645
Long-term debt	6,016	11,357
Accrued interest and other liabilities	9,860	8,164
TOTAL LIABILITIES	1,134,320	982,371
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 10,656,921 and 10,064,945 shares at September 30, 2015 and December 31, 2014, respectively	76,711	67,181
Retained earnings	73,330	69,394
Treasury shares at cost, 753,627 shares at September 30, 2015 and December 31, 2014	(11,665)	(11,665)
Accumulated other comprehensive income, net of taxes	2,475	785
TOTAL SHAREHOLDERS' EQUITY	140,851	125,695
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,275,171	1,108,066

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

The consolidated balance sheet as of December 31, 2014 has been derived from the audited consolidated balance sheet as of that day.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
INTEREST INCOME:				
Interest and fees on loans	$8,540	8,168	26,572	24,008
Interest on investment securities:				
Taxable	1,094	984	2,983	2,901
Non-taxable	732	716	2,087	2,019
Other investments	43	38	205	182
TOTAL INTEREST INCOME	10,409	9,906	31,847	29,110
INTEREST EXPENSE:				
Interest on deposits	834	800	2,187	2,423
Interest on short-term borrowings	5	10	13	18
Interest on long-term debt	73	101	222	305
TOTAL INTEREST EXPENSE	912	911	2,422	2,746
NET INTEREST INCOME	9,497	8,995	29,425	26,364
PROVISION FOR LOAN LOSSES	240	401	986	737
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,257	8,594	28,439	25,627
NON-INTEREST INCOME:				
Trust income	754	688	2,406	2,071
Service charges and fees on deposit accounts	1,314	1,245	3,655	3,619
Net gain (loss) on sales of securities	—	97	332	93
Bank owned life insurance income	156	165	470	507
Gains from sales of loans	34	24	288	92
Other operating income	128	96	372	311
TOTAL NON-INTEREST INCOME	2,386	2,315	7,523	6,693
NON-INTEREST EXPENSE:				
Salaries and employee benefits	4,340	4,022	13,011	11,896
Equipment expenses	324	337	914	976
Occupancy expense, net	570	541	1,749	1,706
State franchise tax	251	231	753	714
Marketing	176	212	559	541
Amortization of intangibles	189	150	510	424
FDIC insurance premiums	136	183	432	492
Merger-related expenses	49	4	641	1,366
Other non-interest expense	2,053	1,558	5,594	5,395
TOTAL NON-INTEREST EXPENSE	8,088	7,238	24,163	23,510
INCOME BEFORE INCOME TAXES	3,555	3,671	11,799	8,810
PROVISION FOR INCOME TAXES	922	953	3,209	2,158
NET INCOME	$2,633	2,718	8,590	6,652
Dividends declared per common share	$0.16	0.16	0.48	0.48

Earnings per common share:				
Basic	$0.26	0.30	0.89	0.72
Diluted	0.26	0.29	0.88	0.71
Weighted average common shares outstanding:				
Basic	9,898,233	9,299,691	9,637,344	9,293,866
Diluted	10,005,788	9,405,013	9,742,839	9,407,110

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 COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	$2,633	2,718	8,590	6,652
Other comprehensive income (loss):				
Net unrealized gain (loss) on available-for-sale securities (net of taxes of $1,015 and $(353) for the three months ended September 30, 2015 and 2014, respectively and $940 and $962 for the nine months ended September 30, 2015 and 2014 respectively)	1,972	(687)	1,825	1,867
Reclassification adjustment for net realized (gain) loss on sale of available-for-sale securities included in net income (net of taxes of $- and $33 for the three months ended September 30, 2015 and 2014, respectively and $113 and $32 for the nine months ended September 30, 2015 and 2014 respectively)	—	(64)	(219)	(61)
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of $15 and $3 for the three months ended September 30, 2015 and 2014, respectively and $44 and $4 for the nine months ended September 30, 2015 and 2014 respectively)	28	4	84	7
TOTAL COMPREHENSIVE INCOME	$4,633	1,971	10,280	8,465

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
(Dollars in thousands, except per share amounts)
(Unaudited)

	Common Shares Outstanding	Common Stock	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2013	9,287,536	$66,785	65,475	(11,665)	(1,722)	118,873
Net income			6,652			6,652
Other comprehensive income, net of taxes					1,813	1,813
Dividend Reinvestment and Stock Purchase Plan	17,672	283				283
Compensation expense relating to stock options		18				18
Common stock dividends, $0.48 per share			(4,460)			(4,460)
Balance at September 30, 2014	9,305,208	$67,086	67,667	(11,665)	91	123,179
Balance at December 31, 2014	9,311,318	$67,181	69,394	(11,665)	785	125,695
Net income			8,590			8,590
Other comprehensive income, net of taxes					1,690	1,690
Dividend Reinvestment and Stock Purchase Plan	18,395	289				289
Acquisition of BNB Bancorp, Inc.	560,132	9,063				9,063
Exercise of stock options	13,449	152				152
Excess tax benefit on exercise of stock options		13				13
Compensation expense relating to stock options		13				13
Common stock dividends, $0.48 per share			(4,654)			(4,654)
Balance at September 30, 2015	9,903,294	$76,711	73,330	(11,665)	2,475	140,851

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
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 8,590	6,652
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization, and accretion	2,108	2,299
Provision for loan losses	986	737
Increase in cash surrender value of bank owned life insurance	(470)	(507)
Realized gain from sales of securities available-for-sale	(332)	(93)
Realized gain from sales of premises and equipment	(1)	(116)
Realized loss from sales and write-downs of other real estate owned and repossessed assets	146	9
Origination of mortgage loans for sale	(5,237)	(5,024)
Realized gains from sales of loans	(288)	(92)
Proceeds from sales of mortgage loans	5,291	5,066
Compensation expense related to stock options	13	18
Changes in:		
Accrued income receivable	(1,103)	(575)
Other assets	(1,789)	689
Other liabilities	776	(46)
TOTAL ADJUSTMENTS	100	2,365
NET CASH FLOWS FROM OPERATING ACTIVITIES	8,690	9,017
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of investment securities available-for-sale	54,955	55,795
Proceeds from maturities and calls of investment securities:		
Available-for-sale	19,658	24,133
Held-to-maturity	1,574	3,345
Purchases of investment securities:		
Available-for-sale	(89,961)	(76,801)
Held-to-maturity	(3,413)	(10,526)
Purchase of Federal Reserve Bank stock	—	(743)
Proceeds from redemption of Federal Reserve Bank stock	—	41
Proceeds from sale of impaired loans	4,559	—
Net (increase) decrease in loans	(34,281)	3,152
Proceeds from redemption of bank owned life insurance	—	3,633
Proceeds from sale of other real estate owned and repossessed assets	114	711
Additions to other real estate owned	(20)	(20)
Purchases of premises and equipment	(444)	(857)
Proceeds from sale of premises and equipment	22	167
Net cash acquired from (paid for) acquisition	8,993	(9,114)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(38,244)	(7,084)
CASH FLOWS FROM FINANCING ACTIVITIES:		

Net increase in deposits	58,175	5,631
Net (decrease) increase in short-term borrowings	(1,714)	15,648
Principal payments on long-term debt	(5,341)	(670)
Proceeds from issuance of common stock	46	50
Proceeds and excess tax benefit from exercise of stock options	165	—
Cash dividends paid on common stock	(4,411)	(4,227)
NET CASH FLOWS FROM FINANCING ACTIVITIES	46,920	16,432
NET CHANGE IN CASH AND CASH EQUIVALENTS	17,366	18,365
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	15,845	14,688
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$33,211	33,053
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$2,490	2,665
Income taxes paid	3,470	2,000
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Transfer from loans to other real estate owned and repossessed assets	79	435

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

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

Note 1 - Basis of Presentation

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

The unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation of financial position, results of operations, and cash flows for the interim periods, as required by Regulation S-X, Rule 10-01.

The consolidated balance sheet as of December 31, 2014 has been derived from the audited consolidated balance sheet as of that day.

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

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

Results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the full year ending December 31, 2015. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, accounting policies, and financial notes thereto included in LCNB's 2014 Annual Report on Form 10-K filed with the SEC.

Note 2 – Acquisitions

On December 29, 2014, LCNB and BNB Bancorp, Inc. (“BNB”) entered into an Agreement and Plan of Merger (“Merger Agreement”) pursuant to which BNB was acquired by LCNB on April 30, 2015. Immediately following the merger of BNB into LCNB, Brookville National Bank ("Brookville"), a wholly-owned subsidiary of BNB, was merged into LCNB National Bank. Brookville operated a main office and a branch office, both in Brookville, Ohio. These offices became branches of the Bank after the merger.

Under the terms of the Merger Agreement, the shareholders of BNB common stock received, for each share of BNB common stock, (i) $15.75 in cash and (ii) 2.005 LCNB common shares.

On October 28, 2013, LCNB and Colonial Banc Corp. (“Colonial”) entered into a Stock Purchase Agreement (“Purchase Agreement”) pursuant to which LCNB purchased from Colonial on January 24, 2014 all of the issued and outstanding shares of Eaton National Bank & Trust Co. ("Eaton National"). Immediately following the acquisition, Eaton National was merged into the Bank. Eaton National operated five full–service branches with a main office and another facility in Eaton, Ohio and branch offices in each of West Alexandria, Ohio, New Paris, Ohio, and Lewisburg, Ohio. These offices became branches of the Bank after the merger.

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

Note 2 – Acquisitions (continued)

The mergers with BNB and Eaton National were accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid were recorded at their estimated fair values as of the respective merger dates, as summarized in the following table (in thousands):

	BNB	Eaton National
Consideration Paid:		
Common shares issued	$9,063	—
Cash paid to shareholder(s)	4,403	24,750
Total consideration paid	13,466	24,750
Identifiable Assets Acquired:		
Cash and cash equivalents	13,396	15,635
Investment securities	58,239	35,859
Federal Reserve Bank stock	130	41
Federal Home Loan Bank stock	—	784
Loans	34,661	115,944
Premises and equipment	2,311	1,314
Bank owned life insurance	—	3,618
Core deposit intangible	1,418	2,466
Other real estate owned	—	262
Other assets	527	1,624
Total identifiable assets acquired	110,682	177,547
Liabilities Assumed:		
Deposits	99,133	165,335
Short-term borrowings	—	651
Deferred income taxes	576	—
Other liabilities	57	263
Total liabilities assumed	99,766	166,249
Total Identifiable Net Assets Acquired	10,916	11,298
Goodwill resulting from merger	2,550	13,452

The amount of goodwill recorded reflects LCNB's entrance into new markets and related synergies that are expected to result from the acquisitions and represent the excess purchase price over the estimated fair value of the net assets acquired. The goodwill will not be amortizable on LCNB's financial records, but is deductible for tax purposes. The core deposit intangible for BNB and Eaton National is being amortized over nine and eight years, respectively, using the straight-line method.

Prior to the end of the one-year measurement period for finalizing the purchase allocation for BNB, if information becomes available which would indicate adjustments to the purchase price allocation, such adjustments will be included in the purchase price retrospectively.

Direct costs related to the acquisitions were expensed as incurred and are recorded as a merger-related expense in the consolidated statements of income.

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(Unaudited)
(Continued)

Note 2 – Acquisitions (continued)

The results of operations are included in the consolidated statement of income from the dates of the mergers. The estimated amount of BNB revenue (net interest income plus non-interest income) and net income, excluding merger-related expenses, included in LCNB's consolidated statement of income for the three and nine months ended September 30, 2015 were as follows (in thousands):

	Three Months	Nine Months
Total revenue	$448	773
Net income	131	196

The following table presents unaudited pro forma information as if the merger with BNB had occurred on January 1, 2014 (in thousands). This pro forma information gives effect to certain adjustments, including acquisition accounting fair value adjustments, amortization of the core deposit intangible, and related income tax effects. It does not include merger-related expenses. The pro forma information does not necessarily reflect the results of operations that would have occurred had the merger with BNB occurred in 2014. In particular, expected operational cost savings are not reflected in the pro forma amounts.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Total revenue	$11,849	12,078	37,741	35,201
Net income	2,643	2,869	9,020	6,965
Basic earnings per common share	0.26	0.29	0.91	0.71
Diluted earnings per common share	0.26	0.29	0.90	0.70

Note 3 - Investment Securities

The amortized cost and estimated fair value of investment securities at September 30, 2015 and December 31, 2014 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2015				
Available-for-Sale:				
U.S. Treasury notes	$89,925	1,211	4	91,132
U.S. Agency notes	111,825	701	128	112,398
U.S. Agency mortgage-backed securities	26,119	331	122	26,328
Certificates of deposit	2,084	2	—	2,086
Municipal securities:				
Non-taxable	98,114	1,766	111	99,769
Taxable	25,109	550	18	25,641
Mutual funds	2,509	—	29	2,480
Trust preferred securities	49	—	—	49
Equity securities	871	55	68	858
	$356,605	$4,616	480	360,741
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	23,975	178	112	24,041
Taxable	600	—	2	598
	$24,575	178	114	24,639
December 31, 2014				
Available-for-Sale:				
U.S. Treasury notes	$62,406	290	136	62,560
U.S. Agency notes	84,661	188	1,212	83,637
U.S. Agency mortgage-backed securities	37,838	413	219	38,032
Certificates of deposit	3,076	10	—	3,086
Municipal securities:				
Non-taxable	75,727	1,972	304	77,395
Taxable	16,005	465	75	16,395
Mutual funds	2,483	—	22	2,461
Trust preferred securities	50	—	—	50
Equity securities	1,415	372	38	1,749
	$283,661	3,710	2,006	285,365
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	22,525	108	695	21,938

Taxable	200	—	—	200
	$22,725	108	695	22,138

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LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
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Note 3 - Investment Securities (continued)

Information concerning investment securities with gross unrealized losses at September 30, 2015 and December 31, 2014, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (dollars in thousands):

	Less than Twelve Months		Twelve Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2015				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$—	—	$4,903	4
U.S. Agency notes	4,992	—	22,311	128
U.S. Agency mortgage-backed securities	3,934	36	4,757	86
Municipal securities:				
Non-taxable	9,194	42	8,096	69
Taxable	2,671	5	887	13
Mutual funds	1,209	4	276	25
Trust preferred securities	49	—	—	—
Equity securities	264	29	144	39
	$22,313	116	$41,374	364
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$10	—	4,243	112
Taxable	398	2	—	—
	$408	2	$4,243	112
December 31, 2014				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$9,141	7	$8,774	129
U.S. Agency notes	—	—	65,971	1,212
U.S. Agency mortgage-backed securities	3,795	2	11,456	217
Municipal securities:				
Non-taxable	7,211	58	11,419	246
Taxable	3,117	15	3,668	60
Mutual funds	281	12	1,190	10
Trust preferred securities	50	—	—	—
Equity securities	197	29	123	9
	$23,792	123	$102,601	1,883
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$8,152	540	$4,200	155
Taxable	—	—	—	—

	$8,152	540	$4,200	155

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

Note 3 - Investment Securities (continued)

Management has determined that the unrealized losses at September 30, 2015 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because LCNB does not have the intent to sell the investments and it is more likely than not that LCNB will not be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, LCNB does not consider these investments to be other-than-temporarily impaired.

Contractual maturities of investment securities at September 30, 2015 were as follows (in thousands). Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$20,324	20,382	4,577	4,593
Due from one to five years	195,313	197,663	3,467	3,456
Due from five to ten years	108,447	109,871	4,534	4,453
Due after ten years	2,973	3,110	11,997	12,137
	327,057	331,026	24,575	24,639
U.S. Agency mortgage-backed securities	26,119	26,328	—	—
Mutual funds	2,509	2,480	—	—
Trust preferred securities	49	49	—	—
Equity securities	871	858	—	—
	$356,605	360,741	24,575	24,639

Investment securities with a market value of $224,053,000 and $175,094,000 at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Certain information concerning the sale of investment securities available-for-sale for the three and nine months ended September 30, 2015 and 2014 was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Proceeds from sales	$—	29,724	54,955	55,795
Gross realized gains	—	169	345	171
Gross realized losses	—	72	13	78

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

Note 4 - Loans

Major classifications of loans at September 30, 2015 and December 31, 2014 are as follows (in thousands):

	September 30, 2015	December 31, 2014
Commercial and industrial	45,325	35,424
Commercial, secured by real estate	407,264	379,141
Residential real estate	274,054	254,087
Consumer	19,283	18,006
Agricultural	16,016	11,472
Other loans, including deposit overdrafts	676	680
	762,618	698,810
Deferred net origination costs (fees)	215	146
	762,833	698,956
Less allowance for loan losses	2,958	3,121
Loans, net	759,875	695,835

All advances from the Federal Home Loan Bank of Cincinnati are secured by a blanket pledge of LCNB's 1-4 family first lien mortgage loans in the amount of approximately $233 million and $212 million at September 30, 2015 and December 31, 2014, respectively. Additionally, LCNB is required to hold minimum levels of FHLB stock, based on the outstanding borrowings.

Loans acquired through mergers are recorded at fair value with no carryover of the acquired entity's previously established allowance for loan losses. The excess of expected cash flows over the estimated fair value of acquired loans is recognized as interest income over the remaining contractual lives of the loans using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows result in the recognition of additional interest income over the then-remaining contractual lives of the loans.

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

The following table provides certain information at the acquisition date on loans acquired from BNB on April 30, 2015 and Eaton National on January 24, 2014, not including loans considered to be impaired (in thousands):

	BNB	Eaton National
Contractually required principal at acquisition	$32,174	102,483

Less fair value adjustment	199	1,347
Fair value of acquired loans	$31,975	101,136
Contractual cash flows not expected to be collected	$195	1,702

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Note 4 – Loans (continued)

The following table provides details on acquired impaired loans obtained through the mergers with BNB and Eaton National that are accounted for in accordance with FASB ASC 310-30 (in thousands):

	BNB	Eaton National
Contractually required principal at acquisition	$3,511	23,414
Contractual cash flows not expected to be collected (nonaccretable difference)	(404)	(6,088)
Expected cash flows at acquisition	3,107	17,326
Interest component of expected cash flows (accretable discount)	(413)	(2,163)
Fair value of acquired impaired loans	$2,694	15,163

Non-accrual, past-due, and accruing restructured loans as of September 30, 2015 and December 31, 2014 are as follows (in thousands):

	September 30, 2015	December 31, 2014
Non-accrual loans:		
Commercial and industrial	$—	—
Commercial, secured by real estate	1,302	4,277
Agricultural	39	70
Residential real estate	913	1,252
Total non-accrual loans	2,254	5,599
Past-due 90 days or more and still accruing	130	203
Total non-accrual and past-due 90 days or more and still accruing	2,384	5,802
Accruing restructured loans	13,887	14,269
Total	$16,271	20,071

LCNB sold impaired loans with a carrying value of approximately $4.5 million during the second quarter 2015. The decrease in non-accrual loans at September 30, 2015 as compared to December 31, 2014 is primarily due to this sale.

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Note 4 – Loans (continued)

The allowance for loan losses for the three and nine months ended September 30, 2015 and 2014 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
Three Months Ended September 30, 2015							
Allowance for loan losses:							
Balance, beginning of period	$ 162	1,655	914	62	83	3	2,879
Provision charged to expenses	167	97	(60)	14	9	13	240
Losses charged off	(89)	(29)	(46)	(20)	—	(26)	(210)
Recoveries	3	—	23	12	—	11	49
Balance, end of period	$ 243	1,723	831	68	92	1	2,958
Nine Months Ended September 30, 2015							
Allowance for loan losses:							
Balance, beginning of year	$ 129	1,990	926	63	11	2	3,121
Provision charged to expenses	209	612	57	1	81	26	986
Losses charged off	(100)	(975)	(243)	(49)	(67)	(52)	(1,486)
Recoveries	5	96	91	53	67	25	337
Balance, end of period	$ 243	1,723	831	68	92	1	2,958
Three Months Ended September 30, 2014							
Allowance for loan losses:							
Balance, beginning of period	$ 331	2,068	916	69	8	2	3,394
Provision charged to expenses	75	97	201	5	3	20	401
Losses charged off	(261)	(112)	(106)	(24)	—	(32)	(535)
Recoveries	1	—	1	25	—	11	38
Balance, end of period	$ 146	2,053	1,012	75	11	1	3,298
Nine Months Ended September 30, 2014							
Allowance for loan losses:							
Balance, beginning of year	$ 175	2,520	826	66	—	1	3,588
Provision charged to expenses	221	16	440	19	11	30	737
Losses charged off	(261)	(483)	(281)	(85)	—	(65)	(1,175)
Recoveries	11	—	27	75	—	35	148
Balance, end of period	$ 146	2,053	1,012	75	11	1	3,298

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Note 4 – Loans (continued)

A breakdown of the allowance for loan losses and the loan portfolio by loan segment at September 30, 2015 and December 31, 2014 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
September 30, 2015							
Allowance for loan losses:							
Individually evaluated for impairment	$ 9	295	68	—	—	—	372
Collectively evaluated for impairment	234	1,428	763	68	92	1	2,586
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of period	$ 243	1,723	831	68	92	1	2,958
Loans:							
Individually evaluated for impairment	$ 378	12,421	1,591	51	—	—	14,441
Collectively evaluated for impairment	43,215	386,335	269,809	19,281	15,985	157	734,782
Acquired credit impaired loans	1,754	8,173	3,082	43	39	519	13,610
Balance, end of period	$ 45,347	406,929	274,482	19,375	16,024	676	762,833
December 31, 2014							
Allowance for loan losses:							
Individually evaluated for impairment	$ 10	415	89	—	—	—	514
Collectively evaluated for impairment	119	1,273	836	63	11	2	2,304
Acquired credit impaired loans	—	302	1	—	—	—	303
Balance, end of period	$ 129	1,990	926	63	11	2	3,121
Loans:							
Individually evaluated for impairment	$ 401	13,022	1,701	55	—	—	15,179
Collectively evaluated for impairment	33,941	352,774	249,374	17,954	11,371	167	665,581
Acquired credit impaired loans	1,092	12,984	3,425	81	101	513	18,196
Balance, end of period	$ 35,434	378,780	254,500	18,090	11,472	680	698,956

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Note 4 – Loans (continued)

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

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

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

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

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

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

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

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

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

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

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Note 4 – Loans (continued)

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

- Pass – loans categorized in this category are higher quality loans that do not fit any of the other categories described below.
- Other Assets Especially Mentioned (OAEM) - loans in this category are currently protected but are potentially weak. These loans constitute a risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an undue risk in light of the circumstances surrounding a specific asset.
- Substandard – loans in this category are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that LCNB will sustain some loss if the deficiencies are not corrected.
- Doubtful – loans classified in this category have all the weaknesses inherent in loans classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

A breakdown of the loan portfolio by credit quality indicators at September 30, 2015 and December 31, 2014 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
September 30, 2015					
Commercial & industrial	$44,446	—	901	—	45,347
Commercial, secured by real estate	385,748	8,002	13,179	—	406,929
Residential real estate	268,629	1,241	4,612	—	274,482
Consumer	19,316	—	59	—	19,375
Agricultural	14,781	—	1,243	—	16,024
Other	676	—	—	—	676
Total	$733,596	9,243	19,994	—	762,833
December 31, 2014					
Commercial & industrial	$34,322	—	1,112	—	35,434
Commercial, secured by real estate	353,957	6,421	18,402	—	378,780
Residential real estate	246,335	920	7,245	—	254,500
Consumer	17,979	—	111	—	18,090
Agricultural	11,273	—	199	—	11,472
Other	680	—	—	—	680
Total	$664,546	7,341	27,069	—	698,956

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Note 4 – Loans (continued)

A loan portfolio aging analysis at September 30, 2015 and December 31, 2014 is as follows (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans Greater Than 90 Days and Accruing
September 30, 2015							
Commercial & industrial	$43	—	—	43	45,304	45,347	—
Commercial, secured by real estate	242	—	1,302	1,544	405,385	406,929	—
Residential real estate	807	275	779	1,861	272,621	274,482	116
Consumer	69	10	14	93	19,282	19,375	14
Agricultural	30	1,110	—	1,140	14,884	16,024	—
Other	85	—	—	85	591	676	—
Total	$1,276	1,395	2,095	4,766	758,067	762,833	130
December 31, 2014							
Commercial & industrial	$4	—	—	4	35,430		