LCNB CORP
Form 10-Q
August 05, 2016

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 June 30, 2016
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 001-35292
LCNB Corp.
(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
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 August 4, 2016 was 9,978,975 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 CONDENSED BALANCE SHEETS
(Dollars in thousands, except per share data)

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS:		
Cash and due from banks	$17,254	14,155
Interest-bearing demand deposits	1,753	832
Total cash and cash equivalents	19,007	14,987
Investment securities:		
Available-for-sale, at fair value	353,528	377,978
Held-to-maturity, at cost	39,447	22,633
Federal Reserve Bank stock, at cost	2,732	2,732
Federal Home Loan Bank stock, at cost	3,638	3,638
Loans, net	797,092	767,809
Premises and equipment, net	24,985	22,100
Goodwill	30,183	30,183
Core deposit and other intangibles	4,986	5,396
Bank owned life insurance	26,921	22,561
Other assets	10,116	10,514
TOTAL ASSETS	$1,312,635	1,280,531
LIABILITIES:		
Deposits:		
Noninterest-bearing	$252,498	250,306
Interest-bearing	872,200	836,854
Total deposits	1,124,698	1,087,160
Short-term borrowings	30,541	37,387
Long-term debt	726	5,947
Accrued interest and other liabilities	10,960	9,929
TOTAL LIABILITIES	1,166,925	1,140,423
COMMITMENTS AND CONTINGENT LIABILITIES	—	—
SHAREHOLDERS' EQUITY:		
Preferred shares – no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares – no par value; authorized 19,000,000 and 12,000,000 shares at June 30, 2016 and December 31, 2015, respectively; issued 10,690,889 and 10,679,174 shares at June 30, 2016 and December 31, 2015, respectively	75,602	76,908
Retained earnings	77,384	74,629
Treasury shares at cost, 753,627 shares at June 30, 2016 and December 31, 2015	(11,665)	(11,665)

Accumulated other comprehensive income, net of taxes	4,389	236
TOTAL SHAREHOLDERS' EQUITY	145,710	140,108
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,312,635	1,280,531

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

The consolidated condensed balance sheet as of December 31, 2015 has been derived from the audited consolidated balance sheet as of that day.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
INTEREST INCOME:				
Interest and fees on loans	$8,892	9,492	17,519	18,032
Interest on investment securities:				
Taxable	1,187	1,033	2,376	1,889
Non-taxable	794	702	1,552	1,355
Other investments	135	121	182	162
TOTAL INTEREST INCOME	11,008	11,348	21,629	21,438
INTEREST EXPENSE:				
Interest on deposits	870	671	1,693	1,353
Interest on short-term borrowings	8	4	22	8
Interest on long-term debt	5	73	17	149
TOTAL INTEREST EXPENSE	883	748	1,732	1,510
NET INTEREST INCOME	10,125	10,600	19,897	19,928
PROVISION FOR LOAN LOSSES	396	677	486	746
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,729	9,923	19,411	19,182
NON-INTEREST INCOME:				
Trust income	837	852	1,600	1,652
Service charges and fees on deposit accounts	1,243	1,234	2,436	2,341
Net gain on sales of securities	279	221	650	332
Bank owned life insurance income	191	155	360	314
Gains from sales of loans	61	219	102	254
Other operating income	139	150	244	244
TOTAL NON-INTEREST INCOME	2,750	2,831	5,392	5,137
NON-INTEREST EXPENSE:				
Salaries and employee benefits	4,532	4,381	9,095	8,671
Equipment expenses	239	302	488	590
Occupancy expense, net	588	584	1,157	1,179
State franchise tax	276	250	557	502
Marketing	201	220	368	383
Amortization of intangibles	188	175	375	321
FDIC insurance premiums	162	145	327	296
Other real estate owned	356	20	385	55
Merger-related expenses	—	522	—	592
Other non-interest expense	1,926	1,827	4,008	3,486
TOTAL NON-INTEREST EXPENSE	8,468	8,426	16,760	16,075
INCOME BEFORE INCOME TAXES	4,011	4,328	8,043	8,244
PROVISION FOR INCOME TAXES	1,043	1,205	2,111	2,287
NET INCOME	$2,968	3,123	5,932	5,957
Dividends declared per common share	$0.16	0.16	0.32	0.32

Earnings per common share:				
Basic	$0.30	0.33	0.60	0.63
Diluted	0.29	0.32	0.59	0.62
Weighted average common shares outstanding:				
Basic	$9,922,024	9,694,732	9,919,070	9,504,739
Diluted	9,943,797	9,804,728	9,971,900	9,609,050

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$2,968	3,123	5,932	5,957
Other comprehensive income (loss):				
Net unrealized gain (loss) on available-for-sale securities (net of taxes of $742 and $838 for the three months ended June 30, 2016 and 2015, respectively and $2,332 and $75 for the six months ended June 30, 2016 and 2015, respectively.)	1,439	(1,627)	4,526	(147)
Reclassification adjustment for net realized (gain) loss on sale of available-for-sale securities included in net income (net of taxes of $95 and $75 for the three months ended June 30, 2016 and 2015, respectively and $221 and $113 for the six months ended June 30, 2016 and 2015, respectively)	(184)	(146)	(429)	(219)
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of $14 and $15 for the three months ended June 30, 2016 and 2015, respectively and $28 and $29 for the six months ended June 30, 2016 and 2015, respectively)	28	28	56	56
TOTAL COMPREHENSIVE INCOME	$4,251	1,378	10,085	5,647

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

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

	Common Shares Outstanding	Common Stock	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2014	9,311,318	$67,181	69,394	(11,665)	785	125,695
Net income			5,957			5,957
Other comprehensive income, net of taxes					(310)	(310)
Dividend Reinvestment and Stock Purchase Plan	12,005	188				188
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		10				10
Common stock dividends, $0.32 per share			(3,070)			(3,070)
Balance at June 30, 2015	9,896,904	$76,607	72,281	(11,665)	475	137,698
Balance at December 31, 2015	9,925,547	$76,908	74,629	(11,665)	236	140,108
Net income			5,932			5,932
Other comprehensive income, net of taxes					4,153	4,153
Dividend Reinvestment and Stock Purchase Plan	11,715	192				192
Repurchase of stock warrants		(1,545)				(1,545)
Compensation expense relating to stock options		2				2
Compensation expense relating to restricted stock		45				45
Common stock dividends, $0.32 per share			(3,177)			(3,177)
Balance at June 30, 2016	9,937,262	$75,602	77,384	(11,665)	4,389	145,710

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

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$5,932	5,957
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization, and accretion	1,680	1,257
Provision for loan losses	486	746
Increase in cash surrender value of bank owned life insurance	(360)	(314)
Realized gain from sales of securities available-for-sale	(650)	(332)
Realized loss from sales of premises and equipment	35	—
Realized (gain) loss from sales and write-downs of other real estate owned and repossessed assets	346	(9)
Origination of mortgage loans for sale	(4,850)	(3,594)
Realized gains from sales of loans	(102)	(254)
Proceeds from sales of mortgage loans	4,907	3,633
Compensation expense related to stock options	2	10
Compensation expense related to restricted stock	45	—
Changes in:		
Accrued income receivable	(224)	(66)
Other assets	46	(2,671)
Other liabilities	(613)	651
TOTAL ADJUSTMENTS	748	(943)
NET CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES	6,680	5,014
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of investment securities available-for-sale	36,529	54,955
Proceeds from maturities and calls of investment securities:		
Available-for-sale	33,025	10,858
Held-to-maturity	3,342	1,471
Purchases of investment securities:		
Available-for-sale	(38,915)	(70,922)
Held-to-maturity	(20,156)	(3,413)
Proceeds from sale of impaired loans	—	4,559
Net increase in loans	(29,740)	(26,123)
Purchase of bank owned life insurance	(4,000)	—
Proceeds from sale of other real estate owned and repossessed assets	—	114
Additions to other real estate owned	(182)	(20)
Purchases of premises and equipment	(3,565)	(231)
Proceeds from sale of premises and equipment	61	21
Net cash acquired from acquisition	—	8,993
NET CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES	(23,601)	(19,738)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	37,538	38,695
Net decrease in short-term borrowings	(6,846)	(3,914)

Principal payments on long-term debt	(5,221)	(5,272)
Proceeds from issuance of common stock	30	28
Repurchase of stock warrants	(1,545)	—
Proceeds and excess tax benefit from exercise of stock options	—	165
Cash dividends paid on common stock	(3,015)	(2,910)
NET CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES	20,941	26,792
NET CHANGE IN CASH AND CASH EQUIVALENTS	4,020	12,068
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	14,987	15,845
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$19,007	27,913
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$1,780	1,542
Income taxes paid	2,160	2,450
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Transfer from loans to other real estate owned and repossessed assets	—	79

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

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LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED 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 condensed financial statements include the accounts of LCNB and the Bank.

The unaudited interim consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation of financial position, results of operations, and cash flows for the interim periods, as required by Regulation S-X, Rule 10-01.

The consolidated balance sheet as of December 31, 2015 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.

LCNB adopted ASU No. 2015-07, "Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)" during the first quarter of 2016. ASU No. 2015-07 applies to entities that measure an investment's fair value using the net asset value per share, or an equivalent, as a practical expedient. It eliminates the requirement to classify such investments within the fair value hierarchy. The amendments are to be applied retrospectively to all periods presented. LCNB measures the fair value of certain mutual fund investments using the net asset value per share practical expedient and disclosures concerning these investments in Note 15 - Fair Value Measurements have been changed to comply with the new guidance. Adoption did not have an impact on LCNB's results of operations or financial position.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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 six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the full year ending December 31, 2016. 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 2015 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.

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LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
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Note 2 – Acquisitions (continued)

The merger with BNB was 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 merger date, as summarized in the following table (in thousands):

Consideration Paid:	
Common shares issued	$ 9,063
Cash paid to shareholder(s)	4,403
Total consideration paid	13,466
Identifiable Assets Acquired:	
Cash and cash equivalents	13,396
Investment securities	58,239
Federal Reserve Bank stock	130
Loans	34,661
Premises and equipment	2,311
Core deposit intangible	1,418
Other assets	532
Total identifiable assets acquired	110,687
Liabilities Assumed:	
Deposits	99,133
Deferred income taxes	576
Other liabilities	57
Total liabilities assumed	99,766
Total Identifiable Net Assets Acquired	10,921
Goodwill resulting from merger	$ 2,545

The amount of goodwill recorded reflects LCNB's entrance into a new market and related synergies that are expected to result from the acquisition 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 is being amortized over nine years using the straight-line method.

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

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(Continued)

Note 3 - Investment Securities

The amortized cost and estimated fair value of investment securities at June 30, 2016 and December 31, 2015 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2016				
Available-for-Sale:				
U.S. Treasury notes	$ 52,567	1,414	—	53,981
U.S. Agency notes	113,554	1,784	—	115,338
U.S. Agency mortgage-backed securities	47,701	592	17	48,276
Certificates of deposit	248	—	—	248
Municipal securities:				
Non-taxable	108,842	2,397	6	111,233
Taxable	20,507	721	2	21,226
Mutual funds	2,508	8	17	2,499
Trust preferred securities	49	—	—	49
Equity securities	633	48	3	678
	$ 346,609	$ 6,964	45	353,528
Held-to-Maturity:				
Municipal securities:				
Non-taxable	30,084	796	29	30,851
Taxable	9,363	68	—	9,431
	$ 39,447	864	29	40,282
December 31, 2015				
Available-for-Sale:				
U.S. Treasury notes	$ 72,672	309	135	72,846
U.S. Agency notes	140,876	164	1,151	139,889
U.S. Agency mortgage-backed securities	29,608	174	404	29,378
Certificates of deposit	248	1	—	249
Municipal securities:				
Non-taxable	103,900	1,713	134	105,479
Taxable	26,738	337	134	26,941
Mutual funds	2,517	—	51	2,466
Trust preferred securities	49	1	—	50
Equity securities	659	40	19	680
	$ 377,267	2,739	2,028	377,978
Held-to-Maturity:				
Municipal securities:				

Non-taxable	22,233	95	97	22,231
Taxable	400	—	1	399
	$ 22,633	95	98	22,630

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LCNB CORP. AND SUBSIDIARIES
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Note 3 - Investment Securities (continued)

Information concerning investment securities with gross unrealized losses at June 30, 2016 and December 31, 2015, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (dollars in thousands):

	Less than Twelve Months		Twelve Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2016				
Available-for-Sale:				
U.S. Treasury notes	$—	—	$—	—
U.S. Agency notes	—	—	—	—
U.S. Agency mortgage-backed securities	—	—	3,909	17
Municipal securities:				
Non-taxable	—	—	2,770	6
Taxable	1,005	—	451	2
Mutual funds	—	—	263	17
Trust preferred securities	49	—	—	—
Equity securities	68	3	—	—
	$1,122	3	$7,393	42
Held-to-Maturity:				
Municipal securities:				
Non-taxable	$—	—	2,636	29
Taxable	—	—	—	—
	$—	—	$2,636	29
December 31, 2015				
Available-for-Sale:				
U.S. Treasury notes	$32,854	75	$4,846	60
U.S. Agency notes	104,053	1,000	9,869	151
U.S. Agency mortgage-backed securities	19,190	256	4,068	148
Municipal securities:				
Non-taxable	13,124	74	7,037	60
Taxable	15,601	114	880	20
Mutual funds	1,215	17	268	34
Trust preferred securities	—	—	—	—
Equity securities	248	12	73	7
	$186,285	1,548	$27,041	480
Held-to-Maturity:				
Municipal securities:				
Non-taxable	$832	3	$3,426	94

Taxable	399	1	—	—
	$1,231	4	$3,426	94

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

Note 3 - Investment Securities (continued)

Management has determined that the unrealized losses at June 30, 2016 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because LCNB does not have the intent to sell the investments and it is more likely than not that LCNB will not be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, LCNB does not consider these investments to be other-than-temporarily impaired.

Contractual maturities of investment securities at June 30, 2016 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	$23,089	23,181	3,620	3,626
Due from one to five years	150,743	153,748	4,211	4,222
Due from five to ten years	121,380	124,583	11,073	11,239
Due after ten years	506	514	20,543	21,195
	295,718	302,026	39,447	40,282
U.S. Agency mortgage-backed securities	47,701	48,276	—	—
Mutual funds	2,508	2,499	—	—
Trust preferred securities	49	49	—	—
Equity securities	633	678	—	—
	$346,609	353,528	39,447	40,282

Investment securities with a market value of $228,901,000 and $215,952,000 at June 30, 2016 and December 31, 2015, respectively, were pledged to secure public deposits and for other purposes required as permitted by law.

Certain information concerning the sale of investment securities available-for-sale for the three and six months ended June 30, 2016 and 2015 was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Proceeds from sales	$16,100	48,953	$36,529	54,955
Gross realized gains	300	234	671	345
Gross realized losses	21	13	21	13

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
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Note 4 - Loans

Major classifications of loans at June 30, 2016 and December 31, 2015 are as follows (in thousands):

	June 30, 2016	December 31, 2015
Commercial and industrial	$45,153	45,275
Commercial, secured by real estate	455,654	419,633
Residential real estate	266,625	273,139
Consumer	18,545	18,510
Agricultural	13,605	13,479
Other loans, including deposit overdrafts	635	665
	800,217	770,701
Deferred net origination costs (fees)	248	237
	800,465	770,938
Less allowance for loan losses	3,373	3,129
Loans, net	$797,092	767,809

All advances from the Federal Home Loan Bank ("FHLB") of Cincinnati are secured by a blanket pledge of LCNB's 1-4 family first lien mortgage loans in the amount of approximately $225 million and $231 million at June 30, 2016 and December 31, 2015, 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.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
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(Continued)

Note 4 – Loans (continued)

Non-accrual, past-due, and accruing restructured loans as of June 30, 2016 and December 31, 2015 are as follows (in thousands):

	June 30, 2016	December 31, 2015
Non-accrual loans:		
Commercial and industrial	$—	—
Commercial, secured by real estate	1,362	876
Residential real estate	951	799
Consumer	—	—
Agricultural	384	48
Total non-accrual loans	2,697	1,723
Past-due 90 days or more and still accruing	369	559
Total non-accrual and past-due 90 days or more and still accruing	3,066	2,282
Accruing restructured loans	13,855	13,723
Total	$16,921	16,005

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Note 4 – Loans (continued)

The allowance for loan losses for the three and six months ended June 30, 2016 and 2015 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
Three Months Ended June 30, 2016							
Allowance for loan losses:							
Balance, beginning of period	$ 247	1,868	896	81	56	2	3,150
Provision charged to expenses	74	320	(1)	(12)	6	9	396
Losses charged off	(49)	(117)	(14)	(9)	—	(19)	(208)
Recoveries	1	—	4	20	—	10	35
Balance, end of period	$ 273	2,071	885	80	62	2	3,373
Six Months Ended June 30, 2016							
Allowance for loan losses:							
Balance, beginning of year	$ 244	1,908	854	54	66	3	3,129
Provision charged to expenses	74	285	65	49	(4)	17	486
Losses charged off	(49)	(140)	(42)	(53)	—	(42)	(326)
Recoveries	4	18	8	30	—	24	84
Balance, end of period	$ 273	2,071	885	80	62	2	3,373
Three Months Ended June 30, 2015							
Allowance for loan losses:							
Balance, beginning of period	$ 131	1,640	934	54	77	1	2,837
Provision charged to expenses	41	552	53	16	6	9	677
Losses charged off	(11)	(633)	(115)	(18)	(67)	(12)	(856)
Recoveries	1	96	42	10	67	5	221
Balance, end of period	$ 162	1,655	914	62	83	3	2,879
Six Months Ended June 30, 2015							
Allowance for loan losses:							
Balance, beginning of year	$ 129	1,990	926	63	11	2	3,121
Provision charged to expenses	42	515	117	(13)	72	13	746
Losses charged off	(11)	(946)	(197)	(29)	(67)	(26)	(1,276)
Recoveries	2	96	68	41	67	14	288
Balance, end of period	$ 162	1,655	914	62	83	3	2,879

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Note 4 – Loans (continued)

A breakdown of the allowance for loan losses and the loan portfolio by loan segment at June 30, 2016 and December 31, 2015 are as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
June 30, 2016							
Allowance for loan losses:							
Individually evaluated for impairment	$ 6	195	90	9	—	—	300
Collectively evaluated for impairment	267	1,875	795	71	62	2	3,072
Acquired credit impaired loans	—	1	—	—	—	—	1
Balance, end of period	$ 273	2,071	885	80	62	2	3,373
Loans:							
Individually evaluated for impairment	$ 354	12,672	1,584	47	384	—	15,041
Collectively evaluated for impairment	43,452	436,405	262,558	18,571	13,230	164	774,380
Acquired credit impaired loans	1,363	6,249	2,941	20	—	471	11,044
Balance, end of period	$ 45,169	455,326	267,083	18,638	13,614	635	800,465
December 31, 2015							
Allowance for loan losses:							
Individually evaluated for impairment	$ 9	306	48	—	—	—	363
Collectively evaluated for impairment	235	1,602	806	54	66	3	2,766
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of period	$ 244	1,908	854	54	66	3	3,129
Loans:							
Individually evaluated for impairment	$ 370	12,351	1,541	56	—	—	14,318
Collectively evaluated for impairment	43,726	399,092	269,001	18,516	13,438	179	743,952
Acquired credit impaired loans	1,191	7,877	3,039	27	48	486	12,668
Balance, end of period	$ 45,287	419,320	273,581	18,599	13,486	665	770,938

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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 adjustment periods ranging from one month to five years. Adjustments are generally based on a publicly available index rate plus a margin. The margin varies based on the terms and collateral securing the loan. Commercial and industrial loans are offered to businesses and professionals for short and medium terms on both a collateralized and uncollateralized basis. Commercial and industrial loans typically are underwritten on the basis of the borrower’s ability to make repayment from the cash flow of the business. Collateral, when obtained, may include liens on furniture, fixtures, equipment, inventory, receivables, or other assets. As a result, such loans involve complexities, variables, and risks that require thorough underwriting and more robust servicing than other types of loans.

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

Commercial real estate loans are underwritten based on the ability of the property, in the case of income producing property, or the borrower’s business to generate sufficient cash flow to amortize the debt. Secondary emphasis is placed upon global debt service, collateral value, financial strength of any guarantors, and other factors. Commercial real estate loans are generally originated with a 75% 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 June 30, 2016 and December 31, 2015 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
June 30, 2016					
Commercial & industrial	$44,477	39	653	—	45,169
Commercial, secured by real estate	438,822	4,487	12,017	—	455,326
Residential real estate	261,423	998	4,662	—	267,083
Consumer	18,528	—	110	—	18,638
Agricultural	12,037	850	727	—	13,614
Other	635	—	—	—	635
Total	$775,922	6,374	18,169	—	800,465
December 31, 2015					
Commercial & industrial	$44,596	—	691	—	45,287
Commercial, secured by real estate	397,938	9,316	12,066	—	419,320
Residential real estate	267,567	1,935	4,079	—	273,581
Consumer	18,528	—	71	—	18,599
Agricultural	12,246	850	390	—	13,486
Other	665	—	—	—	665
Total	$741,540	12,101	17,297	—	770,938

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Note 4 – Loans (continued)

A loan portfolio aging analysis at June 30, 2016 and December 31, 2015 is as follows (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans Greater Than 90 Days and Accruing
June 30, 2016							
Commercial & industrial	$15	—	—	15	45,154	45,169	—
Commercial, secured by real estate	—	—	1,362	1,362	453,964	455,326	—
Residential real estate	590	436	1,140	2,166	264,917	267,083	335
Consumer	16	22	34	72	18,566	18,638	34
Agricultural	44	—	384	428	13,186	13,614	—
Other	97	—	—	97	538	635	—
Total	$762	458	2,920	4,140	796,325	800,465	369
December 31, 2015							
Commercial & industrial	$—	—	—	—	45,287	45,287	—
Commercial, secured by real estate	73	81	876	1,030	418,290	419,320	—
Residential real estate	777	198	1,124	2,099	271,482	273,581	516
Consumer	62	7	43	112	18,487	18,599	43
Agricultural	—	—	—	—	13,486	13,486	—
Other	109	—	—	109	556	665	—
Total	$1,021	286	2,043	3,350	767,588	770,938	559

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Note 4 – Loans (continued)

Impaired loans, including acquired credit impaired loans, at June 30, 2016 and December 31, 2015 are as follows (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance
June 30, 2016			
With no related allowance recorded:			
Commercial & industrial	$ 1,362	1,635	—
Commercial, secured by real estate	16,289	18,063	—
Residential real estate	3,808	4,980	—
Consumer	33	48	—
Agricultural	384	384	—
Other	471	665	—
Total	$ 22,347	25,775	—
With an allowance recorded:			
Commercial & industrial	$ 355	354	6
Commercial, secured by real estate	2,632	2,709	196
Residential real estate	717	855	90
Consumer	34	34	9
Agricultural	—	—	—
Other	—	—	—
Total	$ 3,738	3,952	301
Total:			
Commercial & industrial	$ 1,717	1,989	6
Commercial, secured by real estate	18,921	20,772	196
Residential real estate	4,525	5,835	90
Consumer	67	82	9
Agricultural	384	384	—
Other	471	665	—
Total	$ 26,085	29,727	301
December 31, 2015			
With no related allowance recorded:			
Commercial & industrial	$ 1,205	1,500	—
Commercial, secured by real estate	16,345	18,335	—
Residential real estate	3,734	5,055	—
Consumer	81	109	—
Agricultural	48	151	—
Other	486	701	—
Total	$ 21,899	25,851	—

With an allowance recorded:			
Commercial & industrial	$ 356	356	9
Commercial, secured by real estate	3,883	4,014	306
Residential real estate	846	958	48
Consumer	2	1	—
Agricultural	—	—	—
Other	—	—	—
Total	$ 5,087	5,329	363
Total:			
Commercial & industrial	$ 1,561	1,856	9
Commercial, secured by real estate	20,228	22,349	306
Residential real estate	4,580	6,013	48
Consumer	83	110	—
Agricultural	48	151	—
Other	486	701	—
Total	$ 26,986	31,180	363

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Note 4 – Loans (continued)

The following presents information related to the average recorded investment and interest income recognized on impaired loans, including acquired credit impaired loans, for the three and six months ended June 30, 2016 and 2015 (in thousands):

	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Three Months Ended June 30,				
With no related allowance recorded:				
Commercial & industrial	$964	26	1,609	60
Commercial, secured by real estate	17,292	278	19,259	742
Residential real estate	3,855	123	4,175	138
Consumer	40	8	93	3
Agricultural	423	123	110	35
Other	495	20	516	20
Total	$23,069	578	25,762	998

With an allowance recorded: