Ocean Power Technologies, Inc.
Form DEF 14A
August 28, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

Ocean Power Technologies, Inc.

(Name of Registrant as Specified In Its Charter)

Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

1590 Reed Road

Pennington, NJ 08534 USA

Tel: 609-730-0400 — Fax: 609-730-0404

August 28, 2013

Dear Stockholder,

We cordially invite you to attend our 2013 Annual Meeting of Stockholders to be held at 9:00 a.m. Eastern Daylight Time on Thursday, October 3, 2013 at our offices at 1590 Reed Road, Pennington, NJ 08534. The attached notice of annual meeting and proxy statement describes the business we will conduct at the meeting and provides information about Ocean Power Technologies, Inc. that you should consider when you vote your shares.

Your vote is very important, regardless of the number of shares you hold. Whether or not you plan to attend the meeting, please carefully review the enclosed proxy statement and then cast your vote.

We hope that you will join us on October 3, 2013.

Sincerely,

/s/CHARLES F. DUNLEAVY

Charles F. Dunleavy

Chairman of the Board of Directors

OCEAN POWER TECHNOLOGIES, INC.

1590 Reed Road

Pennington, NJ 08534

Notice of 2013 Annual Meeting of Stockholders

NOTICE IS HEREBY GIVEN that the 2013 Annual Meeting of Stockholders of Ocean Power Technologies, Inc., a Delaware corporation, will be held on:

Date:	October 3, 2013
Time:	9:00 a.m. Eastern Daylight Time
Place:	1590 Reed Road Pennington, NJ 08534 USA
Purposes:	1. To elect five persons to our Board of Directors; 2. To consider and take action on the ratification of the selection of KPMG LLP as our independent registered public accounting firm for fiscal 2014; 3. To conduct a nonbinding advisory vote on executive officer compensation; 4. To approve an amendment to our 2006 Stock Incentive Plan to increase the aggregate number of shares authorized for issuance under the plan by 800,000 shares; and 5. To transact such other business as may properly come before the meeting or any adjournments thereof.
Record Date:	The Board of Directors has fixed the close of business on August 19, 2013 as the record date for determining stockholders entitled to notice of, and to vote at, the meeting or any adjournment or postponement of the meeting.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE 2013 ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON OCTOBER 3, 2013:

Copies of this proxy statement and of our annual report for the fiscal year ended April 30, 2013 are available by visiting the following website: http://phx.corporate-ir.net/phoenix.zhtml?c=155437&p=proxy

FOR THE BOARD OF DIRECTORS

/s/BRIAN M. POSNER

Brian M. Posner

Chief Financial Officer,

Secretary and Treasurer

Pennington, NJ

August 28, 2013

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OCEAN POWER TECHNOLOGIES, INC.

1590 Reed Road

Pennington, NJ 08534

PROXY STATEMENT

Annual Meeting of Stockholders To Be Held October 3, 2013

GENERAL INFORMATION

This Proxy Statement is furnished to stockholders of Ocean Power Technologies, Inc., a Delaware corporation (the "Company"), in connection with the solicitation by our Board of Directors of proxies for use at our Annual Meeting of Stockholders (the "Meeting"). The Meeting is scheduled to be held on Thursday, October 3, 2013, at 9:00 a.m., Eastern Daylight Time, at our offices located at 1590 Reed Road, Pennington, NJ. We anticipate that this Proxy Statement and the enclosed form of proxy will be mailed to stockholders on or about August 28, 2013.

At the Meeting, stockholders will be asked to vote upon: (1) the election of five directors; (2) the ratification of the selection of our independent registered public accounting firm for fiscal 2014; (3) a nonbinding advisory vote on executive officer compensation; (4) the approval of an amendment to our 2006 Stock Incentive Plan to increase the aggregate number of shares issuable under the plan by 800,000; and (5) such other business as may properly come before the Meeting and at any adjournments thereof.

Voting Rights and Votes Required

The close of business on August 19, 2013 has been fixed as the record date for the determination of stockholders entitled to receive notice of and to vote at the Meeting. As of the close of business on such date, we had outstanding and entitled to vote 10,356,946 shares of Common Stock, par value $0.001 per share (the "Common Stock"). Because stockholders often cannot attend the meeting in person, a large number of shares is usually represented by proxy. You may vote your shares by completing the enclosed proxy card and mailing it in the envelope provided. Stockholders who hold shares in "street name" should refer to their proxy card or the information forwarded by their bank, broker or other holder of record for instructions on the voting options available to them.

A majority of the shares of Common Stock entitled to vote at the Meeting must be represented in person or by proxy at the Meeting in order to constitute a quorum for the transaction of business. The record holder of each share of Common Stock entitled to vote at the Meeting will have one vote for each share so held. Abstentions and broker nonvotes will count for quorum purposes.

Directors are elected by a plurality of the votes cast. Stockholders may not cumulate their votes. The five candidates receiving the highest number of votes will be elected. If the shares you own are held in street name by a bank or brokerage firm, that bank or brokerage firm, as the record holder of your shares, is required to vote your shares according to your instructions. **If you do not instruct your bank or broker how to vote with respect to this item, your bank or broker may not vote with respect to the election of directors.** In tabulating the votes, votes withheld in connection with the election of one or more nominees and broker nonvotes will be disregarded and will have no effect on the outcome of the vote.

In addition, each of the following proposals requires the affirmative vote of a majority of the votes cast for approval:

- The proposal to ratify the selection of our independent registered public accounting firm (Proposal 2);
- The proposal to approve the compensation of our Executive Officers by a nonbinding advisory vote (Proposal 3);
- The proposal to approve an amendment to our 2006 Stock Incentive Plan to increase the aggregate number of shares authorized for issuance by 800,000 shares (Proposal 4).

For each of these proposals, abstentions and broker non-votes will be disregarded and will have no effect on the outcome.

Voting of Proxies

If the accompanying proxy is properly executed and returned, the shares represented by the proxy will be voted at the Meeting as specified in the proxy. If no instructions are specified, the shares represented by any properly executed proxy will be voted **FOR** the election of the nominees listed below under "Proposal One - Election of Directors," **FOR** the ratification of the selection of our independent registered public accounting firm, **FOR** the approval of the compensation of our Executive Officers by a nonbinding advisory vote and **FOR** the approval of the amendment to our 2006 Stock Incentive Plan to increase aggregate number of shares issuable under the plan by 800,000.

Revocation of Proxies

Any proxy given pursuant to this solicitation may be revoked by a stockholder at any time before it is exercised by: (i) providing written notice to our Secretary, (ii) delivery to us of a properly executed proxy bearing a later date, or (iii) voting in person at the Meeting.

Solicitation of Proxies

We will bear the cost of this solicitation, including amounts paid to banks, brokers, and other record owners to reimburse them for their expenses in forwarding solicitation materials regarding the Meeting to beneficial owners of Common Stock. The solicitation will be by mail, with the materials being forwarded to stockholders of record and certain other beneficial owners of Common Stock, and by our officers and other regular employees (at no additional compensation). Our officers and employees may also solicit proxies from stockholders by personal contact, by telephone, or by other means if necessary in order to assure sufficient representation at the Meeting.

Computershare Investor Services has been retained to receive and tabulate proxies.

PROPOSAL ONE - ELECTION OF DIRECTORS

Pursuant to our by-laws, our directors serve one-year terms and are elected for a new one-year term at each annual meeting of stockholders.

The five persons listed in the table below have been designated by the Board of Directors as nominees for election as directors with terms expiring at the 2013 annual meeting. Bruce A. Peacock and David L. Davis are not standing for reelection to the Board of Directors, and David L. Keller is a new nominee for director. Unless a contrary direction is indicated, it is intended that proxies received will be voted for the election as directors of the five nominees, to serve for one-year terms, and in each case until their successors are elected and qualified. Each of the nominees has consented to being named in this Proxy Statement and to serve as a director if elected. In the event any nominee for director declines or is unable to serve, the proxies may be voted for a substitute nominee selected by the Board of Directors. Our Board of Directors has resolved that immediately after the conclusion of the current term of our directors and immediately before the commencement of the term of the directors elected at the Meeting that the size of the Board of Directors be reduced to five.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR *ALL* NOMINEES.

All of our directors bring to our Board of Directors executive leadership experience from their service as executives and/or directors of our Company and/or other entities. The biography of each of the nominees below contains information regarding the person’s service as a director, business experience, director positions held currently or at any time during the last five years, and the experiences, qualifications, attributes and skills that caused the Nominating and Corporate Governance Committee and our Board of Directors to determine that the person should serve as a director, given our business and structure.

Name	**Age**	**Position(s) with Ocean Power Technologies, Inc.**	**Served as Director From**
Terence J. Cryan	51	Director	2012
David L. Keller	59	New Nominee for Director	—
Seymour S. Preston III	79	Vice Chairman and Lead Independent Director	2003
Dr. George W. Taylor	79	Executive Vice Chairman	1984
Charles F. Dunleavy	64	Chairman of the Board and Chief Executive Officer	1990

Terence J. Cryan has been a member of the OPT Board of Directors since October 2012. Since September 2001, Mr. Cryan has been Co-founder and Managing Director of Concert Energy Partners, LLC, an investment banking and private equity investment firm with a focus on the traditional and alternative energy, power and natural resources industries. In addition to his responsibilities at Concert Energy Partners, from 2007 through 2010, Mr. Cryan also served as President and CEO of Medical Acoustics LLC, a medical device technology company. Between 1990 and 2001, Mr. Cryan was a Senior Managing Director in the investment banking department at Bear Stearns & Co. Inc. in New York City and a Managing Director at Paine Webber/Kidder Peabody in both New York City and London serving clients in the energy and natural resources sector. Mr. Cryan has served on the boards of directors of a number of publically traded companies including, Uranium Resources, Inc., since 2006; Global Power Equipment Group Inc., since 2008; Gryphon Gold Corporation from 2009 to 2012; and The Providence Service Corporation from 2009 to 2011. From September 2012 until April 2013, Mr. Cryan also served as interim President and CEO of Uranium Resources, Inc. Prior to joining our Board of Directors, Mr. Cryan was a member of our Board of Advisors since 2003. Mr. Cryan earned his Bachelor of Arts degree from Tufts University in 1983 and a Masters of Science degree in Economics from The London School of Economics in 1984. We believe Mr. Cryan's qualifications to sit on our Board of Directors include his significant experience in financial matters, his prior board and executive experience at other companies, his broad energy industry background and his extensive expertise in financings, mergers and acquisitions.

David L. Keller is a new nominee for director. He is currently an independent director of ThermoEnergy, Inc., a company engaged in the worldwide development, sales and commercialization of patented and/or proprietary municipal and industrial wastewater treatment and power generation technologies. Mr. Keller previously served as

President, Chief Executive Officer and Director of Global Power Equipment Group Inc., a comprehensive provider of power generation equipment and modification and maintenance services for customers in the domestic and international energy, power infrastructure and service industries, from September 2009 until his retirement in June 2012 and, following his retirement, continued to serve Global Power Equipment Group Inc. as a consultant until March 2013. Mr. Keller served as the President and Chief Operating Officer of The Babcock & Wilcox Company ("B&W"), a wholly owned subsidiary of McDermott International, Inc., from March 2001 until his retirement in June 2007. Mr. Keller's prior position was President of Diamond Power International, Inc., a wholly owned subsidiary of B&W, from March 1998 to February 2001. During his tenure with B&W, Mr. Keller served as a Board Chairman or Director of subsidiaries and joint ventures in the People's Republic of China, Denmark, the United Kingdom, Australia and South Africa. Mr. Keller holds a Bachelor of Science degree in Mathematics from the University of Akron. He brings to the Board of Directors a comprehensive knowledge of the power generation industry. In addition to his experience and understanding in the industry, Mr. Keller also has significant executive management experience, having directly overseen sales, manufacturing, accounting, legal, supply chain and personnel functions of a business whose revenues reached approximately $2 billion under his management.

Seymour S. Preston III has been a director since September 2003. Mr. Preston has been our vice chairman and lead independent director since January 2009. Since 1994, Mr. Preston has been President of The Millrace Group, a management consulting firm. Mr. Preston is also a director and serves on the audit committee of Independent Publications, Inc., a newspaper publisher. Mr. Preston was a director of Albemarle Corporation, a specialty chemicals company, from 1996 to 2008; Scott Specialty Gas Corporation, a provider of gases for calibration, testing and emission standards, from 1994 to 2007; and, Tufco Technologies, Inc., a consumer products contract manufacturing company, from 1999 to 2009. From 1994 to 2003, he was the chairman and chief executive officer of AAC Engineered Systems, Inc., a privately-held manufacturing company. Over the period from 1961 to 1989, Mr. Preston held various positions at Pennwalt Corporation, including serving as president, chief operating officer and director from 1978 to 1989. Mr. Preston served as president and chief executive officer of Elf Atochem North America, Inc., a chemical and plastics company, from 1990 to 1993. Mr. Preston received his Masters of Business Administration from Harvard Business School and his B.A. degree from Williams College. We believe Mr. Preston's qualifications to sit on our Board of Directors include his leadership and business skills. Mr. Preston has prior experience as a chairman, chief executive officer, board member, audit committee member and president of several companies.

Dr. George W. Taylor has served as our executive vice chairman since October 2011. From January 2009 to October 2011 he served as our executive chairman. Prior to January 2009, Dr. Taylor had served as our chief executive officer since 1993 and as a director since 1984, when he co-founded our company. From 1990 to 2004, Dr. Taylor was our president, and from 1984 to 1990, he was our vice president. In 1979, he co-founded and served as president of Princeton Research Associates, Inc., a consulting engineering, technical marketing and product development company. In 1970, Dr. Taylor co-founded Princeton Materials Science, Inc., a manufacturer of liquid crystal displays and digital watches. Dr. Taylor received a Bachelor of Engineering degree with First Class Honours in Electrical Engineering and a Doctor of Engineering degree from the University of Western Australia and a Ph.D. in Electrical Engineering degree from the University of London. He is a Fellow of the Institute of Engineers, Australia and the Institute of Electrical Engineers, London. We believe Dr. Taylor's qualifications to sit on our Board of Directors include his leadership skills, business development experience and technical knowledge. Dr. Taylor has been a director of the Company for over 25 years and offers the perspective, institutional knowledge and deep understanding of our business accumulated over his many years of involvement with the Company.

Charles F. Dunleavy has served as our chairman since October 2011. He has also served as our chief executive officer since January 2010. Prior to his appointment as our chief executive officer, he served as our chief financial officer and our senior vice president since 2001 and as a director and as our treasurer and secretary since 1990. From 1993 to 2001, Mr. Dunleavy served as our vice president, finance. From 1990 to 1993, Mr. Dunleavy served as vice president, chief financial officer and director of Whole Systems International Corp., a privately held company specializing in multimedia instructional systems and information technology. From 1983 to 1990, Mr. Dunleavy was the corporate controller for Intermetrics, Inc., a publicly held software engineering company that is now a part of L-3 Communications. Mr. Dunleavy holds a Master of Business Administration degree with honors from Rutgers Graduate School of Business Administration. He received his A.B. degree from Colgate University with honors. We believe Mr. Dunleavy's qualifications to sit on our Board of Directors include his leadership skills and significant business development, finance and capital market experience. In addition, Mr. Dunleavy has over 20 years of experience with the Company and over that time has developed a significant perspective, institutional knowledge and understanding of the Company's business.

Executive Officers

We have one executive officer who is not also a director:

Name	Age	Position with Ocean Power Technologies, Inc.
Brian M. Posner	51	Chief Financial Officer, Secretary and Treasurer

Brian M. Posner has served as our chief financial officer since June 2010. From January 2009 until its sale to Covidien plc in September 2009, Mr. Posner was chief financial officer of Power Medical Interventions, a publicly-traded medical device company. From June 1999 to December 2008, Mr. Posner served in a series of positions of increasing responsibility with Pharmacopeia, Inc., a clinical development stage biopharmaceutical company, culminating in his service as Executive Vice President and Chief Financial Officer from May 2006 to December 2008. Mr. Posner also worked at other early-stage and publicly-held businesses and served on the audit staff of PricewaterhouseCoopers LLP where he had a diverse group of clients in the manufacturing, banking and natural resources sectors. Mr. Posner is a Certified Public Accountant and holds a Master of Business Administration degree from Pace University and a Bachelors degree in accounting from Queens College in New York City.

On July 31, 2013, Mr. Posner notified the Company of his decision to resign as the Chief Financial Officer in order to pursue another business opportunity. Mr. Posner’s last date of employment with the Company will be August 30, 2013, and until that date, he will continue to perform his responsibilities and assist with transition matters. Mr. Posner’s decision to submit his resignation was not the result of any disagreement with the Company, its board of directors or its management on any matter relating to the Company’s operations, policies or practices.

After Mr. Posner’s departure, Mr. Dunleavy will serve as Interim Chief Financial Officer while the Company conducts a search for a permanent Chief Financial Officer.

Director Compensation

Each non-employee director annually receives $15,000 and a choice of either (a) an option worth $20,000, based on the Black-Scholes formula, to purchase shares of Common Stock that is fully vested at the time of grant, or (b) Common Stock worth $20,000, which vests in equal installments over three years. Prior to the October 2012 Annual Meeting, equity compensation was awarded to each non-employee board member at the time of the annual meeting for the past year served. Beginning with the October 2012 meeting, equity compensation to non-employee board members was changed to an award at the time of the Annual meeting on a prospective basis, or for the year to be served. Such change resulted in an unusually large aggregate award in fiscal 2013. Each non-employee director also receives $3,000 for each Board meeting he attends in person or by video or teleconference, $2,500 for each Audit Committee meeting he attends in person or by video or teleconference, $2,000 for each Compensation Committee he attends in person or by video or teleconference and $1,500 for each Nominating and Corporate Governance Committee meeting he attends in person or by video or teleconference.

We reimburse each non-employee director for out-of-pocket expenses incurred in connection with attending our Board and Board committee meetings. Compensation for our directors, including cash and equity compensation, is determined, and remains subject to adjustment, by our Board of Directors.

The following table summarizes compensation paid to our non-employee directors in fiscal 2013.

Name	Fees Earned or Paid in Cash ($)	Restricted Stock and Option Awards ($) (1)(2)	All Other Compensation ($)		Total ($)
Terence J. Cryan	33,500	20,000	4,365	(3)	57,865
David L. Davis	56,000	40,000	—		96,000
Thomas J. Meaney(4)	21,500	20,000	42,000	(4)	83,500
Bruce A. Peacock	49,000	40,000	—		89,000
Seymour S. Preston III	55,000	40,000	—		95,000

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NET CASH FLOWS FROM FINANCING ACTIVITIES		89,667	57,234
NET CHANGE IN CASH AND CASH EQUIVALENTS		12,952	9,409
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		18,020	31,190
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	30,972	40,599
SUPPLEMENTAL CASH FLOW INFORMATION:			
CASH PAID DURING THE YEAR FOR:			
Interest	$	7,813	10,315
Income taxes		1,560	1,750
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:			
Transfer from loans to other real estate owned and repossessed assets		2,392	-

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

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - Basis of Presentation

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

The unaudited interim consolidated financial statements, which have been reviewed by J.D. Cloud & Co. L.L.P., LCNB s independent registered public accounting firm, in accordance with standards established by the Public Company Accounting Oversight Board, as indicated by their report included herein and which does not express an opinion on those statements, have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the rules and regulations of the Securities and Exchange Commission (the SEC). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation of financial position, results of operations, and cash flows for the interim periods, as required by Regulation S-X, Rule 10-01.

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

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

Management has reviewed and evaluated transactions and events for subsequent event accounting and disclosure purposes through November 5, 2009, the date the financial statements were issued.

Results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the results to be expected for the full year ending December 31, 2009. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, accounting policies, and financial notes thereto included in LCNB's 2008 Form 10-K filed with the SEC.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities

The amortized cost and estimated fair value of available-for-sale investment securities at September 30, 2009 and December 31, 2008 are summarized as follows (in thousands):

	September 30, 2009			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury notes	$ 5,313	63	-	5,376
U.S. Agency notes	45,479	362	65	45,776
U.S. Agency mortgage-backed securities	51,936	1,308	73	53,171
Corporate securities	7,413	198	-	7,611
Municipal securities:				
Non-taxable	75,945	2,730	2	78,673
Taxable	9,755	276	-	10,031
Trust preferred securities	348	48	-	396
Other debt securities	536	3	-	539
Marketable equity securities	39	2	-	41
	$ 196,764	4,990	140	201,614

	December 31, 2008			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value

U.S. Agency notes	$	44,264	372	-	44,636
U.S. Agency mortgage-backed securities		32,310	491	33	32,768
Corporate securities		1,010	4	1	1,013
Municipal securities:					
Non-taxable		53,821	430	627	53,624
Taxable		3,605	46	4	3,647
Other debt securities		521	-	9	512
Marketable equity securities		37	7	-	44
	$	135,568	1,350	674	136,244

The fair value of held-to-maturity investment securities, consisting of non-taxable and taxable municipal securities, approximates amortized cost at September 30, 2009.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 2 - Investment Securities (continued)

Information concerning securities with gross unrealized losses at September 30, 2009, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

		Less than Twelve Months		Twelve Months or Greater	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Agency notes	$	10,992	65	-	-
U.S. Agency mortgage-backed securities		9,985	72	42	1
Corporate securities		250	-	-	-
Municipal securities:					
Non-taxable		-	-	438	2
Taxable		200	-	-	-
Marketable equity securities		41	-	-	-
	$	21,468	137	480	3

The unrealized losses at September 30, 2009 are primarily due to increases in market interest rates. Because LCNB does not have the intent to sell the investments and it is more likely than not that LCNB will not be required to sell the investments before recovery of their amortized cost bases, which may be maturity, LCNB does not consider these investments to be other-than-temporarily impaired at September 30, 2009.

Accumulated other comprehensive income at September 30, 2009 consisted solely of the net unrealized gain on available-for-sale investment securities.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Loans

Major classifications of loans at September 30, 2009 and December 31, 2008 are as follows (in thousands):

		September 30, 2009	December 31, 2008
Commercial and industrial	$	43,707	38,724
Commercial, secured by real estate		181,286	174,493
Residential real estate		193,695	194,039
Consumer		27,863	33,369
Agricultural		3,348	3,216
Other loans, including deposit overdrafts		9,477	9,203
		459,376	453,044
Deferred net origination costs		622	767
		459,998	453,811
Less allowance for loan losses		2,799	2,468
Loans, net	$	457,199	451,343

Changes in the allowance for loan losses for the nine months ended September 30, 2009 and 2008 were as follows (in thousands):

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008

Balance, beginning of period	$	2,468	2,468
Provision for loan losses		970	322
Charge-offs		(910)	(646)
Recoveries		271	324
Balance, end of period	$	2,799	2,468

Charge-offs for the nine months ended September 30, 2009 included charge-offs on three commercial real estate loans totaling $352,000. The balance of charge-offs during this period consisted primarily of residential second mortgage loans, consumer loans, and checking and NOW account overdrafts. Charge-offs for the nine months ended September 30, 2008 consisted primarily of consumer loans and checking and NOW account overdrafts.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Loans (continued)

Non-accrual, past-due, and restructured loans as of September 30, 2009 and December 31, 2008 were as follows (in thousands):

		September 30, 2009	December 31, 2008
Non-accrual loans	$	1,445	2,281
Past-due 90 days or more and still accruing		336	806
Restructured loans		2,468	332
Total	$	4,249	3,419
Percent to total loans		0.92%	0.75%

Non-accrual loans at September 30, 2009 consisted of three commercial real estate loans totaling $789,000 and four residential real estate loans totaling $656,000. Included in the commercial real estate non-accrual loans at September 30, 2009 were two loans totaling $647,000 that had been classified as past-due 90 days or more and still accruing interest at December 31, 2008, when their total balance outstanding was $670,000. Non-accrual loans at December 31, 2008 included a commercial real estate loan with a balance of $2,149,000. The borrower was unsuccessful in its efforts to sell the property and LCNB accepted a deed in lieu of foreclosure during the third quarter 2009. The remaining balance of non-accrual loans at December 31, 2008 consisted primarily of residential real estate mortgage loans.

Loans past-due 90 days or more and still accruing interest at September 30, 2009 were primarily composed of consumer and residential mortgage loans. Loans past-due 90 days or more and still accruing interest at December 31, 2008 were primarily composed of the two commercial real estate loans mentioned previously and consumer and residential mortgage loans.

The increase in restructured loans is due to a commercial real estate loan which was restructured during the first quarter 2009. Its balance at September 30, 2009 was $2,162,000. Restructured loans at September 30, 2009 and December 31, 2008 also include a commercial real estate loan in the amount of $306,000 and $310,000, respectively.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 3 - Loans (continued)

The following is a summary of information pertaining to loans considered to be impaired at September 30, 2009 and December 31, 2008 (in thousands):

		September 30, 2009	December 31, 2008
Impaired loans without a valuation allowance	$	1,297	2,451
Impaired loans with a valuation allowance		5,330	3,121
Total impaired loans		6,627	5,572
Valuation allowance related to impaired loans	$	1,092	630

Other real estate owned (which includes property acquired through foreclosure or deed-in-lieu of foreclosure and also includes property deemed to be in-substance foreclosed) and other repossessed assets, which are included in other assets in the consolidated balance sheets, totaled approximately $2,424,000 at September 30, 2009, compared to $89,000 at December 31, 2008. Other real estate owned increased due to the transfer of three commercial real estate properties into this category during the third quarter 2009.

Loans sold to and serviced for others are not included in the accompanying balance sheets. The unpaid principal balances of those loans at September 30, 2009 and December 31, 2008 were $57,111,000 and $37,783,000, respectively. Loans sold to the Federal Home Loan Mortgage Corporation during the three and nine months ended September 30, 2009 totaled $2,481,000 and $26,033,000, respectively, and $81,000 and $814,000 during the three and nine months ended September 30, 2008, respectively. The increase in the amount of mortgage loans sold is primarily due to an increase in the number of refinanced loans because of the general decline in market interest rates for residential mortgage loans during the first nine months of 2009.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 4 Borrowings

Funds borrowed from the Federal Home Loan Bank of Cincinnati at September 30, 2009 and December 31, 2008 are as follows (thousands):

	Current Interest Rate	September 30, 2009	December 31, 2008
Fixed Rate Advances, due at maturity:			
Advance due February 2011	2.10%	$ 5,000	-
Advance due July 2012	1.99%	6,000	-
Advance due March 2017	5.25%	5,000	5,000
Fixed Rate Advances, with monthly			
principal and interest payments:			
Advance due March 2014	2.45%	4,527	-
Advance due March 2019	2.82%	4,782	-
		$ 25,309	5,000

All advances from the Federal Home Loan Bank of Cincinnati are secured by a blanket pledge of LCNB s 1-4 family first lien mortgage loans.

Short-term borrowings at September 30, 2009 and December 31, 2008 consisted of U.S. Treasury demand note borrowings of approximately $317,000 and $2,206,000, respectively. The U.S. Treasury was not charging interest at

September 30, 2009 or December 31, 2008.

Note 5 - Commitments and Contingent Liabilities

LCNB is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments included commitments to extend credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. Exposure to credit loss in the event of nonperformance by the other parties to financial instruments for commitments to extend credit is represented by the contract amount of those instruments.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 5 - Commitments and Contingent Liabilities (continued)

LCNB uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Financial instruments whose contract amounts represent off-balance-sheet credit risk at September 30, 2009 and December 31, 2008 were as follows (in thousands):

		September 30, 2009	December 31, 2008
Commitments to extend credit:			
Commercial loans	$	4,461	4,376
Other loans			
Fixed rate		519	1,033
Adjustable rate		604	302
Unused lines of credit:			
Fixed rate		5,267	2,807
Adjustable rate		66,764	70,647
Unused overdraft protection amounts on demand and NOW accounts		10,253	10,408
Standby letters of credit		7,257	8,138
	$	95,125	97,711

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Unused lines of credit include amounts not drawn in line of credit loans. Commitments to extend credit and unused lines of credit generally have fixed expiration dates or other termination clauses.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. At September 30, 2009 and December 31, 2008, outstanding guarantees of $1.7 million and $1.8 million, respectively, were issued to developers and contractors. These guarantees generally are fully secured and have varying maturities. In addition, LCNB has a participation in a letter of credit securing payment of principal and interest on a bond issue. The participation amount at September 30, 2009 and December 31, 2008 was approximately $5.5 million and $6.3 million, respectively. The agreement has a final maturity date of January, 2012.

LCNB evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable; inventory; property, plant and equipment; residential realty; and income-producing commercial properties.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 5 Commitments and Contingent Liabilities (continued)

Management believes that LCNB has sufficient liquidity to fund its lending and capital expenditure commitments.

LCNB and its subsidiaries are parties to various claims and proceedings arising in the normal course of business. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such proceedings and claims will not be material to the consolidated financial position or results of operations.

Note 6 Regulatory Capital

On January 9, 2009, LCNB received $13.4 million of new equity capital from the U.S. Treasury Department s Capital Purchase Program (CPP) established under the Emergency Economic Stabilization Act of 2008. The investment by the U.S. Treasury Department is comprised of $13.4 million in preferred shares, with a warrant to purchase 217,063 common shares of LCNB at an exercise price of $9.26, with a term of ten years. LCNB allocated $583,000 of the proceeds from the preferred stock issuance to the warrants. The resulting discount in the preferred stock is being amortized over five years and is being reported as an adjustment to preferred stock dividends.

The preferred shares pay a dividend of 5% per year for the first five years and will pay 9% thereafter. LCNB may repay the U.S. Treasury Department amounts previously received at any time without penalty, subject to consultation with the Office of the Comptroller of the Currency, LCNB s primary regulator. The minimum redemption amount is 25% of the issue price, or $3,350,000 for LCNB. LCNB may repurchase the warrant at fair market value, as defined in the Securities Purchase Agreement, if it redeems the preferred stock in full. If the warrant is not repurchased at the time the preferred stock is redeemed, the U.S. Treasury Department will attempt to sell the warrant in the secondary market.

Participation in the CPP is voluntary and requires participating institutions to comply with a number of restrictions and provisions, including, but not limited to, restrictions on compensation of certain executive officers and limitations on stock repurchase activities and dividend payments. Generally, LCNB will be unable to increase dividends to common shareholders or repurchase common shares without U.S. Treasury Department permission for a period of three years from the date of participation unless the preferred securities are no longer held by the U.S. Treasury Department. Additionally, no dividends may be paid on common stock unless and until all accrued and unpaid dividends for all past dividend periods owed to the U.S. Treasury Department on the preferred shares are fully paid. For more information regarding the terms of agreement between LCNB and the U.S. Treasury Department under the CPP and the securities issued by LCNB to the Treasury thereunder, please see the Current Report on Form 8-K filed by LCNB with the SEC on January 9, 2009, which is hereby, along with exhibits thereto, incorporated by reference.

On October 21, 2009, LCNB redeemed all 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A. See Notes to Consolidated Financial Statements, Note 11 - Subsequent Event of this report for additional information pertaining to the redemption of the preferred shares.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 6 Regulatory Capital (continued)

The Bank and LCNB are required by regulators to meet certain minimum levels of capital adequacy. These 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 LCNB's assets, provide for weighing assets based on assigned risk factors and include off-balance sheet items such as stand-by letters of credit. The ratio of Tier 1 capital to risk-weighted assets must be at least 4.0% and the ratio of Total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8.0%. 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 3.0%.

For various regulatory purposes, financial institutions are classified into categories based upon capital adequacy. The highest "well-capitalized" category requires capital ratios of at least 10% for total risk-based, 6% for Tier 1 risk-based, and 5% for leverage. As of the most recent notification from their regulators, the Bank and LCNB were categorized as "well-capitalized" under the regulatory framework for prompt corrective action. Management believes that no conditions or events have occurred since the last notification that would change the Bank's or LCNB's category. A summary of the regulatory capital and capital ratios of LCNB follows (dollars in thousands):

		At September 30, 2009	At December 31, 2008
Regulatory Capital:			
Shareholders' equity	$	79,165	58,116
Goodwill and other intangibles		(6,534)	(6,600)
Accumulated other comprehensive (income) loss		(3,201)	2,591
Tier 1 risk-based capital		69,430	54,107

Eligible allowance for loan losses		2,799	2,468
Total risk-based capital	$	72,229	56,575
Capital ratios:			
Total risk-based (required 8.00%)		15.08%	12.61%
Tier 1 risk-based (required 4.00%)		14.50%	12.06%
Leverage (required 3.00%)		9.48%	8.19%

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 7 Employee Benefits

Effective January 1, 2009, LCNB redesigned its qualified noncontributory defined benefit retirement plan and merged its single-employer plan into a multiple-employer plan, which is accounted for as a multi-employer plan because assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer. Accordingly, the assets and obligations of the single-employer plan were transferred to the multiple-employer plan in January 2009. At that time, the pension plan related balance sheet accounts were adjusted resulting in an approximate $3.0 million increase in other comprehensive income, which is included in shareholders equity, and a $722,000 charge to non-interest expense in the consolidated statements of income. Employees hired on or after January 1, 2009 are not eligible to participate in this plan.

Effective February 1, 2009, LCNB amended the plan to reduce benefits for those whose age plus vesting service equaled less than 65 at that date. Also effective February 1, 2009, an enhanced 401-K plan was made available to those hired on or after January 1, 2009 and to those who received benefit reductions from the amendments to the noncontributory defined benefit retirement plan. Employees hired on or after January 1, 2009 will receive a 50% employer match on their contributions into the 401-K plan, up to a maximum LCNB contribution of 3% of each individual employee s annual compensation. Employees who received a benefit reduction under the retirement plan amendments will receive an automatic contribution of 5% or 7% of annual compensation, depending on the sum of an employee s age and vesting service, into the 401-K plan, regardless of the contributions made by the employees. This contribution will be made annually and these employees will not receive any employer matches to their 401-K contributions.

Funding and administrative costs of the qualified noncontributory defined benefit retirement plan charged to pension and other employee benefits in the consolidated statements of income for the three and nine months ended September 30, 2009 were $10,000 and $82,000, respectively. Employer expense incurred in connection with the 401-K plan during the three and nine months ended September 30, 2009 was $58,000 and $170,000 respectively.

The components of net periodic pension cost of the qualified noncontributory defined benefit retirement plan for the three and nine months ended September 30, 2008 are summarized as follows (in thousands):

	For the Three Months Ended September 30,	For the Nine Months Ended September 30,
	2008	2008
Service cost	$ 186	559
Interest cost	140	420
Expected return on plan assets	(132)	(396)
Amortization of net loss	30	91
Net periodic pension cost	224	674

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 7 Employee Benefits (continued)

Effective February 1, 2009, LCNB established a nonqualified defined benefit retirement plan for certain highly compensated employees. The nonqualified plan ensures that participants receive the full amount of benefits to which they would have been entitled under the noncontributory defined benefit retirement plan in the absence of limits on benefit levels imposed by certain sections of the Internal Revenue Code.

The components of net periodic pension cost of the nonqualified defined benefit retirement plan for the three and nine months ended September 30, 2009 are summarized as follows (in thousands):

	For the Three Months Ended September 30,	For the Nine Months Ended September 30,
	2009	2009
Service cost	$ 41	108
Interest cost	7	19
Prior service cost	12	32
Net periodic pension cost	60	159

Note 8 - Stock Options

Under the Ownership Incentive Plan (the "Plan"), LCNB may grant 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 common shares. As of September 30, 2009, only stock options have been granted under the Plan. Options granted to date vest ratably over a five year period and expire ten years after the date of grant. Stock options outstanding at September 30, 2009 were as follows:

	Outstanding		Exercisable		
Expiration Date	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price	Number Exercised
Feb 2013	11,056	$ 13.09	11,056	$ 13.09	-
Jan 2014	8,108	17.66	8,108	17.66	-
Jan 2016	7,934	18.95	4,760	18.95	-
Feb 2017	8,116	17.88	3,246	17.88	-
Feb 2018	13,918	12.55	2,784	12.55	-
Jan 2019	29,110	9.00	-	-	-
	78,242	$ 13.04	29,954	$ 15.73	-

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 8 - Stock Options (continued)

The following table summarizes stock option activity for the periods indicated:

	Nine Months ended September 30,			
	2009		2008	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, January 1,	49,132	$ 15.43	35,214	$ 16.57
Granted	29,110	9.00	13,918	12.55
Exercised	-	-	-	-
Outstanding, September 30,	78,242	$ 13.04	49,132	$ 15.43
Exercisable, September 30,	29,954	$ 15.73	22,339	$ 15.60

At September 30, 2009, the aggregate intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) for options outstanding at that date and that were in the money (market price greater than exercise price) was approximately $58,000. There was no aggregate intrinsic value at that date for only the options that were exercisable. The intrinsic value changes based on changes in the market price of the Company s stock.

The estimated weighted-average fair value of the options granted in the first quarter of 2009 and 2008 was $1.89 and $2.27 per option, respectively. The fair value was estimated at the dates of grant using the Black-Scholes option-pricing model and the following assumptions:

	2009	2008
Risk-free interest rate	3.49%	3.56%
Average dividend yield	4.04%	3.77%
Volatility factor of the expected market		
price of LCNB s common stock	27.54%	22.72%
Average life in years	9.0	8.2

Total expense related to options included in salaries and wages in the consolidated statements of income for the three and nine months ended September 30, 2009 were $9,000 and $24,000, respectively and $8,000 and $23,000 for the three and nine months ended September 30, 2008, respectively.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 9 - Earnings per Common Share

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is adjusted for the dilutive effects of stock options and warrants. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock options and warrants with proceeds used to purchase treasury shares at the average market price for the period. The computations were as follows (dollars in thousands, except share and per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income available to common shareholders	$ 1,837	1,794	4,932	4,936
Weighted average number of shares outstanding used in the calculation of basic earnings per common share	6,687,232	6,687,232	6,687,232	6,687,232
Add dilutive effect of warrants	20,514	-	5,800	-
Adjusted weighted average number of shares outstanding used in the calculation of diluted earnings per common share	6,707,746	6,687,232	6,693,032	6,687,232

Basic earnings per common share	$	0.27	0.27	0.74	0.74
Diluted earnings per common share	$	0.27	0.27	0.74	0.74

Note 10 - Fair Value of Financial Instruments

The inputs to valuation techniques used to measure fair value are assigned to one of three broad input levels:

- Level 1 quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date;

- Level 2 inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly; and

- Level 3 - inputs that are unobservable for the asset or liability.

Level 2 inputs may include quoted prices for similar assets in active markets, quoted prices for identical assets or liabilities in markets that are not active, inputs other than quoted prices (such as interest rates or yield curves) that are observable for the asset or liability, and inputs that are derived from or corroborated by observable market data.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 10 - Fair Value Measurements (continued)

The majority of LCNB s debt securities are classified as available-for-sale. The securities are reported at fair value with unrealized holding gains and losses reported net of income taxes in accumulated other comprehensive income.

LCNB utilizes a pricing service for determining the fair values of most of its investment securities. Fair value for U.S. Treasury Notes and corporate securities are determined based on market quotations (level 1). Fair value for most of the other investment securities is calculated using the discounted cash flow method for each security. The discount rates for these cash flows are estimated by the pricing service using rates observed in the market (level 2). Cash flow streams are dependent on estimated prepayment speeds and the overall structure of the securities given existing market conditions. In addition, approximately $539,000 is invested in a mutual fund. LCNB uses the fair value estimate provided by the mutual fund company, which uses market quotations when such quotes are available and good faith judgment when market quotations are not available. Because LCNB does not know the portion of the mutual fund valued using market quotations and the portion valued using good faith judgment, the entire investment in the mutual fund has been classified as a level 3 input. Additionally, Dakin owns stock in an insurance company and LCNB Corp. owns trust preferred securities in various financial institutions. Market quotations (level 1) are used to determine fair value for these investments.

The following table summarizes the valuation of LCNB s financial assets and liabilities measured on a recurring basis by the input levels defined by the fair value hierarchy as of September 30, 2009 and December 31, 2008 (000 s):

		Fair Value Measurements at Reporting Date Using		
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs

		(Level 1)	(Level 2)	(Level 3)
September 30, 2009				
Available-for-sale securities	$ 201,614	13,424	187,651	539
December 31, 2008				
Available-for-sale securities	$ 136,244	1,057	132,731	2,456

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LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 10 - Fair Value Measurements (continued)

The following table is a reconciliation of the beginning and ending balances of recurring fair value measurements that use significant unobservable inputs (level 3) for the three and nine months ended September 30, 2009 and 2008 (000 s):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
Beginning balance	$ 526	2,087	2,456	1,592
Purchases	-	-	-	500
Tax-exempt municipal securities reclassified as held-to-maturity	-	-	(1,944)	-
Dividends reinvested	5	5	15	16
Net change in unrealized gains (losses) included in other comprehensive income	8	1	12	(15)
Ending balance	$ 539	2,093	539	2,093

Assets that may be recorded at fair value on a nonrecurring basis include impaired loans, other real estate owned, and other repossessed assets. A loan is considered impaired when management believes it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Impaired loans are carried at the present value of estimated future cash flows using the loan s existing rate or the fair value of collateral if the loan is collateral dependent, if this value is less than the loan balance. When the fair value of the collateral is based on an observable market price or current appraised value, the inputs are considered to be level 2. When an appraised value is not available and there is not an observable market price, the inputs are considered to be level 3.

Other real estate owned is adjusted to fair value upon transfer of the loan to foreclosed assets, usually based on an appraisal of the property. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. The inputs for a valuation based on current appraised value are considered to be level 2.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 10 - Fair Value Measurements (continued)

The following table summarizes the valuation of LCNB s assets measured on a nonrecurring basis by the input levels defined by the fair value hierarchy as of September 30, 2009 and December 31, 2008 (000 s):

		Fair Value Measurements at Reporting Date Using		
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2009				
Impaired loans	$ 5,535	-	-	5,535
Other real estate owned	2,424	-	2,424	-
Totals	$ 7,959		2,424	5,535
December 31, 2008				
Impaired loans	$ 2,491	-	-	2,491
Other real estate owned	39	-	39	-
Repossessed assets	50	-	50	-
Totals	$ 2,580	-	89	2,491

Carrying amounts and estimated fair values of financial instruments as of September 30, 2009 and December 31, 2008 were as follows (000 s):

	September 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
FINANCIAL ASSETS:				
Cash and cash equivalents	$ 30,972	30,972	18,020	18,020
Securities available for sale	201,614	201,614	136,244	136,244
Securities held to maturity	12,156	12,156	-	-
Federal Reserve Bank and Federal Home Loan Bank stock	3,031	3,031	3,028	3,028
Loans, net	457,199	470,428	451,343	465,201
FINANCIAL LIABILITIES:				
Deposits	639,081	642,789	577,622	581,536
Short-term borrowings	317	317	2,206	2,206
Long-term debt	25,309	26,665	5,000	5,493

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 10 - Fair Value Measurements (continued)

The fair value of off-balance-sheet financial instruments at September 30, 2009 and December 31, 2008 was not material.

Fair values of financial instruments are based on various assumptions, including the discount rate and estimates of future cash flows. Therefore, the fair values presented may not represent amounts that could be realized in actual transactions. In addition, because the required disclosures exclude certain financial instruments and all nonfinancial instruments, any aggregation of the fair value amounts presented would not represent the underlying value of the Company. The following methods and assumptions were used to estimate the fair value of certain financial instruments:

Cash and cash equivalents

The carrying amounts presented are deemed to approximate fair value.

Investment securities

Fair values for securities, excluding Federal Home Loan Bank and Federal Reserve Bank stock, are based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities and/or discounted cash flow analyses. The carrying value of Federal Home Loan Bank and Federal Reserve Bank stock approximates fair value based on the respective redemptive provisions. The amortized cost of held-to-maturity securities approximates fair value.

Loans

Fair value is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, incorporating assumptions of current and projected prepayment speeds.

Deposits

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Borrowings

The carrying amounts of federal funds purchased and U.S. Treasury demand note borrowings are deemed to approximate fair value of short-term borrowings. For long-term debt, fair values are estimated based on the discounted value of expected net cash flows using current interest rates.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 11 Subsequent Event

On October 21, 2009, LCNB entered into a repurchase agreement with the U.S. Department of the Treasury (the Treasury Department) pursuant to which LCNB redeemed all 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A, sold to the Treasury Department on January 9, 2009 in connection with the Treasury Department s Capital Purchase Program (CPP). Under the CPP, the Treasury Department also received a warrant to purchase 217,063 shares of the Company s common stock with an exercise price of $9.26 per share.

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 Corp. 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 will reduce the fourth quarter s net income available to common shareholders and earnings per common share.

The funds for the redemption were obtained, in part, through the sale of approximately $10.9 million of available-for-sale investment securities at a total net loss of $74,000. All securities sold had an unrealized gain at September 30, 2009.

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

LCNB Corp. does not intend to negotiate the repurchase of 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 an exhibit to this report. Both documents are incorporated by reference into this Note 11, and the foregoing summary of certain provisions of these documents is qualified in its entirety by reference thereto.

LCNB CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Continued)

Note 12 Recent Accounting Pronouncements

Statement of Financial Accounting Standards (SFAS) No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140* and SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* were issued by the Financial Accounting Standards Board (the FASB) on June 12, 2009. Both standards will be effective for LCNB on January 1, 2010.

SFAS No. 166 requires more information about transfers of financial assets, including securitization transactions and the continued risk exposures related to such transfers. It eliminates the concept of a qualifying special-purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosures.

SFAS No. 167 changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting or similar rights should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. Additional disclosures are also required.

LCNB management does not anticipate that adoption of SFAS No. 166 and No. 167 will have a material effect on LCNB s consolidated financial statements.

Accounting Standards Update No. 2009-05, *Measuring Liabilities at Fair Value* was issued by the FASB in August 2009. For those entities that elect to value liabilities at fair value, this release provides guidance for measuring the fair value of liabilities and classifying the inputs as level 1, level 2, or level 3. It is effective for the first reporting period, including interim periods, after issuance. LCNB does not currently value any of its liabilities at fair value and does not anticipate that adoption of this update will have a material effect on its consolidated financial statements.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

LCNB Corp. and subsidiaries

Lebanon, Ohio

We have reviewed the accompanying consolidated balance sheet of LCNB Corp. and subsidiaries as of September 30, 2009, and the related consolidated statements of income and comprehensive income for each of the three-month and nine-month periods ended September 30, 2009 and 2008, and the related consolidated statements of shareholders equity and cash flows for each of the nine-month periods ended September 30, 2009 and 2008. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with U.S. generally accepted accounting principles.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of LCNB Corp. and subsidiaries as of December 31, 2008, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated February 27, 2009, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2008, is fairly stated in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ J.D. Cloud & Co. L.L.P.

Cincinnati, Ohio

November 5, 2009

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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, or c statements concerning opinions or judgments of LCNB 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.

Results of Operations

LCNB s net income available to common shareholders was $1,837,000 or $0.27 basic and diluted earnings per common share and $4,932,000 or $0.74 basic and diluted earnings per common share for the three and nine-month periods ended September 30, 2009, respectively. Net income available to common shareholders was $1,794,000 or $0.27 basic and diluted earnings per common share and $4,936,000 or $0.74 basic and diluted earnings per common share for the comparable periods in 2008. Affecting net income to common shareholders and earnings per common share for the three and nine month periods was an increase in net interest income, offset by increases in the provision for loan losses and non-interest expense. Negatively affecting net income available to common shareholders during 2009 were preferred stock dividends paid and related discount accretion recorded in connection with the preferred shares and warrant issued under the Capital Purchase Program (the CPP) on January 9, 2009.

Net interest income grew during the three and nine month periods of 2009 compared to 2008 primarily because of growth in interest earning assets and a general market decline in deposit interest rates. Non-interest expense during the three and nine periods of 2009 was influenced by industry-wide increases in FDIC deposit insurance premiums, an industry-wide special assessment levied by the FDIC, and a pension-related charge recognized by LCNB during the first quarter 2009.

Current economic conditions have contributed to an increase in loan delinquencies, but LCNB s loan portfolio continues to benefit from responsible underwriting and lending practices. Net charge-offs for the first nine months of 2009 and 2008 totaled $639,000 and $322,000, respectively. Non-accrual loans and loans past due 90 days or more and still accruing interest totaled $1,781,000 or 0.39% of total loans at September 30, 2009, compared to $3,087,000 or 0.68% of total loans at December 31, 2008. Other real estate owned and other repossessed assets totaled approximately $2,424,000 at September 30, 2009, compared to $89,000 at December 31, 2008. Non-accrual loans and loans past due 90 days or more decreased and other real estate owned increased largely due to the transfer of commercial real estate property into the other real estate owned category.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

LCNB s net income was $2,043,000 for the three months ended September 30, 2009, compared to $1,794,000 for the three months ended September 30, 2008. The return on average assets (ROAA) for the third quarter 2009 was 1.09% and the return on average total equity (ROAE) was 10.46%, compared with an ROAA of 1.09% and an ROAE of 12.27% for the third quarter of 2008. LCNB s net income was $5,446,000 during the first nine months of 2009 compared to $4,936,000 for the first nine months of 2008. The ROAA and ROAE for the first nine months of 2009 were 1.02% and 9.54%, respectively. The comparable ratios for the first nine months of 2008 were 1.05% and 11.38%, respectively. The decrease in ROAE during the 2009 periods is primarily due to the addition of preferred stock to equity on January 9, 2009.

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LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

<u>Net Interest Income</u>

<u>Three Months Ended September 30, 2009 vs. 2008.</u>

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 three months ended September 30, 2009 and 2008, 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.

	Three Months Ended September 30,					
	2009			2008		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Loans (1)	$ 457,372	$ 6,884	5.97%	$ 443,602	$ 7,115	6.36%
Federal funds sold and interest-bearing demand deposits	20,014	13	0.26%	24,201	126	2.07%
Interest-bearing deposits in banks	-	-	-%	3,913	25	2.53%
Federal Reserve Bank stock	940	-	-%	938	-	-%
Federal Home Loan Bank stock	2,091	26	4.93%	2,063	28	5.38%
Investment securities:						
Taxable	112,375	1,050	3.71%	74,410	784	4.18%
Non-taxable (2)	86,662	1,205	5.52%	53,130	803	6.00%

Total earnings assets		679,454	9,178	5.36%		602,257	8,881	5.85%
Non-earning assets		64,019				54,005		
Allowance for loan losses		(2,678)				(2,473)		
Total assets	$	740,795			$	653,789		
Interest-bearing deposits	$	548,512	2,278	1.65%	$	501,341	3,220	2.55%
Short-term borrowings		599	-	-%		725	4	2.19%
Long-term debt		23,929	177	2.93%		5,000	66	5.24%
Total interest-bearing liabilities		573,040	2,455	1.70%		507,066	3,290	2.57%
Demand deposits		84,927				83,443		
Other liabilities		5,342				5,312		
Capital		77,486				57,968		
Total liabilities and capital	$	740,795			$	653,789		
Net interest rate spread (3)				3.66%				3.28%
Net interest income and net interest margin								
on a taxable-equivalent basis (4)			$ 6,723	3.93%			$ 5,591	3.68%
Ratio of interest-earning assets to interest-bearing liabilities		118.57%				118.77%		

(1)

Includes nonaccrual loans, if any.

(2)

Income from tax-exempt securities is included in interest income on a taxable-equivalent basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34%.

(3)

The net interest spread is the difference between the average rate on total interest-earning assets and interest-bearing liabilities.

(4)

The net interest margin is the taxable-equivalent net interest income divided by average interest-earning assets.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

The following table presents the changes in taxable-equivalent basis 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 three months ended September 30, 2009 as compared to the same period in 2008. 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.

	Three Months Ended September 30, 2009 vs. 2008 Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
Interest-earning Assets:			
Loans	$ 216	(447)	(231)
Federal funds sold and interest-bearing demand deposits	(19)	(94)	(113)
Interest-bearing deposits in banks	(25)	-	(25)
Federal Reserve Bank stock	-	-	-
Federal Home Loan Bank stock	-	(2)	(2)
Investment securities:			
Taxable	363	(97)	266
Nontaxable	471	(69)	402
Total interest income	1,006	(709)	297
Interest-bearing Liabilities:			
Deposits	280	(1,222)	(942)
Short-term borrowings	(1)	(3)	(4)
Long-term debt	151	(40)	111
Total interest expense	430	(1,265)	(835)

Net interest income	$	576	556	1,132

Net interest income on a fully tax-equivalent basis for the three months ended September 30, 2009 totaled $6,723,000, an increase of $1,132,000 from the comparable period in 2008. Total interest income increased $297,000 and total interest expense decreased $835,000.

The increase in total interest income was due to a $77.2 million increase in average earning assets, partially offset by a 49 basis point (one basis point equals 0.01%) decrease in the average rate earned on earning assets. The increase in interest earning assets was primarily due to a $71.5 million increase in average investment securities and a $13.8 million increase in the loan portfolio. The decrease in the average rate earned on earning assets was primarily due to general decreases in market interest rates.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

The decrease in total interest expense was primarily due to an 87 basis point decrease in the average rate paid, partially offset by a $66.0 million increase in average interest-bearing liabilities. The decrease in the average rate paid on interest-bearing liabilities was primarily due to general decreases in market interest rates. The increase in average interest-bearing liabilities was due to average interest-bearing deposits, which increased $47.2 million, and average long-term borrowings, which increased $18.9 million due to additional borrowings from the Federal Home Loan Bank of Cincinnati during the first and third quarters of 2009.

Nine Months Ended September 30, 2009 vs. 2008.

The following table presents, for the nine months ended September 30, 2009 and 2008, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resultant average yields earned or rates paid.

	Nine Months Ended September 30,					
	2009			2008		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Loans (1)	$ 452,047	$ 20,580	6.09%	$ 445,882	$ 21,850	6.55%
Federal funds sold and interest-bearing demand deposits	21,107	41	0.26%	24,248	428	2.36%
Interest-bearing deposits in banks	-	-	-%	2,044	38	2.48%
Federal Reserve Bank stock	939	28	3.99%	850	24	3.77%

Federal Home Loan Bank stock		2,091	73	4.67%		2,036	82	5.38%
Investment securities:								
Taxable		106,067	3,183	4.01%		55,156	1,806	4.37%
Non-taxable (2)		76,217	3,226	5.66%		48,957	2,211	6.03%
Total earnings assets		658,468	27,131	5.51%		579,173	26,439	6.10%
Non-earning assets		60,313				52,829		
Allowance for loan losses		(2,555)				(2,472)		
Total assets	$	716,226			$	629,530		
Interest-bearing deposits	$	531,461	7,269	1.83%	$	478,511	9,996	2.79%
Short-term borrowings		718	-	-%		726	12	2.21%
Long-term debt		18,665	440	3.15%		5,000	197	5.26%
Total interest-bearing liabilities		550,844	7,709	1.87%		484,237	10,205	2.82%
Demand deposits		84,672				82,472		
Other liabilities		4,413				4,882		
Capital		76,297				57,939		
Total liabilities and capital	$	716,226			$	629,530		
Net interest rate spread (3)				3.64%				3.28%
Net interest income and net interest margin on a taxable-equivalent basis (4)			$ 19,422	3.94%			$ 16,234	3.74%
Ratio of interest-earning assets to interest-bearing liabilities		119.54%				119.61%		

(1)

Includes nonaccrual loans, if any. Income from tax-exempt loans is included in interest income on a tax-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.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table presents the changes in taxable-equivalent basis 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 nine months ended September 30, 2009 as compared to the same period in 2008.

	Nine Months Ended September 30, 2009 vs. 2008 Increase (decrease) due to:		
	Volume	Rate	Total
	(In thousands)		
Interest-earning Assets:			
Loans	$ 299	(1,569)	(1,270)
Federal funds sold and interest-bearing demand deposits	(49)	(338)	(387)
Interest-bearing deposits in banks	(38)	-	(38)
Federal Reserve Bank stock	3	1	4
Federal Home Loan Bank stock	2	(11)	(9)
Investment securities:			
Taxable	1,539	(162)	1,377
Nontaxable	1,162	(147)	1,015
Total interest income	2,918	(2,226)	692
Interest-bearing Liabilities:			
Deposits	1,013	(3,740)	(2,727)
Short-term borrowings	-	(12)	(12)
Long-term debt	350	(107)	243
Total interest expense	1,363	(3,859)	(2,496)
Net interest income	$ 1,555	1,633	3,188

Net interest income on a fully tax-equivalent basis for the first nine months of 2009 totaled $19,422,000, a $3,188,000 increase from the first nine months of 2008. Total interest income increased $692,000 and total interest expense decreased $2,496,000.

The increase in total interest income was primarily due to a $79.3 million increase in average total earning assets, partially offset by a 59 basis point decrease in the average rate earned on earning assets. The increase in average earning assets was primarily due to a $78.2 million increase in average investment securities. The decrease in the average rate earned on earning assets was primarily due to general decreases in market interest rates.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

The decrease in total interest expense was due primarily to a 95 basis point decrease in the average rate paid on interest-bearing liabilities, partially offset by a $66.6 million increase in average interest-bearing liabilities. The increase in average interest-bearing liabilities was primarily due to a $53.0 million increase in average interest-bearing deposits and a $13.7 million increase in average long term debt due to additional borrowings from the Federal Home Loan Bank of Cincinnati during the first and third quarters of 2009.

Provision and Allowance For Loan Losses

The total provision for loan losses is determined based upon management's evaluation as to the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the 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, and current economic conditions that may affect borrowers ability to pay. The provision for loan losses for the three months ended September 30, 2009 and 2008 was $664,000 and $188,000, respectively, and $970,000 and $322,000 for the nine months ended September 30, 2009 and 2008, respectively. The increase in the provision for loan losses reflects an increase in non-accrual and delinquent loans, the net charge-off trend, and the current economic conditions.

Non -Interest Income

Three Months Ended September 30, 2009 vs. 2008.

Non-interest income for the third quarter of 2009 was $27,000 less than for the same period in 2008. Service charges and fees decreased $151,000 primarily due to fewer overdraft fees on checking and NOW accounts. This decrease was partially offset by a $60,000 increase in gains on sales of securities and a $44,000 increase in gains from sales of mortgage loans.

Gains from sales of mortgage loans increased due to a higher volume of sales to the Federal Home Loan Mortgage Corporation during the 2009 period. Loan sales during the third quarter 2009 totaled $2,481,000 compared to $81,000 in sales during the third quarter 2008. The increase in the amount of mortgage loans sold is primarily due to an increase in the number of loans being refinanced, reflecting a general decline in market interest rates for residential mortgage loans during the first nine months of 2009.

Nine Months Ended September 30, 2009 vs. 2008.

Non-interest income for the first nine months of 2009 was $87,000 greater than for the same period in 2008. Gains from sales of mortgage loans increased $368,000, partially offset by a $237,000 decrease in service charges and fees and a $121,000 decrease in insurance agency income. Loan sales for the first nine months of 2009 totaled $26,033,000, compared to $814,000 of loans sold for the first nine months of 2008. Service charges and fees decreased primarily due to fewer overdraft fees on checking and NOW accounts and insurance agency income decreased due to a $64,000 decrease in contingency commissions and a general decline in commission income due to market factors. Contingency commissions are profit-sharing arrangements on property and casualty policies between the originating agency and the carrier and are generally based on underwriting results and written premiums. As such, the amount received each year can vary significantly depending on loss experience.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

Non-Interest Expense

Three Months Ended September 30, 2009 vs. 2008.

Total non-interest expense increased $266,000 during the third quarter 2009 as compared to the third quarter 2008 primarily due to a $296,000 increase in FDIC premiums reflecting an industry-wide increase in quarterly premiums. Salaries and wages increased $119,000 primarily due to additional employees, partially due to the opening of the Centerville office in September 2008, and annual salary and wage increases.

These expense increases were partially offset by a $98,000 decrease in pension and other employee benefits primarily due to lower pension expense.

Nine Months Ended September 30, 2009 vs. 2008.

Total non-interest expense increased $1,903,000 during the first nine months of 2009 as compared to the first nine months of 2008 primarily due to an $874,000 increase in FDIC premiums and a $722,000 write-off of a pension asset during the first quarter 2009. The increase in FDIC premiums includes an approximate $325,000 expense recognized for an industry-wide special assessment levied by the FDIC as of June 30, 2009. The balance of the increase reflects industry-wide increases in quarterly premiums. The write-off of the pension asset is related to the redesign during the first quarter 2009 of LCNB s retirement program. The plans were redesigned to provide competitive benefits to employees and provide more predictable and lower retirement plan costs over the long term. Because of the redesign, pension plan related balance sheet accounts were adjusted resulting in an approximate $3.0 million after tax increase in other comprehensive income, which is a component of shareholders equity, and the $722,000 charge to non-interest expense.

The remainder of the increase in total non-interest expense is due to a $398,000 increase in salaries and wages primarily for the same reasons discussed above, partially offset by a $204,000 decrease in intangible amortization.

The decrease in the intangible amortization is primarily due to the amortization in full during 2008 of an intangible asset related to the purchase of three offices from another bank in 1997.

Income Taxes

LCNB s effective tax rates for the nine months ended September 30, 2009 and 2008 were 22.1% and 25.4%, respectively. The difference between the statutory rate of 34.0% and the effective tax rate is primarily due to tax-exempt interest income from municipal securities and tax-exempt earnings from bank owned life insurance.

Financial Condition

Total assets at September 30, 2009 were $100.1 million greater than at December 31, 2008. The growth in total assets were primarily funded by a $61.5 million increase in total deposits, a $20.3 million increase in long-term debt, and $13.4 million received from the sale of preferred stock to the U.S. Treasury Department under the CPP.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

Net loans at September 30, 2009 were $5,856,000 greater than at December 31, 2008. Commercial and industrial loans were $4,983,000 greater at September 30, 2009 and commercial real estate loans were $6,793,000 greater. During the same period, residential real estate loans decreased $344,000 and consumer loans decreased $5,506,000. Residential real estate loans decreased primarily because new loans originated were sold to FHLMC. New residential real estate loans sold during the nine months ended September 30, 2009 totaled $26,033,000. Consumer loans decreased primarily due to weak demand.

The investment securities portfolio at September 30, 2009 was $77.5 million greater than at December 31, 2008. Most of the growth was in U. S. Agency mortgage-backed securities, which increased $20.4 million and municipal securities, which increased $43.6 million.

The $20.3 million increase in long-term debt is due to new borrowings from the Federal Home Loan Bank of Cincinnati during the first and third quarters of 2009. Of the $61.5 million increase in total deposits, approximately $29.8 million was due to increases in public fund deposits by local governmental entities. LCNB has also been receiving a higher than normal increase in deposits due, in part, to the volatility of current economic conditions. Most of the deposit growth has been in liquid NOW account, money fund deposit account, and regular savings account products.

On January 9, 2009, LCNB received $13.4 million of new 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. LCNB allocated $583,000 of the proceeds from the preferred stock issuance to the warrants. The resulting discount in the preferred stock is being amortized over five years and is being reported as an adjustment to preferred stock dividends. The issuance of preferred stock significantly increased LCNB s capital and liquidity levels. The preferred stock pays a cumulative dividend of 5% per annum for the first five years and 9% per annum thereafter if not redeemed first. For more information regarding the terms of agreement between LCNB and the U.S. Treasury Department under the CPP and the securities issued by LCNB to the U.S. Treasury Department thereunder, please see the Current Report on Form 8-K filed by LCNB with the SEC on January 9, 2009 which is hereby, along with exhibits thereto, incorporated by reference.

On October 21, 2009, LCNB redeemed all 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A. See Notes to Consolidated Financial Statements, Note 11 Subsequent Event for additional information pertaining to the redemption of the preferred shares.

Other assets at September 30, 2009 were $2.8 million greater than at December 31, 2008 primarily due to the transfer of three commercial real estate properties totaling $2.4 million from the loan portfolio into other real estate owned during the third quarter 2009.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

Liquidity

On October 21, 2009, LCNB redeemed all 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A. See Notes to Consolidated Financial Statements, Note 11 Subsequent Event for additional information pertaining to the redemption of the preferred shares.

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 Office of the Comptroller of the Currency, 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.

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. Asset liquidity is provided by cash and assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash and cash equivalents, interest-bearing deposits in other banks, and securities available for sale. At September 30, 2009, LCNB s liquid assets amounted to $232.6 million or 31.0% of total assets, an increase from $154.3 million or 23.7% of total assets at December 31, 2008. Most of this growth was due to growth in investment securities available for sale.

Liquidity is also provided by access to core funding sources, primarily core depositors in the bank s market area. Approximately 76.5% of total deposits at September 30, 2009 were core deposits, compared to 79.6% of deposits at December 31, 2008. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than $100,000. The percentage of core deposits to total deposits decreased because of the growth in public fund deposits discussed above in relation to total growth in deposits.

Secondary sources of liquidity include LCNB s ability to sell loan participations, borrow funds from the Federal Home Loan Bank, purchase federal funds, or use a line of credit established with another bank.

Management closely monitors the level of liquid assets available to meet ongoing funding needs. 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 as a result of the current liquidity levels.

LCNB CORP. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations (continued)

Recent Accounting Pronouncements

Statement of Financial Accounting Standards (SFAS) No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140* and SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* were issued by the Financial Accounting Standards Board (the FASB) on June 12, 2009. Both standards will be effective for LCNB on January 1, 2010.

SFAS No. 166 requires more information about transfers of financial assets, including securitization transactions and the continued risk exposures related to such transfers. It eliminates the concept of a qualifying special-purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosures.

SFAS No. 167 changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting or similar rights should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. Additional disclosures are also required.

LCNB management does not anticipate that adoption of SFAS No. 166 and No. 167 will have a material effect on LCNB s consolidated financial statements.

Accounting Standards Update No. 2009-05, *Measuring Liabilities at Fair Value* was issued by the FASB in August 2009. For those entities that elect to value liabilities at fair value, this release provides guidance for measuring the fair value of liabilities and classifying the inputs as level 1, level 2, or level 3. It is effective for the first reporting period, including interim periods, after issuance. LCNB does not currently value any of its liabilities at fair value and does not anticipate that adoption of this update will have a material effect on its consolidated financial statements.

LCNB CORP. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures about Market Risks

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. IRSA 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 300 basis points scenario to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the September 30, 2009 IRSA indicates that an increase in interest rates would have a positive effect on net interest income (NII), and a decrease in rates would have a negative effect on NII. The changes in NII for all rate assumptions are within LCNB s acceptable ranges.

Rate Shock Scenario in Basis Points		Amount	$ Change in Net Interest Income	% Change in Net Interest Income
		(Dollars in thousands)		
Up 300	$	28,067	889	3.27%
Up 200		27,789	611	2.25%
Up 100		27,411	233	0.86%
Base		27,178	-	-%
Down 100		26,970	(208)	-0.77%
Down 200		26,832	(346)	-1.27%

IRSA shows the effect on NII during a one-year period only. A more long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. As shown below, the September 30, 2009 EVE analysis indicates that an increase in interest rates would have a negative effect on the EVE and a decrease in rates would have a positive effect on the EVE. The changes in EVE for all rate assumptions are within LCNB s acceptable ranges.

Rate Shock Scenario in Basis Points		Amount	$ Change in EVE	% Change in EVE
		(Dollars in thousands)		
Up 300	$	75,554	(21,368)	-22.05%
Up 200		83,069	(13,853)	-14.29%
Up 100		89,816	(7,106)	-7.33%
Base		96,922	-	-%
Down 100		102,349	5,427	5.60%
Down 200		108,518	11,596	11.96%

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LCNB CORP. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures about Market Risks (continued)

The IRSA and EVE simulations discussed above are not projections of future income or equity and should not be relied on as being indicative of future operating results. Assumptions used, including the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment or replacement of asset and liability cash flows, are inherently uncertain and, as a result, the models cannot precisely measure future net interest income or equity. Furthermore, the models do not reflect actions that borrowers, depositors, and management may take in response to changing economic conditions and interest rate levels.

Item 4. Controls and Procedures

a) **Disclosure controls and procedures.** The Chief Executive Officer and the Chief Financial Officer have carried out an evaluation of the effectiveness of LCNB's disclosure controls and procedures that ensure that information relating to LCNB required to be disclosed by LCNB in the reports that it files or submits under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to LCNB s management, including its principal executive officer and principal financial officer, as appropriate, in order to allow timely decisions to be made regarding required disclosures. Based upon this evaluation, these officers have concluded, that as of September 30, 2009, LCNB's disclosure controls and procedures were effective.

b) **Changes in internal control over financial reporting.** During the period covered by this report, there were no changes in LCNB's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, LCNB's internal control over financial reporting.

PART II. OTHER INFORMATION

LCNB CORP. AND SUBSIDIARIES

Item 1. Legal Proceedings

Not applicable

Item 1A. Risk Factors

No material changes

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the period of this report, LCNB did not sell any of its securities that were not registered under the Securities Act, except as previously disclosed in the Current Report on Form 8-K filed on January 9, 2009.

During the period covered by this report, LCNB did not purchase any shares of its equity securities.

During the period of this report, LCNB was unable to increase dividends to common shareholders without U.S. Treasury Department permission for a period of three years from the date of participation in the CPP unless the preferred securities are no longer held by the U.S. Treasury Department. Additionally, no dividends were permitted to be paid on common stock unless and until all accrued and unpaid dividends for all past dividend periods owed to the U.S. Treasury Department on the preferred shares are fully paid. On October 21, 2009, LCNB redeemed all 13,400 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A. See Notes to Consolidated Financial Statements, Note 11 - Subsequent Event of this report for additional information pertaining to the redemption of the preferred shares.

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 Office of the Comptroller of the Currency, 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.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

Not applicable

LCNB CORP. AND SUBSIDIARIES

Item 6. Exhibits

Exhibit No.	Exhibit Description
3.1	Amended and Restated Articles of Incorporation of LCNB Corp. incorporated by reference to Form 10-K for the fiscal year ended December 30, 2008, Exhibit 3.1.
3.2	Code of Regulations of LCNB Corp. incorporated by reference to Form 10-Q for the quarterly period ended March 31, 2005, Exhibit 3(ii).
4.1	Warrant to Purchase Shares of Common Stock of the Registrant, dated January 9, 2009 incorporated by reference to the Registrant s Current Report on Form 8-K filed on January 9, 2009, Exhibit 4.1.
4.2	Letter Agreement, dated as of January 9, 2009 between the Registrant and the U.S. Department of the Treasury, which includes the Securities Purchase Agreement Standard Terms incorporated by reference to the Registrant s Current Report on Form 8-K filed on January 9, 2009, Exhibit 10.1.
4.3	Substitute Warrant to Purchase Shares of Common Stock of the Registrant, dated January 9, 2009.
4.4	Repurchase Letter Agreement, dated as of October 21, 2009 between the Registrant and the U.S. Department of the Treasury incorporated by reference to the Registrant s Current Report on Form 8-K filed on October 21, 2009, Exhibit 10.1.
10.1	LCNB Corp. Ownership Incentive Plan incorporated by reference to Registrant s Form DEF 14A Proxy Statement pursuant to Section 14(a), dated March 15, 2002, Exhibit A (000-26121).
10.2	Form of Option Grant Agreement under the LCNB Corp. Ownership Incentive Plan incorporated by reference to Form 10-K for the fiscal year ended December 31, 2005, Exhibit 10.2.
10.3	Letter Agreement, dated as of January 9, 2009 between the Registrant and the U.S. Department of the Treasury, which includes the Securities Purchase Agreement Standard

	Terms incorporated by reference to the Registrant s Current Report on Form 8-K filed on January 9, 2009, Exhibit 10.1.
10.4	Nonqualified Executive Retirement Plan incorporated by reference to the Registrant s quarterly report on Form 10-Q for the period ended June 30, 2009, Exhibit 10.4.
10.5	Repurchase Letter Agreement, dated as of October 21, 2009 between the Registrant and the U.S. Department of the Treasury incorporated by reference to the Registrant s Current Report on Form 8-K filed on October 21, 2009, Exhibit 10.1.

LCNB CORP. AND SUBSIDIARIES

Item 6. Exhibits (continued)

Exhibit No.	Exhibit Description
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LCNB Corp.

November 5, 2009

/s/ Stephen P. Wilson

Stephen P. Wilson, Chief Executive Officer and

Chairman of the Board of Directors

November 5, 2009

/s/Robert C. Haines, II

Robert C. Haines, II, Executive Vice President

and Chief Financial Officer