LCNB CORP
Form 10-K
February 28, 2012

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, 2011
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	x Accelerated 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, 2011 determined using a per share closing price on that date of $11.92 as quoted on the Nasdaq Over-the-Counter Bulletin Board, was $74,869,735.

As of February 27, 2012, 6,705,307 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 24, 2012, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2011 are incorporated by reference into Part III.

LCNB CORP.

For the Year Ended December 31, 2011

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

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

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. completed the sale of its subsidiary, Dakin Insurance Agency, Inc. (“Dakin”) to Rixey-Berry Insurance Group on March 23, 2011. 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. At the close of business on December 20, 2007, Sycamore National Bank (“Sycamore”) merged with and into the Bank. A Cincinnati, Ohio based commercial bank, Sycamore operated two offices located on Cincinnati’s West side. These two offices became branches of the Bank at the time of the merger. The Bank's main office is located in Warren County, Ohio and 24 branch offices are located in Warren, Butler, Clinton, Clermont, Hamilton, and Montgomery Counties, Ohio. In addition, the Bank operates 31 automated teller machines ("ATMs") in its market area.

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, Classic 50 accounts (a senior citizen program), individual retirement accounts, and certificates of deposit. 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”).

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Loan products offered include commercial and industrial loans, commercial and residential real estate 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. 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, travelers' checks, money orders, 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, 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.

Market Area

LCNB's primary market area consists of Warren, Butler, and Clinton Counties and portions of Hamilton, Clermont, and Montgomery Counties in Southwestern Ohio. Certain demographic information for Warren, Butler, Clinton, Hamilton, and Montgomery Counties are as follows:

	Warren	Butler	Clinton	Hamilton	Montgomery
Population, 2000 census	158,383	332,807	40,543	845,303	559,062
Population, 2010 census	212,693	368,130	42,040	802,374	535,153
Percentage increase/decrease in population	34.3 %	10.6 %	3.0 %	-5.1 %	-4.3 %
Estimated percentage of persons below poverty level	6.1 %	12.7 %	12.9 %	14.2 %	15.4 %
Estimated median household income	$ 70,939	$ 54,344	$ 47,842	$ 48,363	$ 43,815
Median age	36.8	35.4	37.4	36.8	38.2
Unemployment rate:					
December 2011	7.0 %	7.9 %	11.1 %	7.5 %	8.5 %
December 2010	8.4 %	8.8 %	15.0 %	8.5 %	10.1 %
December 2009	9.3 %	9.9 %	18.5 %	9.5 %	12.0 %

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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. People employed within Warren County usually work in the trade, transportation, and utilities sector, the manufacturing sector, the professional and businesses services sector, and the leisure and hospitality sector. 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 and Gamble's Mason Business Center, Atrium Medical Center (a hospital), 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 industries 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. A fourth urban center, Fairfield, was incorporated in 1955.

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. People employed within Butler County usually work in the trade, transportation, and utilities sector, the manufacturing sector, the education and health services sector, the professional and business services sector, and the leisure and hospitality sector. 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 Fort Hamilton Hospital. In addition to Fort Hamilton Hospital, Mercy Hospital Fairfield, McCullough-Hyde Memorial Hospital, and Butler County Medical Center 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 at December 2009, 2010, and 2011 are unusually high, even for the current economy, 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 May 2008 DHL announced that its sorting and air freight operations at the Wilmington Air Park would be discontinued. This resulted 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.

Hamilton County's economics are dominated by Cincinnati. Fortune 500 companies with their headquarters in Hamilton County include American Financial Group, Federated Department Stores, 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 the Health Alliance of Greater Cincinnati.

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LCNB's two offices in Montgomery County are located in the communities of Oakwood and Centerville. 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, LexisNexis, and Honda of America.

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 Act requires the prior approval of the Federal Reserve Board for a bank or financial holding company to acquire or hold more than a 5% voting interest in any bank and restricts interstate banking activities.

On September 29, 1994, the Act was amended by the Interstate Banking and Branch Efficiency Act of 1994, which authorizes interstate bank acquisitions anywhere in the country, effective one year after the date of enactment, and interstate branching by acquisition and consolidation, effective June 1, 1997, in those states that have not opted out by that date.

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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. Under the Bank Holding Company Act of 1956, as amended, and under Regulations of the Federal Reserve Board pursuant thereto, a bank or financial holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit.

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 rather than holders of LCNB's securities. 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.

Financial institutions that are public companies, such as LCNB, are not relieved from their SOX internal control reporting and attestation requirements or their audit committee independence requirements by the provisions of FDICIA.

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At December 31, 2011, the Bank was well capitalized based on FDICIA's guidelines.

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" or "complementary to a financial activity." The Gramm-Leach-Bliley Act defines "financial in nature" to include:

1. securities underwriting, dealing, and market making;
2. sponsoring mutual funds and investment companies;
3. insurance underwriting and agency;
4. merchant banking activities; and
5. other activities that the Federal Reserve Board, in consultation with and subject to the approval of the U.S. Department of the Treasury (the “Treasury Department”), determines are financial in nature.

Financial holding companies may commence the activities listed above or acquire a company engaged in any of those activities without additional approval from the Federal Reserve. Notice of the commencement or acquisition must be provided to the Federal Reserve within thirty days of the start of the activity. Sixty days advance notice is required before the start of any activity that is "complementary to a financial activity."

The Sarbanes-Oxley Act of 2002 ("SOX") was signed into law by President George W. Bush 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:

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;

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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;

3. Adjusting deposit insurance levels of $100,000 for non-retirement accounts and $250,000 for retirement accounts every five years based on an inflation index, with the first adjustment to be effective on January 1, 2011;

4. 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;

5. Eliminating certain restrictions on premium rates the FDIC charges covered institutions and establishing a risk-based premium system; and

6. Providing for a one-time credit for institutions that paid premiums to the Bank Insurance Fund or the Savings Association Insurance Fund prior to December 31, 1996.

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President George W. Bush signed the Emergency Economic Stabilization Act of 2008 (the “EESA”) on October 3, 2008. The EESA provided broad authority to the Treasury Secretary to restore liquidity and stability to the United States’ financial system, primarily by authorizing the Secretary to establish the Troubled Asset Relief Program (“TARP”). In addition, the EESA temporarily raised the basic limit on federal deposit insurance coverage for non-retirement accounts from $100,000 to $250,000 effective immediately upon the President’s signature and continuing through December 31, 2013, as extended by the Helping Families Save Their Homes Act of 2009, at which time the insurance level would have returned to $100,000.

On October 14, 2008, the Treasury Department announced the implementation of the TARP Capital Purchase Program (the “CPP”), which provided for direct equity investments, in the form of perpetual preferred stock, by the Treasury Department in qualifying financial institutions. The CPP was voluntary and provided for a minimum investment of 1% of an institution’s total risk-weighted assets and a maximum investment of 3% of total risk-weighted assets, not to exceed $25 billion. The perpetual preferred stock had a dividend rate of 5% per year until the fifth anniversary of the CPP investment and 9% thereafter. Under the CPP, the Treasury Department received warrants for an institution’s common stock equal to 15% of the capital invested. The warrants have a ten-year term. Participants in the CPP program must comply with various restrictions and provisions, including, but not limited to, restrictions in compensation for certain executive officers, restrictions on dividends paid to shareholders, and limitations on treasury share purchases.

On January 9, 2009, LCNB received $13.4 million of new capital from the Treasury Department under the CPP and issued 13,400 shares of its Fixed Rate Cumulative Perpetual 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. LCNB redeemed all 13,400 shares of the preferred stock on October 21, 2009. In connection with this redemption, LCNB paid approximately $13.5 million to the Treasury Department, which included the original investment amount of $13.4 million plus accrued and unpaid dividends of approximately $123,000. LCNB did not repurchase the warrant.

On November 21, 2008, the FDIC announced the final rules for the Temporary Liquidity Guarantee Program, which was designed to strengthen confidence and encourage liquidity in the banking system. The new program had two parts:

1. The FDIC guaranteed certain newly issued senior unsecured debt of eligible institutions, including FDIC-insured banks and thrifts and certain holding companies, issued on or after October 14, 2008 and before June 30, 2009; and

2. The FDIC temporarily provided full deposit insurance coverage for non-interest bearing deposit transaction accounts in FDIC-insured institutions, regardless of the dollar amount, through December 31, 2009, later extended to December 31, 2010.

For purposes of the Temporary Liquidity Guarantee Program, the FDIC included NOW accounts with an interest rate of 0.50% or less and accounts commonly known as Interest on Lawyers Trust Accounts in the definition of noninterest-bearing transaction accounts. The extension for the period from July 1, 2010 through December 31, 2010 reduced the interest rate for NOW accounts eligible for coverage under the program from 0.50% to 0.25%.

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All eligible banks and thrift institutions were automatically covered by the Temporary Liquidity Guarantee Program unless they opted out of one or both programs on or before December 5, 2008, as extended. Institutions that did not opt out of one or both programs were subject to additional fees for inclusion in the program or programs after the opt-out date. LCNB management chose not to opt out of either program.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law by President Barack Obama 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 establishes 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. The maximum amount had been temporarily set at $250,000 beginning October 3, 2008 and effective until December 31, 2013, as extended, when it would have reverted back to $100,000. The increased limit also retroactively applied to any depositors of financial institutions for which the FDIC had been appointed as receiver or conservator between January 1 and October 3, 2008. 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.

The Dodd-Frank Act provides for temporary unlimited deposit insurance for non-interest bearing transaction accounts. With several important differences, the unlimited coverage is similar to coverage provided by the FDIC's Transaction Account Guarantee Program (the "TAGP"), which expired December 31, 2010, as extended. The Dodd-Frank Act coverage is in effect from January 1, 2011 to December 31, 2012. All insured institutions will have unlimited coverage for non-interest bearing transaction under Dodd-Frank; financial institutions could opt-out of the TAGP. Only non-interest bearing transaction accounts and accounts commonly known as Interest on Lawyers Trust Accounts ("IOLTAs") are covered under the Dodd-Frank provisions. Under TAGP, low-interest NOW accounts were included.

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 advisors 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.

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On November 9, 2010, the FDIC issued a final rule implementing section 343 of the Dodd-Frank Act providing for unlimited insurance coverage of noninterest-bearing transaction accounts and Interest on Lawyers Trust Accounts beginning on December 31, 2010 and ending on December 31, 2012. The extended coverage is available to all depositors including consumer, businesses, and government entities. Money market deposit accounts and NOW accounts are not eligible for the unlimited coverage, even if no interest is paid on the accounts.

LCNB and the Bank are also subject to the state banking laws of Ohio. Ohio adopted nationwide reciprocal interstate banking effective October, 1988.

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, 2011, LCNB employed 235 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 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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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 web site, 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, 2011	2010	2009
	(Dollars in thousands)		
Securities available-for-sale:			
U.S. Treasury notes	$ 17,550	19,585	13,308
U.S. Agency notes	82,927	82,862	45,888
U.S. Agency mortgage-backed securities	52,287	33,094	49,624
Corporate securities	6,365	2,025	8,488
Municipal securities	91,610	96,396	83,323
Mutual funds	2,125	1,053	538
Trust preferred securities	564	604	344
Equity securities	578	263	65
Total securities available-for-sale	254,006	235,882	201,578
Securities held-to-maturity:			
Municipal securities	10,734	12,141	13,030
Federal Reserve Bank Stock	940	939	940
Federal Home Loan Bank Stock	2,091	2,091	2,091
Total securities	$ 267,771	251,053	217,639

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Contractual maturities of securities at December 31, 2011, 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:								
One to five years	$7,709	7,824	0.97	%	-	-	-	%
Five to ten years	9,676	9,726	1.22	%	-	-	-	%
Total U.S. Treasury notes	17,385	17,550	1.11	%	-	-	-	%
U.S. Agency notes:								
One to five years	81,415	82,927	1.42	%	-	-	-	%
Total U.S. Agency notes	81,415	82,927	1.42	%	-	-	-	%
Corporate securities:								
One to five years	6,334	6,365	1.30	%	-	-	-	%
Total corporate securities	6,334	6,365	1.30	%	-	-	-	%
Municipal securities (1):								
Within one year	4,364	4,398	1.70	%	1,837	1,837	3.05	%
One to five years	42,320	43,987	3.20	%	678	678	5.89	%
Five to ten years	35,159	37,833	4.58	%	4,314	4,314	6.62	%
After ten years	5,080	5,392	5.64	%	3,905	3,905	8.62	%
Total Municipal securities	86,923	91,610	3.89	%	10,734	10,734	6.69	%
U.S. Agency mortgage- backed securities	50,923	52,287	2.84	%	-	-	-	%
Mutual Funds	2,103	2,125	2.99	%	-	-	-	%
Trust preferred securities	549	564	7.98	%	-	-	-	%
Equity securities	526	578	3.70	%	-	-	-	%
Totals	$246,158	254,006	2.59	%	10,734	10,734	6.69	%

(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, 2011.

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Loan Portfolio

Administration of the lending function is the responsibility of the Chief Lending Officer and certain senior lenders. Such lenders perform their lending 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 and consumer lending. Any loan in excess of $2.0 million 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.

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

	At December 31,									
	2011		2010		2009		2008		2007	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Commercial and industrial	$30,990	6.7 %	36,122	7.9 %	42,807	9.3 %	38,724	8.6 %	37,325	8.4 %
Commercial, secured by real estate	219,188	47.6 %	196,136	43.1 %	185,024	40.2 %	174,493	38.5 %	159,384	35.8 %
Residential real estate	186,904	40.5 %	190,277	41.9 %	193,293	42.0 %	194,039	42.8 %	193,920	43.5 %
Consumer	14,562	3.2 %	19,691	4.3 %	26,185	5.7 %	33,369	7.4 %	43,410	9.7 %
Agricultural	2,835	0.6 %	2,966	0.7 %	3,125	0.7 %	3,216	0.7 %	2,707	0.6 %
Other loans, including deposit overdrafts	6,554	1.4 %	9,413	2.1 %	9,422	2.1 %	9,203	2.0 %	9,114	2.0 %
	461,033	100.0%	454,605	100.0%	459,856	100.0%	453,044	100.0%	445,860	100.0%
Deferred origination costs, net	229		386		560		767		1,027	
Total loans	461,262		454,991		460,416		453,811		446,887	
Less allowance for loan losses	2,931		2,641		2,998		2,468		2,468	
Loans, net	$458,331		452,350		457,418		451,343		444,419	

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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 line 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 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" and "ceiling" 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 collateral value, financial ability of any guarantors, and other factors. Commercial real estate loans are generally originated with a 75 percent 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 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 requires private mortgage insurance for first mortgage loans that have a loan to appraised value ratio of greater than 80%.

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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 agri-related collateral.

As of December 31, 2011, 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.

The following table summarizes the commercial and agricultural loan maturities and sensitivities to interest rate change at December 31, 2011:

	(Dollars in thousands)	
Maturing in one year or less	$	21,401
Maturing after one year, but within five years		62,946
Maturing beyond five years		168,666
Total commercial and agricultural loans	$	253,013
Loans maturing beyond one year:		
Fixed rate	$	70,228
Variable rate		161,384
Total	$	231,612

Risk Elements

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

	At December 31,				
	2011	2010	2009	2008	2007
	(Dollars in thousands)				
Non-accrual loans	$3,668	3,761	2,939	2,281	120
Past-due 90 days or more and still accruing	39	300	924	806	247
Accruing restructured loans	14,739	9,088	7,173	332	2,222
Total	$18,446	13,149	11,036	3,419	2,589
Percent to total loans	4.00 %	2.89 %	2.40 %	0.75 %	0.58 %

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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, 2011, there were no material additional loans not 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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Allocation of the Allowance for Loan Losses

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

	At December 31,									
	2011		2010		2009		2008		2007	
	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 Categoryto Total Loans
	(Dollars in thousands)									
Commercial and industrial	$162	0.04 %	305	0.07 %	546	0.12 %	369	0.08 %	340	0.08 %
Commercial, secured by real estate	1,941	0.42 %	1,625	0.36 %	1,628	0.35 %	1,182	0.26 %	1,233	0.27 %
Residential real estate	656	0.14 %	459	0.10 %	491	0.11 %	471	0.10 %	388	0.09 %
Consumer	166	0.04 %	246	0.05 %	313	0.07 %	429	0.10 %	459	0.10 %
Other loans, including deposit overdrafts	6	- %	6	- %	9	- %	13	- %	7	- %
Unallocated	-	- %	-	- %	11	- %	4	- %	41	0.01 %
Total	$2,931	0.64 %	2,641	0.58 %	2,998	0.65 %	2,468	0.54 %	2,468	0.55 %

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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, 2011:

	(Dollars in thousands)	
Maturity within 3 months	$	10,541
After 3 but within 6 months		8,316
After 6 but within 12 months		7,860
After 12 months		56,046
	$	82,763

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.

The Dodd-Frank Act may adversely affect LCNB's operations and profitability.
The Dodd-Frank Act was signed into law by President Barack Obama on July 21, 2010. It includes provisions that will specifically affect financial institutions and other entities providing financial services and other corporate governance and compensation provisions that will affect most public companies. Key provisions that may affect LCNB are summarized below.

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"). On July 21, 2011, the Bureau assumed responsibility for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by 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 continues to have primary examination and enforcement authority for these institutions. The regulations enforced, however, will be the regulations written by the Bureau. The nature or impact of regulations to be written by the Bureau cannot be predicted at this time.

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 exact nature of the new capital requirements to be developed or their impact on LCNB cannot be predicted at this time.

The Dodd-Frank Act directs the Federal Reserve to set interchange rates in electronic debit card transactions involving issuers with more than $10 billion in assets. On June 29, 2011, the Federal Reserve issued a final rule, which went into effect on October 1, 2011, setting the maximum interchange fee an issuer may receive at the sum of 21 cents per transaction plus five basis points multiplied by the value of the transaction. The Federal Reserve also issued an interim final rule that allows for an upward adjustment of at most one cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures to achieve the fraud prevention standards detailed in the interim final rule. Although institutions with $10 billion or less in total assets are exempt from the new rules, many within the financial institutions industry believe that smaller institutions will need to match the pricing of those institutions with assets greater than $10 billion or lose business to the larger institutions. Due to the recency of these issued rules, the ultimate effect on LCNB's income statement cannot be predicted at this time.

The Act contains many other provisions, the impact of which cannot be determined at this time.

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LCNB's financial results may be adversely affected by current economic conditions and resulting government legislation.
The United States economy had been in an economic recession during much of 2008 and 2009, which has reduced business activity across a wide range of industries and regions. In addition, while the rate of unemployment has declined in Ohio and nationally in 2010 and 2011, the rates remain at historically elevated levels. A direct consequence has been an increase in loan delinquencies and charge-offs.

In response, the United States government has established and most likely will continue to establish a variety of new programs and policies designed to mitigate the effects of the recession, stimulate the economy, and reduce the likelihood of future downturns. The nature of future laws and regulations and their effect on LCNB's operations cannot be predicted.

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.

Banking competition in Southwestern 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. Dominant 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, primarily Ally Bank (formerly General Motors Acceptance Corporation or GMAC) and Ford Motor Credit Company (FMCC), 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.

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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 Ohio could adversely affect LCNB's financial condition and results of operations.
LCNB has 25 offices located in Warren, Butler, Clinton, Clermont, Hamilton, and Montgomery Counties in Southwestern Ohio. As a result of this geographic concentration, LCNB's results are heavily influenced by economic conditions in this area. A further deterioration in economic conditions or a natural or manmade disaster in Southwestern Ohio or Ohio in general could have a material adverse impact on the ability of borrowers to make scheduled loan payments, the fair value of underlying loan collateral, the ability of depositors to maintain or add to deposit balances, the demand for trust and brokerage services, and the demand for other products and services offered by LCNB.

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.

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 the project 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.

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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 to 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.

Approximately 39% of LCNB's investment securities portfolio at December 31, 2011 was composed of municipal securities. 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 the 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.

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 the 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. 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.

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.

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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 determine.

FDIC deposit insurance assessments may materially increase in the future.

Bank and thrift failures during 2009 and 2008 coupled with deteriorating economic conditions significantly decreased the deposit insurance fund's reserve ratio. The FDIC developed and implemented a restoration plan that included a special assessment on all member financial institutions in early 2009, followed by a required prepayment in December 2009 of premiums relating to the period for 2010 through 2012. These industry-wide actions have significantly increased LCNB's non-interest expense in 2010 and 2009. The FDIC implemented a new assessment base during 2011 that uses total assets and tier one capital as opposed to deposits. LCNB's premiums decreased under the new assessment base, but the likelihood of future rate increases and the imposition of additional special assessments are undeterminable.

The FDIC may borrow up to $100 billion from the U.S. Treasury. Although no borrowings were outstanding at December 31, 2011, LCNB cannot predict if the FDIC will borrow funds in the future. The source for repaying any future borrowings will be the premiums paid by financial institutions, which may necessitate additional rate increases or special assessments.

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.

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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.

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.

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.

Item 1B. Unresolved Staff Comments

Not applicable

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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.	Centerville Office	9605 Dayton-Lebanon Pike Centerville, Ohio 45458	Owned
4.	Colerain Township Office	3209 West Galbraith Road Cincinnati, Ohio 45239	Owned
5.	Columbus Avenue Office	730 Columbus Avenue Lebanon, Ohio 45036	Owned
6.	Fairfield Office	765 Nilles Road Fairfield, Ohio 45014	Leased
7.	Goshen Office	6726 Dick Flynn Blvd. Goshen, Ohio 45122	Owned
8.	Hamilton Office	794 NW Washington Blvd. Hamilton, Ohio 45013	Owned
9.	Hunter Office	3878 State Route 122 Franklin, Ohio 45005	Owned
10.	Loveland Office	500 Loveland-Madeira Road Loveland, OH 45140	Owned
11.	Maineville Office	7795 South State Route 48 Maineville, Ohio 45039	Owned
12.	Mason/West Chester Office	1050 Reading Road Mason, Ohio 45040	Owned
13.	Mason Christian Village Office	Mason Christian Village 411 Western Row Road Mason, Ohio 45040	Leased
14.	Middletown Office	4441 Marie Drive Middletown, Ohio 45044	Owned

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	Name of Office	Address	
15.	Monroe Office	101 Clarence F. Warner Drive Monroe, Ohio 45050	Owned
16.	Oakwood Office	2705 Far Hills Avenue Oakwood, Ohio 45419	(2)
17.	Okeana Office	6225 Cincinnati-Brookville Road Okeana, Ohio 45053	Owned
18.	Otterbein Office	Otterbein Retirement Community State Route 741 Lebanon, Ohio 45036	Leased
19.	Oxford Office (1)	30 West Park Place Oxford, Ohio 45056	(2)
20.	Rochester/Morrow Office	Route 22-3 at 123 Morrow, Ohio 45152	Owned
21.	South Lebanon Office	603 Corwin Nixon Blvd. South Lebanon, Ohio 45065	Owned
22.	Springboro/Franklin Office	525 West Central Avenue Springboro, Ohio 45066	Owned
23.	Warrior Office	Lebanon High School 1916 Drake Road Lebanon, Ohio 45036	Leased
24.	Waynesville Office	9 North Main Street Waynesville, Ohio 45068	Owned
25.	Wilmington Office	1243 Rombach Avenue Wilmington, Ohio 45177	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.

LCNB closed its Bridgetown Office in December 2011.

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

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PART II

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

LCNB had approximately 667 registered holders of its common stock as of December 31, 2011. The number of shareholders includes banks and brokers who act as nominees, each of whom may represent more than one shareholder. On September 8, 2011, LCNB's stock began trading on the NASDAQ Capital Market® exchange under the symbol "LCNB." Before that date, it traded on the NASDAQ Over-The-Counter Bulletin Board, also under the symbol "LCNB." Trade prices for shares of LCNB Common Stock are set forth below. Prior to its listing on the NASDAQ Capital Market® exchange, trade prices for shares of LCNB common stock were reported through registered securities dealers and trades could have occurred during those periods without the knowledge of LCNB. The trade prices shown below are interdealer without retail markups, markdowns, or commissions.

	2011		2010	
	High	Low	High	Low
First Quarter	$ 12.25	11.56	12.50	10.50
Second Quarter	13.00	11.70	13.00	10.34
Third Quarter	14.22	11.85	12.50	11.25
Fourth Quarter	13.70	12.22	12.35	11.20

The following table presents cash dividends per share declared and paid in the periods shown.

	2011	2010
First Quarter	$ 0.16	0.16
Second Quarter	0.16	0.16
Third Quarter	0.16	0.16
Fourth Quarter	0.16	0.16
Total	$ 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 other factors beyond management's control.

LCNB depends on dividends from its subsidiaries for the majority of its liquid assets, including the cash needed to pay dividends to its shareholders. National banking law limits the amount of dividends the Bank may pay to the sum of retained net income, as defined, for the current year plus retained net income for the previous two years. Prior approval from the 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 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.

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On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two phases of which continue. Any shares purchased will be held for future corporate purposes. However, as a participant in the Treasury Department's Capital Purchase Program during much of 2009, LCNB was prohibited from repurchasing additional shares of its common stock without prior government permission for a period of three years from the date of participation unless the preferred shares issued were no longer held by the U.S. Treasury Department. This restriction was terminated on October 21, 2009, when LCNB redeemed all 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A.

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, 2011, 290,444 shares have been purchased under this program. No shares were purchased under the Market Repurchase Program during 2011.

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, 2011. No shares were purchased under the Private Sale Repurchase Program during 2011.

LCNB established an Ownership Incentive Plan during 2002 that allows 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 may be in the form of stock options, share awards, and/or appreciation rights. The following table shows information relating to stock options outstanding at December 31, 2011:

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	124,123	$ 12.54	75,877
Equity compensation plans not approved by security holders	-	-	-
Total	124,123	$ 12.54	75,877

A total of 2,511 restricted shares were granted to an executive officer in February 2010 and vested in November 2010. Until they vested, they were restricted from sale, transfer, or assignment in accordance with the terms of the agreement under which they were issued. At the date of vesting, the shares were issued from treasury stock and, therefore, did not affect the number of securities remaining available for future issuance in the table above. No restricted shares were granted prior to February 2010 or during 2011.

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The graph below provides an indicator of cumulative total shareholder returns for LCNB as compared with the Nasdaq Composite and the SNL Midwest OTC-BB and Pink Sheet Banks. This graph covers the period from December 31, 2006 through December 31, 2011. 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, 2006 in LCNB common stock, the Nasdaq Composite, and the SNL Midwest OTC-BB and Pink Sheet Banks and that all dividends were reinvested.

LCNB Corp.

	Period Ending					
Index	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11
LCNB Corp.	100.00	66.76	55.47	69.06	82.90	94.64
NASDAQ Composite	100.00	110.66	66.42	96.54	114.06	113.16
SNL Midwest OTC-BB and Pink Banks Index	100.00	97.62	72.76	62.08	65.89	65.27

Source : SNL Financial LC, Charlottesville, VA

www.snl.com

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Item 6. Selected Financial Data

The following represents selected consolidated financial data of LCNB for the years ended December 31, 2007 through 2011 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,				
	2011	2010	2009	2008	2007
	(Dollars in thousands, except ratios and per share data)				
Income Statement:					
Interest income	$32,093	34,031	34,898	34,398	32,041
Interest expense	6,387	8,334	10,060	13,421	13,838
Net interest income	25,706	25,697	24,838	20,977	18,203
Provision for loan losses	2,089	1,680	1,400	620	266
Net interest income after provision for loan losses	23,617	24,017	23,438	20,357	17,937
Non-interest income	7,764	8,887	7,180	6,759	6,614
Non-interest expenses	21,849	21,277	20,686	18,555	16,991
Income before income taxes	9,532	11,627	9,932	8,561	7,560
Provision for income taxes	2,210	2,494	2,245	2,134	1,823
Net income from continuing operations	7,322	9,133	7,687	6,427	5,737
Income from discontinued operations, net of tax	793	240	79	176	217
Net income	8,115	9,373	7,766	6,603	5,954
Preferred stock dividends and discount accretion	-	-	1,108	-	-
Net income available to common shareholders	$8,115	9,373	6,658	6,603	5,954
Dividends per common share (1)	$0.64	0.64	0.64	0.64	0.62
Basic earnings per common share (1):					
Continuing operations	1.09	1.37	0.99	0.96	0.90
Discontinued operations	0.12	0.03	0.01	0.03	0.04
Diluted earnings per common share (1):					
Continuing operations	1.08	1.36	0.98	0.96	0.90
Discontinued operations	0.12	0.03	0.01	0.03	0.04
Balance Sheet:					
Securities	$267,771	251,053	217,639	139,272	90,154
Loans, net	458,331	452,350	457,418	451,343	444,419
Total assets	791,570	760,134	734,409	649,731	604,058
Total deposits	663,562	638,539	624,179	577,622	535,929
Short-term borrowings	21,596	21,691	14,265	2,206	1,459
Long-term debt	21,373	23,120	24,960	5,000	5,000
Total shareholders' equity	77,960	70,707	65,615	58,116	56,528

Selected Financial Ratios and Other Data:										
Return on average assets	1.02	%	1.22	%	1.07	%	1.03	%	1.08	%
Return on average equity	10.89	%	13.36	%	10.43	%	11.35	%	11.41	%
Equity-to-assets ratio	9.85	%	9.30	%	8.93	%	8.94	%	9.36	%
Dividend payout ratio	52.89	%	45.71	%	64.39	%	64.65	%	65.96	%
Net interest margin, fully taxable equivalent	3.70	%	3.89	%	3.96	%	3.74	%	3.77	%

(1) All per share data in 2007 has been adjusted to reflect a 100% stock dividend accounted for as stock split.

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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.

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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 2011 Annual Report to Shareholders.

Forward-Looking Statements

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

Overview

Net income for 2011 was $8,115,000, compared to $9,373,000 in 2010 and $7,766,000 in 2009. Preferred stock dividends and discount accretion totaled $1,108,000 during 2009, resulting in net income available to common shareholders of $6,658,000 for that year. Preferred stock was not outstanding during 2011 or 2010. Total basic earnings per share available to common shareholders for 2011, 2010, and 2009 were $1.21, $1.40, and $1.00, respectively. Total diluted earnings per share for 2011, 2010, and 2009 were $1.20, $1.39, and $0.99, respectively.

The following items significantly affected earnings for the years indicated:

- Bank owned life insurance income was greater during 2010 due to death benefits received. No death benefits were received during 2011 or 2009.
- FDIC premiums for 2009 included an industry-wide FDIC special assessment of $325,000 that LCNB recognized during the second quarter 2009. FDIC premiums for 2011 were less due to a change in the assessment base.
- Other real estate owned expense was greater during 2010 because of valuation write-downs and related increases in holding costs. Other real estate owned expense for 2011 included a loss recognized on the sale of commercial property.
- Gains from sales of securities were significantly greater in 2011 and 2010 than in 2009.
- The $722,000 write-off of pension asset recognized during 2009 related to a restructuring of LCNB’s retirement plans.

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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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	Years ended December 31,								
	2011			2010			2009		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Ave Yi R
	(Dollars in thousands)								
Loans (1)	$458,049	25,502	5.57%	$458,708	$27,020	5.89%	$453,869	$27,538	6
Interest-bearing demand deposits	13,296	32	0.24%	20,876	51	0.24%	18,727	49	0
Federal Reserve Bank Stock	940	56	5.96%	940	56	5.96%	939	56	5
Federal Home Loan Bank Stock	2,091	89	4.26%	2,091	92	4.40%	2,091	97	4
Investment securities:									
Taxable	176,922	3,843	2.17%	133,556	3,686	2.76%	110,894	4,237	3
Nontaxable (2)	78,917	3,895	4.94%	85,718	4,736	5.53%	78,373	4,426	5
Total earning assets	730,215	33,417	4.58%	701,889	35,641	5.08%	664,893	36,403	5
Non-earning assets	64,735			66,489			61,432		
Allowance for loan losses	(2,936)			(2,815)			(2,638)		
Total assets	$792,014			$765,563			$723,687		
Savings deposits	$122,987	452	0.37%	$108,734	653	0.60%	$97,813	742	0
NOW and money fund	232,418	667	0.29%	221,926	1,282	0.58%	197,805	1,496	0
IRA and time certificates	219,174	4,583	2.09%	231,971	5,678	2.45%	240,783	7,196	2
Short-term borrowings	12,415	28	0.23%	7,606	27	0.35%	1,468	3	0
Long-term debt	22,733	657	2.89%	23,826	694	2.91%	20,282	623	3
Total interest-bearing liabilities	609,727	6,387	1.05%	594,063	8,334	1.40%	558,151	10,060	1
Demand deposits	101,781			95,273			86,270		
Other liabilities	5,964			6,059			4,802		
Capital	74,542			70,168			74,464		
Total liabilities and capital	$792,014			$765,563			$723,687		
Net interest rate spread (3)			3.53%			3.68%			3
Net interest income and net interest margin on a tax equivalent basis (4)		27,030	3.70%		$27,307	3.89%		$26,343	3
Ratio of interest-earning assets to interest-bearing liabilities	119.76 %			118.15 %			119.12 %		

(1) Includes non-accrual loans if any. Income from tax-exempt loans is included in interest income on a taxable-equivalent basis, using an incremental rate of 34%.

(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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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,					
	2011 vs. 2010			2010 vs. 2009		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income attributable to:						
Loans (1)	$(39)	(1,479)	(1,518)	291	(809)	(518)
Interest-bearing demand deposits	(18)	(1)	(19)	5	(3)	2
Interest-bearing deposits in banks	-	-	-	-	-	-
Federal Reserve Bank stock	-	-	-	-	-	-
Federal Home Loan Bank stock	-	(3)	(3)	-	(5)	(5)
Investment securities:						
Taxable	1,043	(886)	157	764	(1,315)	(551)
Nontaxable (2)	(359)	(482)	(841)	408	(98)	310
Total interest income	627	(2,851)	(2,224)	1,468	(2,230)	(762)
Interest expense attributable to:						
Savings deposits	77	(278)	(201)	77	(166)	(89)
NOW and money fund	58	(673)	(615)	168	(382)	(214)
IRA and time certificates	(301)	(794)	(1,095)	(255)	(1,263)	(1,518)
Short-term borrowings	13	(12)	1	20	4	24
Long-term debt	(32)	(5)	(37)	105	(34)	71
Total interest expense	(185)	(1,762)	(1,947)	115	(1,841)	(1,726)
Net interest income	$812	(1,089)	(277)	1,353	(389)	964

(1) Non-accrual loans, if any, are included in average loan balances.

(2) Change in interest income from nontaxable 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%.

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2011 vs. 2010. Net interest income on a fully tax-equivalent basis for 2011 totaled $27,030,000, a decrease of $277,000 from 2010. The decrease resulted from a decrease in total taxable-equivalent interest income of $2,224,000, largely offset by a decrease in total interest expense of $1,947,000.

The decrease in taxable-equivalent interest income was due to a 50 basis point (a basis point equals 0.01%) decrease in the average rate earned on interest-earning assets, partially offset by a $28.3 million increase in total average interest-earning assets. The decrease in average rates earned was primarily due to general decreases in market rates. The increase in average interest-earning assets occurred primarily in the taxable investment securities portfolio, which grew $43.4 million on an average basis.

Interest expense decreased primarily due to a 35 basis point decrease in the average rate paid on interest-bearing liabilities. A secondary factor was a $12.8 million decrease in average IRA and time certificate balances, partially offset by increases in average balances of other deposit account categories and average short-term borrowings. The decrease in average rates paid was primarily due to general decreases in market rates.

The net interest margin, on a taxable-equivalent basis, decreased from 3.89% for 2010 to 3.70% for 2011 primarily due to the limited loan growth during 2011 and low market interest rates. With weak demand for loans and the sale of most residential real estate mortgage loans originated to the Federal Home Loan Mortgage Corporation, deposit growth was largely invested in the investment securities portfolio, which usually pays lower interest rates than the loan portfolio.

2010 vs. 2009. Net interest income on a fully tax-equivalent basis for 2010 totaled $27,307,000, an increase of $964,000 from 2009. The increase resulted from a decrease in total interest expense of $1,726,000, largely offset by a decrease in total taxable-equivalent interest income of $762,000.

Taxable-equivalent interest income decreased due to a 40 basis point decrease in the average rate earned on interest-earning assets, partially offset by a $37.0 million increase in total average interest-earning assets. The decrease in average rates earned was primarily due to general decreases in market rates. The increase in average interest-earning assets occurred primarily in the investment securities portfolio, which grew $30.0 million. The loan portfolio grew $4.8 million on an average basis.

Interest expense decreased primarily due to a 40 basis point decrease in the average rate paid on interest-bearing liabilities, partially offset by a $35.9 million increase in average interest-bearing liabilities. The decrease in average rates paid was primarily due to general decreases in market rates. Most of the deposit growth occurred in the more liquid types of deposits, such as savings deposits and NOW and money fund deposits. Collectively, these deposits grew $35.0 million on an average basis, while IRA and time certificates decreased $8.8 million.

The net interest margin, on a taxable-equivalent basis, decreased from 3.96% for 2009 to 3.89% for 2010 primarily due to the limited loan growth during 2010. With weak demand for loans and the sale to the Federal Home Loan Mortgage Corporation of most residential real estate mortgage loans originated, deposit growth was largely invested in the investment securities portfolio, which usually pays lower interest rates than the loan portfolio.

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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 2007 through 2011:

	2011	2010	2009	2008	2007
	(Dollars in thousands)				
Balance – Beginning of year	$2,641	2,998	2,468	2,468	2,050
Allowance related to Sycamore acquisition	-	-	-	-	453
	2,641	2,998	2,468	2,468	2,503
Loans charged off:					
Commercial and industrial	581	289	36	73	81
Commercial, secured by real estate	598	1,105	352	-	-
Residential real estate	512	331	152	129	71
Consumer	252	422	490	617	231
Agricultural	-	-	-	-	-
Other loans, including deposit overdrafts	127	144	178	228	305
Total loans charged off	2,070	2,291	1,208	1,047	688
Recoveries:					
Commercial and industrial	-	35	2	40	17
Commercial, secured by real estate	30	-	-	-	-
Residential real estate	31	2	3	20	2
Consumer, excluding credit card	122	120	203	201	142
Agricultural	-	-	-	-	-
Credit Card	-	-	-	1	3
Other loans, including deposit overdrafts	88	97	130	165	223
Total recoveries	271	254	338	427	387
Net charge offs	1,799	2,037	870	620	301
Provision charged to operations	2,089	1,680	1,400	620	266
Balance - End of year	$2,931	2,641	2,998	2,468	2,468
Ratio of net charge-offs during the period to average loans outstanding	0.39 %	0.44 %	0.19 %	0.14 %	0.08 %
Ratio of allowance for loan losses to total loans at year-end	0.64 %	0.58 %	0.65 %	0.54 %	0.55 %

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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 charges consisted of loans to five different borrowers.

Of the $1,105,000 in commercial real estate loan charge-offs during 2010, $421,000 was due to four loans while $684,000 was due to two loans made to the same borrower. Commercial and industrial loan charge-offs of $289,000 during 2010 included one charge-off of $281,000 relating to a business that ceased operations during that year.

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 multiple times throughout each year. Specific new credits 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 three basic components: specific allocations for individual loans, general historical 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, and an unallocated component. Due to the number, size, and complexity of loans within the loan portfolio, there is always a possibility of inherent undetected losses. This, combined with the possible imprecision of management's assumptions in the evaluation of loans, can result in the allowance also having an unallocated component.

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

	At December 31,					
	2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Specific allocations	$399	13.62 %	296	11.20 %	858	28.62 %
General allocations:						
Historical loss	1,381	47.29 %	975	36.91 %	576	19.21 %
Adjustments to historical loss	1,151	39.09 %	1,370	51.89 %	1,553	51.80 %
Unallocated	-	- %	-	- %	11	0.37 %
Total	$2,931	100.00 %	2,641	100.00 %	2,998	100.00 %

The decrease in the specific allocation at December 31, 2010 as compared to December 31, 2009 is primarily due to charge-offs recognized during 2010. The increases in the general historical loss from December 31, 2009 to December 31, 2010 and from December 31, 2010 to December 31, 2011 are primarily due to increases in net charge-offs during the historic look-back period.

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Non-Interest Income

2011 vs. 2010. Total non-interest income for 2011 was $1,123,000 less than for 2010. Bank owned life insurance income decreased in 2011 by $793,000 primarily due to the absence of death benefits received during 2010. Gains from sales of mortgage loans were $319,000 less primarily due to a decrease in the volume of loans sold. Loans sold during 2011 totaled $9.4 million, compared to $24.2 million in sales during 2010. Lower interest rates fueled a demand for loan refinancings during 2010. Service charges and fees on deposit accounts decreased $165,000 primarily due to a downward trend in overdraft fees, partially offset by an increase in check card fee income. These unfavorable items were partially offset by a $202,000 increase in trust income that was primarily due to executor fees received and a change in the mix of trust assets.

2010 vs. 2009. Total non-interest income for 2010 was $1,707,000 greater than for 2009. Net gains from sales of investment securities was $838,000 greater during 2010 as compared to 2009 primarily due to an increase in the volume of securities sold as management decided to recognize gains that were inherent in the portfolio. Replacement securities generally have shorter remaining maturities. Bank owned life insurance income was $752,000 greater primarily due to death benefits received. Although mortgage loan sales declined by $3.7 million during 2010 as compared to 2009, an improvement in secondary market pricing increased the gain on sale of mortgage loans by $100,000.

Non-Interest Expense

2011 vs. 2010. Total non-interest expense was $572,000 greater in 2011 as compared to 2010 primarily due to a $472,000 increase in salaries and employee benefits, a $149,000 increase in equipment expenses, a $109,000 increase in computer maintenance and supplies, and a $399,000 increase in other non-interest expenses. While salaries were held to a less than 4% increase, health care costs and pension costs contributed to the balance of the increase in salaries and employee benefits. Equipment expenses increased primarily due to increased depreciation caused by ATM and computer hardware replacements. The increase in other non-interest expenses includes a $56,000 loss recognized on a standby letter of credit, $59,000 in environmental remediation costs for the lot on which LCNB’s new Lebanon Drive-Up facility is located, $50,000 in NASDAQ® application fees, and other smaller miscellaneous costs. Partially offsetting these increases were a $413,000 decrease in FDIC premiums, a $156,000 decrease in other real estate owned expense, and a $114,000 decrease in occupancy expense. FDIC premiums decreased primarily due to implementation of a new assessment base that uses total assets and tier one capital as opposed to deposits. Other real estate owned expense decreased due to the absence of valuation write-downs recognized during 2010.

2010 vs. 2009. Total non-interest expense was $591,000 greater in 2010 as compared to 2009 primarily due to a $737,000 increase in salaries and employee benefits. While salaries were held to a less than 3% increase, health care costs, incentive plan expense, and pension costs contributed to the balance of the increase in salaries and employee benefits. Other real estate owned expense increased $489,000 due to valuation write-downs and related increases in holding costs. These increases were partially offset by a $313,000 decrease in FDIC premiums expenses and the absence of a $722,000 one-time, non-recurring pension-related charge recognized during the first quarter 2009. FDIC premiums decreased due to the absence of a $325,000 payment to the FDIC made by LCNB as its share of a general industry-wide special assessment levied by the FDIC during 2009.

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Income Taxes

LCNB's effective tax rates for the years ended December 31, 2011, 2010, and 2009 were 23.2%, 21.4%, and 22.6%, 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

Net loans increased $6.0 million during 2011. The commercial real estate loan portfolio, which increased $23.1 million, was the only category that experienced growth during 2011. Commercial and industrial loans decreased $5.1 million and consumer loans also decreased $5.1 million, reflecting lower demand due to economic conditions during 2011. Residential real estate loans decreased $3.4 million as LCNB continued to originate and sell low-fixed rate mortgages in the secondary market.

Investment securities available-for-sale increased $18.1 million during 2011. This growth was primarily in the U.S. Agency mortgage-backed securities category, which increased $19.2 million. LCNB invests in both pass-through securities and collateralized mortgage obligations. Management chose to grow the mortgage-backed securities category because of the instruments' liquidity, rate, and low risk due to government guarantees.

Deposits

Total deposits at December 31, 2011 were $25.0 million greater than at December 31, 2010. The growth was in the liquid deposit products – checking accounts, NOW and money fund deposit accounts, and savings deposits. These types of instruments increased a total of $41.5 million, while IRA and time certificate accounts decreased $16.5 million.

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 79.9% of total deposits at December 31, 2011 were "core" deposits. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than $100,000.

Liquid assets include cash, 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, 2011, LCNB's liquid assets amounted to $273.5 million or 34.6% of total assets, an increase from $246.8 million or 32.5% of total assets at December 31, 2010.

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An additional source of funding is borrowings from the FHLB. A short-term advance of $12.0 million and long-term advances totaling $21.4 million were outstanding at December 31, 2011 and the total available borrowing capacity at that date was approximately $14.3 million. LCNB is approved to borrow up to $39.6 million in short-term advances through the FHLB's Cash Management Advance program. 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 and would need to purchase more stock if it were to use the full $39.6 million available in short-term advances.

Besides the 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, 2011, 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. In addition to the FHLB short-term advance, short-term borrowings at December 31, 2011 included $9.6 million in repurchase agreements.

Commitments to extend credit at December 31, 2011 totaled $75.7 million and standby letters of credit totaled $5.6 million and are more fully described in Note 10 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.

Capital expenditures may include the construction or acquisition of new office buildings, improvements to LCNB's twenty-five offices, purchases of furniture and equipment, and additions or improvements to LCNB's information technology system. Commitments for capital expenditures outstanding as of December 31, 2011 were not material.

The following table provides information concerning LCNB's contractual obligations at December 31, 2011:

		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)				
Long-term debt obligations	$21,373	6,000	2,326	5,000	8,047
Short-term borrowing from Federal Home Loan Bank	12,000	12,000	-	-	-
Operating lease obligations	5,713	360	645	504	4,204
Purchase obligations	-	-	-	-	-
Estimated pension plan contribution for 2012	902	902	-	-	-
Certificates of deposit:					
$100,000 and over	82,763	26,717	35,256	10,846	9,944
Other time certificates	126,212	47,425	52,986	20,077	5,724
Total	$248,963	93,404	91,213	36,427	27,919

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The following table provides information concerning LCNB's commitments at December 31, 2011:

	Amount of Commitment Expiration Per Period				
	Total Amounts Committed	1 year or less	Over 1 through 3 years (In thousands)	Over 3 through 5 years	More than 5 years
Commitments to extend credit	$6,717	6,717	-	-	-
Unused lines of credit	68,967	33,929	15,048	9,110	10,880
Standby letters of credit	5,575	546	5,029	-	-
Total	$81,259	41,192	20,077	9,110	10,880

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). The first two 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 Tier 1 capital to risk-weighted assets must be at least 4.00% 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 3.00%. A table summarizing the regulatory capital of LCNB and the Bank at December 31, 2011 and 2010 is included in Note 11, "Regulatory Matters", of the 2011 Annual Report to Shareholders.

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 phases of which continue. Any shares purchased will be held for future corporate purposes. However, as a participant in the Treasury Department’s Capital Purchase Program during much of 2009, LCNB was prohibited from repurchasing additional shares of its common stock without prior government permission for a period of three years from the date of participation unless the preferred shares issued are no longer held by the U.S. Treasury Department. This restriction was terminated on October 21, 2009, when LCNB redeemed all 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A.

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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 the stock dividend. Through December 31, 2011, 290,444 shares, as restated for the stock dividend, had been purchased under this program. No shares were purchased under this program during 2011.

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, 2011. No shares were purchased under this program during 2011.

LCNB established an Ownership Incentive Plan during 2002 that allows for stock-based awards to eligible employees. The awards may be in the form of stock options, share awards, and/or appreciation rights. The plan provides for the issuance of up to 200,000 shares, as restated for the stock dividend. The following table provides the stock options granted to key executive officers of LCNB for the years indicated:

Year	Options Granted
2007	8,116
2008	13,918
2009	29,110
2010	20,798
2011	25,083

The exercise price for stock options granted shall not be less than the fair market value of the stock on the date of grant. Options vest ratably over a five-year period and the maximum term for each grant will be specified by the Board of Directors, but cannot be greater than ten years from the date of grant. In the event of an optionee's death or incapacity, all outstanding options held by that optionee shall immediately vest and be exercisable.

On January 9, 2009, LCNB received $13.4 million of capital from the U.S. Treasury Department under the CPP and issued 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A and a warrant to the U.S. Treasury Department for the purchase of 217,063 common shares of LCNB stock at an exercise price of $9.26 per share. LCNB allocated $583,000 of the proceeds from the preferred stock issuance to the warrant.

On October 21, 2009, LCNB entered into a repurchase agreement with the Treasury Department pursuant to which LCNB redeemed all 13,400 shares of its preferred stock. In connection with this redemption, LCNB paid approximately $13.5 million to the Treasury Department, which includes the original investment amount of $13.4 million plus accrued and unpaid dividends of approximately $123,000. As a result of the redemption, LCNB recorded a reduction in retained earnings of approximately $463,000 in the fourth quarter of 2009 associated with accelerated discount accretion related to the difference between the amount at which the Preferred Stock sale was initially recorded and its redemption price. The Preferred Stock dividend and the acceleration of the accretion reduced 2009’s net income available to common shareholders and earnings per common share.

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LCNB Corp. did not repurchase the warrant issued to the Treasury Department as part of the CPP. Instead, pursuant to the terms of the repurchase agreement, the warrant has been cancelled and LCNB has issued a substitute warrant to the Treasury Department with the same terms as the original warrant, except that Section 13(H) of the original warrant, which dealt with the reduction of shares subject to the warrant in the event that LCNB raised $13.4 million in a qualified stock offering prior to December 31, 2009, has been removed. A copy of the repurchase agreement was filed by LCNB as Exhibit 10.1 to its Current Report on Form 8-K dated October 21, 2009, and a copy of the substitute warrant is included as Exhibit 4.3 to its Form 10-Q for the quarterly period ended September 30, 2009. Both documents are incorporated by reference and the foregoing summary of certain provisions of these documents is qualified in its entirety by reference thereto. The Treasury Department sold the warrant to an investor during the fourth quarter 2011.

LCNB Corp. exceeded all regulatory requirements to be classified as "well capitalized" before accepting the CPP investment and exceeded the regulatory requirements after the redemption.

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 collectability 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 collectability 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.

Accounting for Intangibles. LCNB's intangible assets at December 31, 2011 are composed primarily of goodwill and a core deposit intangible related to the acquisition of Sycamore during the fourth quarter 2007 and mortgage servicing rights recorded from sales of mortgage loans to the Federal Home Loan Mortgage Corporation. Goodwill is not subject to amortization, but is reviewed annually for impairment. The core deposit intangible is being amortized on a straight line basis over six 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.

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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 corporate securities 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.

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LCNB CORP. AND SUBSIDIARIES

QUARTERLY FINANCIAL DATA (UNAUDITED)

(Dollars in thousands, except per share data)

	Three Months Ended			
	March 31	June 30	Sep. 30	Dec. 31
2011				
Interest income	$8,130	8,099	7,976	7,888
Interest expense	1,772	1,667	1,537	1,411
Net interest income	6,358	6,432	6,439	6,477
Provision for loan losses	664	224	588	613
Net interest income after provision	5,694	6,208	5,851	5,864
Total non-interest income	1,915	1,835	2,033	1,981
Total non-interest expenses	5,785	5,307	5,436	5,321
Income before income taxes	1,824	2,736	2,448	2,524
Provision for income taxes	346	713	581	570
Net income from continuing operations	1,478	2,023	1,867	1,954
Income (loss) from discontinued operations, net of tax	824	(31)	-	-
Net income	$2,302	1,992	1,867	1,954
Basic earnings per common share:				
Continuing operations	$0.22	0.30	0.28	0.29
Discontinued operations	0.12	-	-	-
Diluted earnings per common share:				
Continuing operations	0.22	0.30	0.28	0.28
Discontinued operations	0.12	-	-	-
2010				
Interest income	$8,602	8,532	8,472	8,425
Interest expense	2,162	2,105	2,081	1,986
Net interest income	6,440	6,427	6,391	6,439
Provision for loan losses	208	511	268	693
Net interest income after provision	6,232	5,916	6,123	5,746
Total non-interest income	1,738	2,527	1,928	2,694
Total non-interest expenses	5,192	5,231	5,540	5,314
Income before income taxes	2,778	3,212	2,511	3,126
Provision for income taxes	637	527	561	769
Net income from continuing operations	2,141	2,685	1,950	2,357
Income from discontinued operations, net of tax	71	67	39	63
Net income	$2,212	2,752	1,989	2,420
Basic earnings per common share:				
Continuing operations	$0.32	0.40	0.30	0.35
Discontinued operations	0.01	0.01	-	0.01
Diluted earnings per common share:				
Continuing operations	0.32	0.40	0.30	0.34
Discontinued operations	0.01	0.01	-	0.01

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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 the down 200 and 300 basis points 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, 2011 IRSA indicates that an increase in interest rates at all shock levels will have a positive effect on net interest income and a decrease in interest rates at the down 100 basis points shock level will have a negative 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	$ 26,497	1,115	4.39 %
Up 200	26,093	711	2.80