

LCNB CORP  
Form 10-Q  
November 06, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-26121

LCNB Corp.

(Exact name of registrant as specified in its charter)

Ohio

(State or other jurisdiction of incorporation or organization)

31-1626393

(I.R.S. Employer Identification Number)

2 North Broadway, Lebanon, Ohio 45036

(Address of principal executive offices, including Zip Code)

(513) 932-1414

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,

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or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

The number of shares outstanding of the issuer's common stock, without par value, as of November 5, 2012 was 6,726,719 shares.

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LCNB CORP. AND SUBSIDIARIES

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

LCNB CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands)

	September 30, 2012 (Unaudited)	December 31, 2011
<b>ASSETS:</b>		
Cash and due from banks	\$ 15,166	12,449
Interest-bearing demand deposits	17,908	7,086
Total cash and cash equivalents	33,074	19,535
<b>Investment securities:</b>		
Available-for-sale, at fair value	265,737	254,006
Held-to-maturity, at cost	12,503	10,734
Federal Reserve Bank stock, at cost	949	940
Federal Home Loan Bank stock, at cost	2,091	2,091
Loans, net	454,541	458,331
Premises and equipment, net	16,820	17,346
Goodwill	5,915	5,915
Bank owned life insurance	16,770	14,837
Other assets	8,792	7,835
<b>TOTAL ASSETS</b>	<b>\$ 817,192</b>	<b>791,570</b>
<b>LIABILITIES:</b>		
<b>Deposits:</b>		
Noninterest-bearing	\$ 116,489	106,793
Interest-bearing	584,591	556,769
Total deposits	701,080	663,562
Short-term borrowings	12,076	21,596
Long-term debt	14,049	21,373
Accrued interest and other liabilities	7,856	7,079
<b>TOTAL LIABILITIES</b>	<b>735,061</b>	<b>713,610</b>
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred shares – no par value, authorized 1,000,000 shares, none outstanding	-	-
Common shares – no par value, authorized 12,000,000 shares, issued 7,480,134 and 7,460,494 shares at September 30, 2012 and December 31, 2011, respectively	27,040	26,753
Retained earnings	60,760	57,877
Treasury shares at cost, 753,627 and 755,771 shares at September 30, 2012 and December 31, 2011, respectively	(11,665 )	(11,698 )
Accumulated other comprehensive income, net of taxes	5,996	5,028
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>82,131</b>	<b>77,960</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 817,192</b>	<b>791,570</b>

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>INTEREST INCOME:</b>				
Interest and fees on loans	\$5,822	6,294	17,950	19,289
Interest on investment securities –				
Taxable	941	1,036	2,810	2,826
Non-taxable	615	619	1,831	1,966
Other short-term investments	26	27	115	124
<b>TOTAL INTEREST INCOME</b>	<b>7,404</b>	<b>7,976</b>	<b>22,706</b>	<b>24,205</b>
<b>INTEREST EXPENSE:</b>				
Interest on deposits	1,050	1,371	3,332	4,454
Interest on short-term borrowings	4	6	12	23
Interest on long-term debt	136	160	440	499
<b>TOTAL INTEREST EXPENSE</b>	<b>1,190</b>	<b>1,537</b>	<b>3,784</b>	<b>4,976</b>
<b>NET INTEREST INCOME</b>	<b>6,214</b>	<b>6,439</b>	<b>18,922</b>	<b>19,229</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>436</b>	<b>588</b>	<b>742</b>	<b>1,476</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,778</b>	<b>5,851</b>	<b>18,180</b>	<b>17,753</b>
<b>NON-INTEREST INCOME:</b>				
Trust income	530	553	1,769	1,572
Service charges and fees on deposit accounts	911	957	2,698	2,810
Net gain on sales of securities	427	273	886	692
Bank owned life insurance income	145	153	432	447
Gains from sales of mortgage loans	151	35	360	92
Other operating income	41	62	151	170
<b>TOTAL NON-INTEREST INCOME</b>	<b>2,205</b>	<b>2,033</b>	<b>6,296</b>	<b>5,783</b>
<b>NON-INTEREST EXPENSE:</b>				
Salaries and employee benefits	3,059	2,983	9,004	8,990
Equipment expenses	263	288	789	745
Occupancy expense, net	445	443	1,242	1,305
State franchise tax	193	190	595	582
Marketing	129	145	409	370
FDIC insurance premiums	83	95	298	563
Other non-interest expense	1,392	1,292	4,005	3,973
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>5,564</b>	<b>5,436</b>	<b>16,342</b>	<b>16,528</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>2,419</b>	<b>2,448</b>	<b>8,134</b>	<b>7,008</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>572</b>	<b>581</b>	<b>2,023</b>	<b>1,640</b>
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>1,847</b>	<b>1,867</b>	<b>6,111</b>	<b>5,368</b>
	-	-	-	793

INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX				
NET INCOME	\$1,847	1,867	6,111	6,161
Dividends declared per common share	\$0.16	0.16	0.48	0.48
Basic earnings per common share:				
Continuing operations	\$0.27	0.28	0.91	0.80
Discontinued operations	-	-	-	0.12
Diluted earnings per common share:				
Continuing operations	\$0.27	0.28	0.90	0.80
Discontinued operations	-	-	-	0.12
Weighted average common shares outstanding:				
Basic	6,721,699	6,690,963	6,713,959	6,690,157
Diluted	6,797,675	6,750,807	6,787,000	6,746,568

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



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## LCNB CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net Income	\$1,847	1,867	6,111	6,161
Other comprehensive income:				
Net unrealized gain on available-for-sale securities (net of taxes of \$556 and \$1,348 for the three months ended September 30, 2012 and 2011, respectively, and \$787 and \$2,054 for the nine months ended September 30, 2012 and 2011, respectively)	1,080	2,618	1,529	3,969
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of taxes of \$145 and \$92 for the three months ended September 30, 2012 and 2011, respectively, and \$300 and \$235 for the nine months ended September 30, 2012 and 2011, respectively)	(282 )	(181 )	(586 )	(457 )
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost (net of taxes of \$4 and \$- for the three months ended September 30, 2012 and 2011, respectively, and \$12 and \$2 for the nine months ended September 30, 2012 and 2011, respectively)	9	-	25	4
Nonqualified pension plan curtailment (net of taxes of \$80)	-	-	-	155
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$2,654</b>	<b>4,304</b>	<b>7,079</b>	<b>9,832</b>

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

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

	Common Shares Outstanding	Common Stock	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income	Total Share Equity
Balance December 31, 2010	6,689,743	\$26,515	54,045	(11,698 )	1,845	70,307
Net income			6,161			6,161
Net unrealized gain on available-for-sale securities, net of taxes					3,969	3,969
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income, net of taxes					(457 )	(457 )
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost, net of taxes					4	4
Nonqualified pension plan curtailment entry, net of taxes					155	155
Dividend Reinvestment and Stock Purchase Plan	7,659	97				97
Compensation expense relating to stock options		35				35
Common stock dividends, \$0.48 per share			(3,211 )			(3,211 )
Balance September 30, 2011	6,697,402	\$26,647	56,995	(11,698 )	5,516	77,902
Balance December 31, 2011	6,704,723	\$26,753	57,877	(11,698 )	5,028	77,855
Net income			6,111			6,111
Net unrealized gain on available-for-sale securities, net of taxes					1,529	1,529
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income, net of taxes					(586 )	(586 )
Change in nonqualified pension plan unrecognized net loss and unrecognized prior service cost, net of taxes					25	25
Dividend Reinvestment and Stock Purchase Plan	19,640	257				257
Exercise of stock options	2,144		(5 )	33		28
Compensation expense relating to stock options		30				30
Net revenues:						
Clinical testing business	\$ 1,676,491	\$ 1,492,177	\$ 3,305,310	\$ 2,883,451		
All other operating segments	161,410	148,979	317,228	283,913		

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Total net revenues	\$ 1,837,901	\$ 1,641,156	\$ 3,622,538	\$ 3,167,364	
Operating earnings (loss):					
Clinical testing business	\$ 337,938	\$ 297,810	\$ 643,902	\$ 533,909	(a)
All other operating segments	14,050	13,059	22,692	10,579	(b) (c)
General corporate expenses	(43,865)	(38,460)	(78,210)	(71,209)	
Total operating income	308,123	272,409	588,384	473,279	
Non-operating expenses, net	(45,118)	(38,577)	(92,827)	(62,322)	
Income from continuing operations					
before income taxes	263,005	233,832	495,557	410,957	
Income tax expense	100,787	91,853	192,645	161,463	
Income from continuing operations	162,218	141,979	302,912	249,494	
Loss from discontinued operations, net					
of taxes	(890)	(647)	(1,977)	(2,269)	
Net income	\$ 161,328	\$ 141,332	\$ 300,935	\$ 247,225	

- (a) During the six months ended June 30, 2007, operating income included \$9.9 million of first quarter charges, associated with workforce reductions in response to reduced volume levels.
- (b) During the six months ended June 30, 2007, operating income included a \$4 million first quarter charge related to the expensing of in-process research and development associated with the acquisition of HemoCue (see Note 2).
- (c) During the six months ended June 30, 2007, operating income included \$0.8 million of first quarter charges, associated with workforce reductions in response to reduced volume levels.

**QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-CONTINUED**  
**(in thousands, unless otherwise indicated)**  
**(unaudited)**

**10. SUMMARIZED FINANCIAL INFORMATION**

The Company's 5.125% senior notes due 2010, 7.5% senior notes due 2011, 5.45% senior notes due 2015, 6.40% senior notes due 2017 and 6.95% senior notes due 2037 are fully and unconditionally guaranteed by certain of the Company's wholly owned subsidiaries that have operations in the United States (the "Subsidiary Guarantors"). With the exception of Quest Diagnostics Receivables Incorporated (see paragraph below), the non-guarantor subsidiaries are primarily foreign subsidiaries and less than wholly owned subsidiaries.

In conjunction with the Company's Secured Receivables Credit Facility, the Company maintains a wholly owned non-guarantor subsidiary, Quest Diagnostics Receivables Incorporated ("QDRI"). The Company and certain of its Subsidiary Guarantors transfer all private domestic receivables to QDRI. QDRI utilizes the transferred receivables to collateralize borrowings under the Company's Secured Receivables Credit Facility. The Company and the Subsidiary Guarantors provide collection services to QDRI. QDRI uses cash collections principally to purchase new receivables from the Company and the Subsidiary Guarantors.

The following condensed consolidating financial data illustrates the composition of the combined guarantors. Investments in subsidiaries are accounted for by the parent using the equity method for purposes of the supplemental consolidating presentation. Earnings (losses) of subsidiaries are therefore reflected in the parent's investment accounts and earnings. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions. HemoCue and AmeriPath have been included in the accompanying condensed consolidating financial data, subsequent to the closing of the acquisitions, as Subsidiary Guarantors.

**QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-CONTINUED**  
(in thousands, unless otherwise indicated)  
**(unaudited)**

*Condensed Consolidating Statement of Operations*  
*Three Months Ended June 30, 2008*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Elim</u>
Net revenues	\$ 210,309	\$ 1,518,732	\$ 160,313	\$
Operating costs and expenses:				
Cost of services	129,935	892,634	60,912	
Selling, general and administrative	55,002	305,632	83,430	
Amortization of intangible assets	58	7,807	2,051	
Royalty (income) expense	(107,694)	107,694	-	
Other operating expense (income), net	4	(49)	(1,611)	
Total operating costs and expenses	77,305	1,313,718	144,782	
Operating income	133,004	205,014	15,531	
Non-operating expenses, net	(39,262)	(44,510)	(6,772)	
Income from continuing operations before taxes .	93,742	160,504	8,759	
Income tax expense	32,462	64,408	3,917	
Income from continuing operations	61,280	96,096	4,842	
Loss from discontinued operations, net of taxes	-	(889)	(1)	
Equity earnings from subsidiaries	100,048	-	-	
Net income	\$ 161,328	\$ 95,207	\$ 4,841	\$

*Condensed Consolidating Statement of Operations*  
*Three Months Ended June 30, 2007*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Elim</u>
Net revenues	\$ 203,886	\$ 1,332,434	\$ 185,680	\$
Operating costs and expenses:				
Cost of services	121,406	782,923	64,413	
Selling, general and administrative	47,482	269,454	84,078	
Amortization of intangible assets	50	4,009	1,291	
Royalty (income) expense	(99,091)	99,091	-	
Other operating expense (income), net	51	(288)	(213)	
Total operating costs and expenses	69,898	1,155,189	149,569	
Operating income	133,988	177,245	36,111	
Non-operating expenses, net	(35,361)	(73,435)	(4,716)	
Income from continuing operations before taxes .	98,627	103,810	31,395	
Income tax expense	37,246	41,534	13,073	
Income from continuing operations	61,381	62,276	18,322	

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Loss from discontinued operations, net of taxes	-	(656)	9
Equity earnings from subsidiaries	79,951	-	-
Net income	\$ 141,332	\$ 61,620	\$ 18,331

**QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-CONTINUED**  
(in thousands, unless otherwise indicated)  
**(unaudited)**

*Condensed Consolidating Statement of Operations*  
*Six Months Ended June 30, 2008*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Elim</u>
Net revenues	\$ 407,728	\$ 2,999,331	\$ 330,469	\$
Operating costs and expenses:				
Cost of services	249,737	1,768,897	123,474	
Selling, general and administrative	97,244	618,406	169,381	
Amortization of intangible assets	113	15,725	3,342	
Royalty (income) expense	(212,334)	212,334	-	
Other operating expense (income), net	4	(150)	(103)	
Total operating costs and expenses	134,764	2,615,212	296,094	
Operating income	272,964	384,119	34,375	
Non-operating expenses, net	(87,096)	(98,102)	(10,703)	
Income from continuing operations before taxes .	185,868	286,017	23,672	
Income tax expense	67,598	114,798	10,249	
Income from continuing operations	118,270	171,219	13,423	
Loss from discontinued operations, net of taxes	-	(1,624)	(353)	
Equity earnings from subsidiaries	182,665	-	-	
Net income	\$ 300,935	\$ 169,595	\$ 13,070	\$

*Condensed Consolidating Statement of Operations*  
*Six Months Ended June 30, 2007*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Elim</u>
Net revenues	\$ 415,769	\$ 2,554,757	\$ 356,565	\$
Operating costs and expenses:				
Cost of services	244,840	1,530,962	124,725	
Selling, general and administrative	100,062	523,782	167,732	
Amortization of intangible assets	135	6,562	3,113	
Royalty (income) expense	(194,228)	194,228	-	
Other operating expense (income), net	44	(282)	4,088	
Total operating costs and expenses	150,853	2,255,252	299,658	
Operating income	264,916	299,505	56,907	
Non-operating expenses, net	(63,698)	(139,570)	(7,103)	
Income from continuing operations before taxes .	201,218	159,935	49,804	
Income tax expense	76,204	64,147	21,112	
Income from continuing operations	125,014	95,788	28,692	

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Loss from discontinued operations, net of taxes	-	(2,176)	(93)
Equity earnings from subsidiaries	122,211	-	-
Net income	\$ 247,225	\$ 93,612	\$ 28,599



**QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-CONTINUED**  
(in thousands, unless otherwise indicated)  
**(unaudited)**

*Condensed Consolidating Balance Sheet*  
*June 30, 2008*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>
<b><u>Assets</u></b>				
Current assets:				
Cash and cash equivalents	\$ 97,829	\$ 11,180	\$ 34,389	\$ -
Accounts receivable, net	16,986	262,224	643,303	-
Other current assets	53,370	199,510	105,518	(7,221)
Total current assets	168,185	472,914	783,210	(7,221)
Property, plant and equipment, net	214,246	632,874	45,953	-
Goodwill and intangible assets, net	153,374	5,397,992	542,037	-
Intercompany receivable (payable)	850,804	(494,125)	(356,679)	-
Investment in subsidiaries	5,315,631	-	-	(5,315,631)
Other assets	173,343	43,958	43,899	(97,731)
Total assets	\$ 6,875,583	\$ 6,053,613	\$ 1,058,420	\$ (5,420,583)

**Liabilities and Stockholders' Equity**

Current liabilities:				
Accounts payable and accrued expenses	\$ 473,646	\$ 567,228	\$ 46,583	\$ (7,221)
Short-term borrowings and current portion of long-term debt				
	-	47,637	2,727	-
Total current liabilities	473,646	614,865	49,310	(7,221)
Long-term debt	2,635,856	248,142	325,300	-
Other liabilities	98,427	475,329	83,456	(97,731)
Stockholders' equity	3,667,654	4,715,277	600,354	(5,315,631)
Total liabilities and stockholders' equity	\$ 6,875,583	\$ 6,053,613	\$ 1,058,420	\$ (5,420,583)

*Condensed Consolidating Balance Sheet*  
*December 31, 2007*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>
<b><u>Assets</u></b>				
Current assets:				
Cash and cash equivalents	\$ 111,610	\$ 14,847	\$ 41,137	\$ -
Accounts receivable, net	27,309	234,532	620,126	-
Other current assets	46,986	183,505	101,055	(6,750)
Total current assets	185,905	432,884	762,318	(6,750)
Property, plant and equipment, net	215,062	654,341	42,595	-
Goodwill and intangible assets, net	153,848	5,422,270	530,719	-
Intercompany receivable (payable)	859,841	(610,371)	(249,470)	-
Investment in subsidiaries	5,149,196	-	-	(5,149,196)

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Other assets	167,105	48,433	38,054	(81,091)
Total assets	\$ 6,730,957	\$ 5,947,557	\$ 1,124,216	\$ (5,237,037)

Liabilities and Stockholders' Equity

Current liabilities:

Accounts payable and accrued expenses	\$ 451,944	\$ 634,079	\$ 45,443	\$ (6,750)
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Short-term borrowings and current portion

of long-term debt	-	62,386	101,195	-
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Total current liabilities	451,944	696,465	146,638	(6,750)
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Long-term debt	2,829,927	247,573	299,712	-
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Other liabilities	124,844	457,837	74,352	(81,091)
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Stockholders' equity	3,324,242	4,545,682	603,514	(5,149,196)
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Total liabilities and stockholders' equity	\$ 6,730,957	\$ 5,947,557	\$ 1,124,216	\$ (5,237,037)
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**QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-CONTINUED**  
(in thousands, unless otherwise indicated)  
**(unaudited)**

*Condensed Consolidating Statement of Cash Flows*  
*Six Months Ended June 30, 2008*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Elim</u>
Cash flows from operating activities:				
Net income	\$ 300,935	\$ 169,595	\$ 13,070	\$ (
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	25,736	97,370	9,578	
Provision for doubtful accounts	5,788	57,873	103,907	
Other, net	(161,572)	16,914	1,619	
Changes in operating assets and liabilities	137,626	(270,297)	(136,932)	
Net cash provided by (used in) operating activities	308,513	71,455	(8,758)	
Net cash (used in) provided by investing activities	(124,134)	(57,283)	18,857	
Net cash used in financing activities	(198,160)	(17,839)	(16,847)	
Net change in cash and cash equivalents	(13,781)	(3,667)	(6,748)	
Cash and cash equivalents, beginning of period	111,610	14,847	41,137	
Cash and cash equivalents, end of period	\$ 97,829	\$ 11,180	\$ 34,389	\$

*Condensed Consolidating Statement of Cash Flows*  
*Six Months Ended June 30, 2007*

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Elim</u>
Cash flows from operating activities:				
Net income	\$ 247,225	\$ 93,612	\$ 28,599	\$ (
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	24,767	72,667	7,799	
Provision for doubtful accounts	6,544	24,126	108,055	
Other, net	(111,979)	34,439	2,063	
Changes in operating assets and liabilities	35,899	(171,163)	(122,307)	
Net cash provided by operating activities	202,456	53,681	24,209	
Net cash used in investing activities	(1,616,132)	(1,227,499)	(313,110)	1,
Net cash provided by financing activities	1,353,431	1,195,565	300,057	(1,
Net change in cash and cash equivalents	(60,245)	21,747	11,156	
Cash and cash equivalents, beginning of period	134,598	7,661	7,381	
Cash and cash equivalents, end of period	\$ 74,353	\$ 29,408	\$ 18,537	\$



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

### **Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions and select accounting policies that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

While many operational aspects of our business are subject to complex federal, state and local regulations, the accounting for our business is generally straightforward with net revenues primarily recognized upon completion of the testing process. Our revenues are primarily comprised of a high volume of relatively low dollar transactions, and about one-half of total operating costs and expenses consist of employee compensation and benefits. Due to the nature of our business, several of our accounting policies involve significant estimates and judgments. These accounting policies have been described in our Annual Report on Form 10-K for the year ended December 31, 2007.

### **Recent Acquisitions**

#### **Acquisition of AmeriPath**

On May 31, 2007, we completed the acquisition of AmeriPath Group Holdings, Inc. ("AmeriPath"), in an all-cash transaction valued at approximately \$2 billion, including approximately \$780 million of assumed debt and related accrued interest. AmeriPath is a leading provider of anatomic pathology, including dermatopathology, and esoteric testing which generates annual revenues of approximately \$800 million.

Through the acquisition, we acquired all of AmeriPath's operations. AmeriPath, with its team of approximately 400 board certified pathologists, operates 40 outpatient anatomic pathology laboratories and provides inpatient anatomic pathology and medical director services for approximately 200 hospitals throughout the country. We financed the all-cash purchase price and related transaction costs, together with the repayment of approximately \$780 million of principal and related accrued interest representing substantially all of AmeriPath's debt, as well as the refinancing of the \$450 million term loan used to finance the acquisition of HemoCue with \$1.6 billion of borrowings under a new five-year term loan facility, \$780 million of borrowings under a new one-year bridge loan, and cash on-hand. In June 2007, we completed an \$800 million senior notes offering. The net proceeds of the senior notes offering were used to repay the \$780 million borrowed under the bridge loan. The acquisition was accounted for under the purchase method of accounting.

#### **Acquisition of HemoCue**

On January 31, 2007, we acquired POCT Holding AB ("HemoCue"), a Sweden-based company specializing in point-of-care testing, in an all-cash transaction valued at approximately \$450 million, including \$113 million of assumed debt of HemoCue. The transaction was financed through an interim credit facility, which was refinanced during the second quarter of 2007 in connection with the financing of the AmeriPath acquisition. In January 2008, we received a payment of approximately \$23 million from an escrow fund established at the time of the acquisition.

HemoCue is the leading international provider in point-of-care testing for hemoglobin, with a growing share in professional glucose and microalbumin testing. HemoCue received Food and Drug Administration ("FDA") clearance in October 2007 for a test to determine white blood cell counts and has applied to receive Clinical Laboratories Improvement Amendments of 1988 ("CLIA")-waived status. Additionally, in June 2008, HemoCue was granted a CLIA waiver for its Albumin 201 System, which will screen patients for microalbuminuria and allow physicians to begin treatment based on the test's results during a single office visit.

This acquisition complements our point-of-care testing for infectious disease and cancer, including new tests for colorectal cancer screening and Herpes Simplex Type 2. The acquisition increases our presence in the growing point-of-care testing market and we plan to leverage HemoCue's international presence to reach new

markets around the world. HemoCue generated annual revenues of approximately \$80 million at the time of acquisition.

## Results of Operations

Our clinical testing business currently represents our one reportable business segment. The clinical testing business accounted for more than 90% of net revenues from continuing operations in both 2008 and 2007. Our other operating segments consist of our risk assessment services business, our clinical trials testing business, our healthcare information technology business, MedPlus, and our diagnostic products business. Our business segment information is disclosed in Note 9 to the interim consolidated financial statements.

### **Three and Six Months Ended June 30, 2008 Compared with Three and Six Months Ended June 30, 2007**

#### *Continuing Operations*

Income from continuing operations for the three months ended June 30, 2008 was \$162 million, or \$0.83 per diluted share, compared to \$142 million, or \$0.73 per diluted share, in 2007. Income from continuing operations for the six months ended June 30, 2008 was \$303 million, or \$1.55 per diluted share, compared to \$249 million, or \$1.28 per diluted share, in 2007. These increases in income from continuing operations were principally driven by revenue growth and actions we have taken to reduce our cost structure. In addition, the favorable resolution of certain tax contingencies increased diluted earnings per share by \$0.01 in the quarter and six months ended June 30, 2008.

During the first quarter of 2007, the Company became a non-contracted provider to United Healthcare Group Inc., ("UNH"). As a result of the change in status, the Company's revenues and earnings were significantly impacted for the first quarter and full year 2007. However, the ongoing profit impact was successfully mitigated by the end of 2007 as a result of actions taken to reduce costs and higher reimbursement for the testing we continued to perform for UNH members as a non-contracted provider.

Results for the six months ended June 30, 2007 include first quarter pre-tax charges of \$10.7 million, or \$0.03 per share, associated with workforce reductions in response to reduced volume levels, and a first quarter pre-tax charge of \$4.0 million, or \$0.01 per share, related to in-process research and development expense associated with the HemoCue acquisition.

#### *Net Revenues*

Net revenues for the three months ended June 30, 2008 grew by 12% over the prior year level to \$1.8 billion. Net revenues for the six months ended June 30, 2008 were \$3.6 billion, 14% above the prior year level. The acquisition of AmeriPath contributed approximately 8.1% and 10.5% to revenue growth for the three and six months ended June 30, 2008, respectively. While the UNH contract change took effect as of January 1, 2007, much of the loss of volume and change in revenues took place over the course of the first quarter last year. Therefore, there continues to be a carry-over impact in comparing the three and six months ended June 30, 2008 volume and revenues to that of the prior year. We estimate that the carry-over impact of our change in status with UNH reduced 2008 revenue growth for the three and six months ended June 30, 2008 by just over 1%.

Our clinical testing business, which accounts for over 90% of our net revenues, grew 12.4% above the prior year level for the three months ended June 30, 2008, with AmeriPath contributing 8.9% growth. Volume, measured by the number of requisitions, increased 4.9% for the three months ended June 30, 2008, with 3.9% due to the impact of the AmeriPath acquisition. We estimate that the impact of our change in status with UNH reduced volume growth for the three months ended June 30, 2008 by approximately 0.8%. After adjusting for the impact of the UNH contract change, we estimate the underlying volume growth to be between one and two percent. This is despite an almost 10% decline in pre-employment drug testing volume which accounted for approximately 7% of our total volume. We believe the volume decrease in pre-employment drug testing is principally due to slower hiring by the employers served by this business. Revenue per requisition increased 7.1% for the three months ended June 30, 2008 and was impacted by the results of AmeriPath, which contributed 4.5% to the improvement. The balance of the increase was primarily driven by a positive test mix, partially offset by price reductions on various health plan contracts.

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For the six months ended June 30, 2008, clinical testing revenues grew 14.6% above the prior year level with AmeriPath contributing 11.5% growth. Volume, measured by the number of requisitions, increased 5.3%



primarily due to the impact of the AmeriPath acquisition, which contributed about 5% volume growth. We estimate that the impact of our change in status with UNH reduced volume growth by approximately 1.2%. After adjusting for the impact of the UNH contract change, results for the six months ended June 30, 2008 reflect underlying volume growth of between one and two percent. Revenue per requisition increased 8.9% for the six months ended June 30, 2008 and was impacted by the results of AmeriPath, which contributed 6.1% to the improvement. The balance of the increase was primarily driven by a positive test mix, partially offset by price reductions on various health plan contracts.

Our businesses other than clinical testing accounted for approximately 9% of our net revenues for the three and six months ended June 30, 2008. These businesses include our risk assessment services business, our clinical trials testing business, our healthcare information technology business, MedPlus, and our diagnostic products business. The revenues for these businesses as a group grew 8% and 12% for the three and six months ended June 30, 2008, respectively, with the increase primarily driven by a strong performance of our healthcare information technology, point-of-care and clinical trials testing businesses.

#### *Operating Costs and Expenses*

Total operating costs and expenses for the three and six months ended June 30, 2008 increased \$161 million and \$340 million, respectively, from the prior year periods. For the three and six months ended June 30, 2008, these increases are primarily due to costs associated with the acquired operations of AmeriPath, and increased costs associated with annual compensation adjustments. These increases were partially offset by actions taken to improve our operating efficiency and reduce the size of our workforce.

Results for the six months ended June 30, 2007 reflect first quarter costs of \$10.7 million associated with workforce reductions (\$3.9 million included in cost of services and \$6.8 million included in selling, general and administrative) and \$4 million of in-process research and development costs associated with the acquisition of HemoCue, which was recorded in "other operating (income) expense, net".

Cost of services, which includes the costs of obtaining, transporting and testing specimens, was 59.0% of net revenues for the three months ended June 30, 2008, similar to the prior year period. For the six months ended June 30, 2008, cost of services, as a percentage of net revenues, was 59.1% of net revenues, decreasing from 60.0% of net revenues in the prior year period. The improvement over the prior year reflects actions taken to reduce our cost structure and higher revenue per requisition.

Selling, general and administrative expenses, which include the costs of the sales force, billing operations, bad debt expense, and general management and administrative support, were 23.8% of net revenues for the three months ended June 30, 2008, compared to 24.1% in the prior year period. For the six months ended June 30, 2008, selling, general and administrative expenses, as a percentage of net revenues, decreased to 24.1% from 24.6% in the prior year period. These improvements were primarily due to actions taken to reduce our cost structure and higher revenue per requisition, partially offset by the impact of the acquired operations of AmeriPath. In addition, selling, general and administrative expenses for the six months ended June 30, 2007 contained first quarter costs associated with efforts to retain business and clarify for patients, physicians and employers misinformation regarding the UNH contract change.

For the three months ended June 30, 2008 and 2007, bad debt expense was 4.4% and 4.3% of net revenues, respectively. For the six months ended June 30, 2008, bad debt expense was 4.6% compared to 4.4% of net revenues in 2007. The increase for the three and six months ended June 30, 2008 was driven by the inclusion of AmeriPath, which carries a higher bad debt rate than the rest of our business, primarily due to its revenue and customer mix, and increased the consolidated bad debt rate by approximately half a percent for both periods.

Amortization of intangible assets for the three and six months ended June 30, 2008 increased \$4.6 million and \$9.4 million, respectively, over the prior year periods. These increases were primarily due to the amortization of intangible assets acquired in conjunction with the acquisition of AmeriPath.

Other operating (income) expense, net represents miscellaneous income and expense items related to operating activities, including gains and losses associated with the disposal of operating assets and provisions for restructurings and other special charges. For the six months ended June 30, 2007, other operating (income) expense, net includes a \$4.0 million first quarter charge related to in-process research and development expense

recorded in connection with the acquisition of HemoCue.

*Operating Income*

Operating income for the three months ended June 30, 2008 was \$308 million, or 16.8% of net revenues, compared to \$272 million, or 16.6% of net revenues, in the prior year period. For the six months ended June 30, 2008, operating income was \$588 million, or 16.2% of net revenues, compared to \$473 million, or 14.9% of net revenues in the prior year period. The increases in operating income were primarily due to actions we have taken to reduce our cost structure, partially offset by the impact of the acquired operations of AmeriPath. In addition, the operating income percentage for the three and six months ended June 30, 2008, reflects the impact of the various items which served to reduce cost of services and selling, general and administrative expenses as a percentage of net revenues.

*Other Income (Expense)*

Interest expense, net for the three and six months ended June 30, 2008 increased \$6.3 million and \$27.4 million, respectively, over the prior year periods. These increases were primarily due to additional interest expense associated with borrowings used to fund the acquisition of AmeriPath.

*Income Tax Expense*

The effective income tax rate for the three and six months ended June 30, 2008 decreased 1.0% and 0.4%, respectively, compared to the prior year periods. These decreases were primarily due to the favorable resolution of certain tax contingencies in the second quarter of 2008.

*Discontinued Operations*

Loss from discontinued operations, net of taxes, for the three months ended June 30, 2008 was \$0.9 million, or \$0.01 per diluted share, compared to \$0.6 million, with no impact to diluted earnings per share in the prior year. Loss from discontinued operations, net of taxes, for the six months ended June 30, 2008 was \$2.0 million, or \$0.01 per diluted share, compared to \$2.2 million, or \$0.01 per diluted share in the prior year. Results for the three and six months ended June 30, 2008 and 2007 reflect expenses associated with the on-going government investigation of NID, which is more fully described in Notes 6 and 8 to the interim consolidated financial statements.

**Quantitative and Qualitative Disclosures About Market Risk**

We address our exposure to market risks, principally the market risk of changes in interest rates, through a controlled program of risk management that may include the use of derivative financial instruments. We do not hold or issue derivative financial instruments for trading purposes. We do not believe that our foreign exchange exposure is material to our financial condition or results of operations. See Note 11 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K for additional discussion of our financial instruments and hedging activities.

At June 30, 2008 and December 31, 2007, the fair value of our debt was estimated at approximately \$3.2 billion and \$3.6 billion, respectively, using quoted market prices and yields for the same or similar types of borrowings, taking into account the underlying terms of the debt instruments. At June 30, 2008, the carrying value exceeded the estimated fair value of the debt by approximately \$13.6 million and at December 31, 2007, the estimated fair value exceeded the carrying value of the debt by \$59.1 million. A hypothetical 10% increase in interest rates on our total debt portfolio (representing approximately 55 and 61 basis points at June 30, 2008 and December 31, 2007, respectively) would potentially reduce the estimated fair value of our debt by approximately \$75 million and \$78 million at June 30, 2008 and December 31, 2007, respectively.

Borrowings under our senior unsecured revolving credit facility, our secured receivables credit facility, our term loan due December 2008, and our term loan due May 2012, are subject to variable interest rates. Interest on our secured receivables credit facility is based on rates that are intended to approximate commercial paper rates for highly-rated issuers. Interest rates on our senior unsecured revolving credit facility, term loan due December 2008 and term loan due May 2012 are subject to a pricing schedule that can fluctuate based on changes in our credit ratings. As such, our borrowing cost under these credit arrangements will be subject to

both fluctuations in interest rates and changes in our credit ratings. As of June 30, 2008, the borrowing rates under these credit facilities were: for our senior unsecured credit facility, LIBOR plus 0.40%; for our term loan due December 2008,

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LIBOR plus 0.55%; and for our term loan due May 2012, LIBOR plus 0.50% . At June 30, 2008, the LIBOR rate was 2.46% . At June 30, 2008, there was \$1.2 billion outstanding under our term loan due May 2012, \$45 million outstanding under our term loan due December 2008; and no borrowings outstanding under our secured receivables credit facility and our \$750 million senior unsecured revolving credit facility.

During the third quarter ended September 30, 2007, we entered into various variable-to-fixed interest rate swap agreements, whereby we fixed the interest rates on \$500 million of our term loan due May 2012 for periods ranging from October 2007 through October 2009. The fixed interest rates range from 5.095% to 5.267% . Based on our net exposure to interest rate changes, a hypothetical 10% change in interest rates on our variable rate indebtedness (representing approximately 29 basis points) would impact annual net interest expense by approximately \$2.3 million, assuming no changes to the debt outstanding at June 30, 2008.

The fair value of the interest rate swap agreements at June 30, 2008 was a liability of \$7.3 million. A hypothetical 10% decrease in interest rates on our term loan (representing approximately 34 basis points) would potentially increase the fair value of the liability of these instruments by approximately \$1.4 million. A hypothetical 10% increase in interest rates would potentially decrease the fair value of the liability of these instruments by approximately \$1.4 million. For details regarding our outstanding debt and our financial instruments, see Notes 10 and 11 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2007 and Note 7 to the interim consolidated financial statements.

### *Risk Associated with Investment Portfolio*

Our investment portfolio includes equity investments in publicly held companies that are classified as available-for-sale securities and other strategic equity holdings in privately held companies. These securities are exposed to price fluctuations and are generally concentrated in the life sciences industry. The carrying values of our available-for-sale equity securities and privately held securities were \$16 million at June 30, 2008.

We do not hedge our equity price risk. The impact of an adverse movement in equity prices on our holdings in privately held companies cannot be easily quantified, as our ability to realize returns on investments depends on, among other things, the enterprises' ability to raise additional capital or derive cash inflows from continuing operations or through liquidity events such as initial public offerings, mergers or private sales.

### *Fair Value Measurements*

On January 1, 2008, we adopted Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"). Adoption of this accounting standard did not have a material effect on our financial position, results of operations or cash flows. See Note 1 to the interim consolidated financial statements for further details.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159") became effective for the Company on January 1, 2008. As of January 1, 2008 and for the period ended June 30, 2008, the Company has elected not to apply the fair value option to any of its financial assets or financial liabilities on-hand because the Company does not believe that application of SFAS 159's fair value option is appropriate given the nature of its business operations. See Note 1 to the interim consolidated financial statements for further details.

## **Liquidity and Capital Resources**

### *Cash and Cash Equivalents*

Cash and cash equivalents at June 30, 2008 totaled \$143 million compared to \$168 million at December 31, 2007. Cash flows from operating activities in 2008 were \$371 million, which were used to fund investing and financing activities of \$69 million and \$326 million, respectively. Cash and cash equivalents at June 30, 2007 totaled \$122 million, compared to \$150 million at December 31, 2006. Cash flows from operating activities in 2007 were \$280 million, which together with cash flows from financing activities of \$1.3 billion and cash on-hand, were used to fund investing activities of \$1.6 billion.



*Cash Flows from Operating Activities*

Net cash provided by operating activities for the six months ended June 30, 2008 was \$371 million compared to \$280 million in the prior year period. This increase was principally due to higher earnings in the current year. Net cash provided by operating activities for the six months ended June 30, 2007 was reduced by \$57 million of fees and other expenses paid in connection with the acquisition of AmeriPath. Days sales outstanding, a measure of billing and collection efficiency, were 46 days at June 30, 2008 compared to 48 days at December 31, 2007.

*Cash Flows from Investing Activities*

Net cash used in investing activities for the six months ended June 30, 2008 was \$69 million, consisting principally of capital expenditures of \$95 million, partially offset by \$23 million related to the receipt of a payment from an escrow fund established at the time of the acquisition of HemoCue, and a decrease in investments of \$6 million.

Net cash used in investing activities for the six months ended June 30, 2007 was \$1.6 billion, consisting principally of \$1.2 billion related to the acquisition of AmeriPath, \$307 million related to the acquisition of HemoCue and capital expenditures of \$89 million.

*Cash Flows from Financing Activities*

Net cash used in financing activities for the six months ended June 30, 2008 was \$326 million, consisting primarily of net reductions of debt of \$284 million, which included the repayment of \$120 million on our Secured Receivables Credit Facility, \$15 million on our Term Loan due December 31, 2008 and \$168 million on our term loan due May 31, 2012, offset partially by borrowings of \$20 million on our Secured Receivables Credit Facility. In addition, cash flows from financing activities include dividend payments of \$39 million.

Since the completion of the AmeriPath acquisition in May 2007, we have reduced our total debt by \$700 million.

Net cash provided by financing activities for the six months ended June 30, 2007 was \$1.3 billion, primarily associated with new borrowings and repayments related to the acquisitions of AmeriPath and HemoCue.

*Dividend Program*

During each of the quarters of 2008 and 2007, our Board of Directors declared a quarterly cash dividend of \$0.10 per common share. On May 21, 2008, our Board of Directors declared a quarterly cash dividend per common share of \$0.10, paid on July 18, 2008. We expect to fund future dividend payments with cash flows from operations, and do not expect the dividend to have a material impact on our ability to finance future growth.

*Share Repurchase Plan*

We did not purchase any shares of our common stock during the six months ended June 30, 2008. Through June 30, 2008, we have repurchased approximately 44.1 million shares of our common stock at an average price of \$45.35 for \$2 billion under our share repurchase program. At June 30, 2008, the total available for repurchases under the remaining authorizations was \$104 million.





*Contractual Obligations and Commitments*

The following table summarizes certain of our contractual obligations as of June 30, 2008:

<u>Contractual Obligations</u>	<u>Total</u>	<b>Payments due by period</b> <b>(in thousands)</b>			<u>After 5</u> <u>years</u>
		<u>Remainder</u> <u>of 2008</u>	<u>1-3 years</u>	<u>3-5 years</u>	
Long-term debt	\$ 3,238,458	\$ 48,755	\$ 418,439	\$ 1,474,669	\$ 1,296,595
Capital lease obligations	21,204	543	2,362	2,592	15,707
Interest payments on outstanding debt	1,586,030	91,737	346,988	227,546	919,759
Operating leases	694,529	95,479	291,127	160,671	147,252
Purchase obligations	91,337	37,498	41,646	11,646	547
Total contractual obligations	\$ 5,631,558	\$ 274,012	\$ 1,100,562	\$ 1,877,124	\$ 2,379,860

Interest payments on our long-term debt have been calculated after giving effect to our interest rate swap agreements, using the interest rates as of June 30, 2008 applied to the June 30, 2008 balances, which are assumed to remain outstanding through their maturity dates.

A full description of the terms of our indebtedness and related debt service requirements and our future payments under certain of our contractual obligations is contained in Note 10 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K. A full discussion and analysis regarding our minimum rental commitments under noncancelable operating leases and noncancelable commitments to purchase products or services at December 31, 2007 is contained in Note 15 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K. Also refer to Note 7 to the interim consolidated financial statements for an update of our indebtedness.

As of June 30, 2008, our total liabilities for unrecognized tax benefits were approximately \$96 million, which were excluded from the table above. Based upon the expiration of statutes of limitations, settlements and/or the conclusion of tax examinations, we believe it is reasonably possible that this amount may decrease by up to \$42 million within the next twelve months. For the remainder, we cannot make reasonably reliable estimates of the timing of the future payments of these liabilities. See Note 5 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K for information regarding our contingent tax liability reserves.

Our credit agreements relating to our senior unsecured revolving credit facility, our term loan due December 2008 and our term loan due May 2012 contain various covenants and conditions, including the maintenance of certain financial ratios, that could impact our ability to, among other things, incur additional indebtedness. We do not expect these covenants to adversely impact our ability to execute our growth strategy or conduct normal business operations.

*Unconsolidated Joint Ventures*

We have investments in unconsolidated joint ventures in Phoenix, Arizona; Indianapolis, Indiana; and Dayton, Ohio, which are accounted for under the equity method of accounting. We believe that our transactions with our joint ventures are conducted at arm's length, reflecting current market conditions and pricing. Total net revenues of our unconsolidated joint ventures equal less than 6% of our consolidated net revenues. Total assets associated with our unconsolidated joint ventures are less than 2% of our consolidated total assets. We have no material unconditional obligations or guarantees to, or in support of, our unconsolidated joint ventures and their operations.

*Requirements and Capital Resources*

We estimate that we will invest between \$240 million and \$260 million during 2008 for capital expenditures to support and expand our existing operations, principally related to investments in information technology, equipment, and facility upgrades. During the first six months of 2008, we continued to make investments in support of our plans to develop and deploy standard systems across both the AmeriPath practices

and our clinical laboratories. We have completed the enhancements to the AmeriPath laboratory and billing systems and have begun deployment of the enhanced systems during the second quarter of 2008. These investments will enable significant productivity gains and improved customer service.

In June 2008, we amended our existing receivables securitization facility (the "Secured Receivables Credit Facility") and increased it from \$375 million to \$400 million. The Secured Receivables Credit Facility is supported by back-up facilities provided on a committed basis by two banks: (a) \$125 million, which matures on December 13, 2008 and (b) \$275 million, which matures on June 10, 2009. Interest on the Secured Receivables Credit Facility is based on rates that are intended to approximate commercial paper rates for highly rated issuers. As of June 30, 2008, we had no borrowings outstanding under this facility.

As of June 30, 2008, \$1.2 billion of borrowing capacity was available under our existing credit facilities, including \$400 million available under our Secured Receivables Credit Facility.

We believe that cash from operations and our borrowing capacity under our credit facilities will provide sufficient financial flexibility to meet seasonal working capital requirements and to fund capital expenditures, debt service requirements, cash dividends on common shares, share repurchases and additional growth opportunities for the foreseeable future. We believe that our credit profile should provide us with access to additional financing, if necessary, to fund growth opportunities that cannot be funded from existing sources.

#### *Impact of New Accounting Standards*

In June 2008, the Financial Accounting Standards Board ("FASB") issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities". In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" and in March 2008, the FASB issued SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133". The impact of these accounting standards is discussed in Note 1 to the interim consolidated financial statements.

#### **Forward-Looking Statements**

Some statements and disclosures in this document are forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as "may", "believe", "will", "expect", "project", "estimate", "anticipate", "plan" or "continue". These forward-looking statements are based on our current plans and expectations and are subject to a number of risks and uncertainties that could significantly cause our plans and expectations, including actual results, to differ materially from the forward-looking statements. Risks and uncertainties that may affect our future results include, but are not limited to, adverse results from pending or future government investigations, lawsuits or private actions, the competitive environment, changes in government regulations, changing relationships with customers, payers, suppliers and strategic partners and other factors discussed in "Business" in Part I, Item 1, "Risk Factors" and "Cautionary Factors That May Affect Future Results" in Item I, Part 1A, "Legal Proceedings" in Part I, Item 3, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 and "Quantitative and Qualitative Disclosures About Market Risk" in Part II, Item 7A in our 2007 Annual Report on Form 10-K and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Quantitative and Qualitative Disclosures About Market Risk" in our 2008 Quarterly Reports on Form 10-Q and other items throughout the 2007 Form 10-K and our 2008 Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

#### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

#### **Item 4. Controls and Procedures**

- (a) Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934,



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as amended). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

- (b) During the second quarter of 2008, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

See Note 8 to the interim consolidated financial statements for information regarding the status of legal proceedings involving the Company.

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

We did not purchase any shares of our common stock during the quarter and six months ended June 30, 2008.

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

- (a) The Annual Meeting of Shareholders of the Company was held on May 16, 2008. At the meeting, the matters described below were approved by the shareholders.
- (b) The following nominees for the office of director were elected for terms expiring at the 2011 Annual Meeting of Shareholders, by the following votes:

	For	Withheld
William F. Buehler	169,241,790	3,266,520
Rosanne Haggerty	169,308,393	3,199,917
Daniel C. Stanzione, Ph.D.	167,872,738	4,635,572

The following persons continue as directors:

John C. Baldwin, Ph.D.  
 Jenne K. Britell, Ph. D.  
 Surya N. Mohapatra, Ph.D.  
 Gary M. Pfeiffer  
 Gail R. Wilensky, Ph.D.  
 John B. Ziegler

- (c) The ratification of the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm to audit the financial statements of the Company and its subsidiaries for the fiscal year ending December 31, 2008, was approved by the following number of shareholder votes for, against, and abstained:

For: 169,235,593                      Against: 1,943,037                      Abstained: 1,329,533

**Item 6. Exhibits**

Exhibits:

- 10.1 Amendment No. 6 dated as of May 23, 2008 to Third Amended and Restated Credit and Security Agreement dated as of April 20, 2004, among Quest Diagnostics Receivables Inc., as Borrower, the Company, as Servicer, each of the lenders party thereto and Wachovia Bank, National Association, as Administrative Agent.
- 10.2 Amendment No. 7 dated as of June 11, 2008 to Third Amended and Restated Credit and Security Agreement dated as of April 20, 2004, among Quest Diagnostics Receivables Inc., as Borrower, the Company, as Servicer, each of the lenders party thereto and Wachovia Bank, National Association, as Administrative Agent.
- 10.3 Fourth Amended and Restated Credit and Security Agreement dated as of June 11, 2008, among Quest Diagnostics Receivables Inc., as Borrower, the Company, as Servicer, each of the lenders party thereto and The Bank of Tokyo-Mitsubishi, UFJ, Ltd., New York Branch, individually, as



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Gotham Agent and as Administrative Agent.

- 10.4 Form of Equity Award Agreement, dated as of March 4, 2008.
- 10.5 Form of Equity Award Agreement, dated as of March 4, 2008, between the Company and Surya N. Mohapatra.
- 10.6 Amendment No. 2 to Letter Agreement between SmithKline Beecham Corporation and the Company.
- 10.7 Amendment No. 3 to Letter Agreement between SmithKline Beecham Corporation and the Company.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to 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.

July 24, 2008

Quest Diagnostics Incorporated

By /s/ Surya N. Mohapatra  
Surya N. Mohapatra, Ph.D.  
Chairman, President and  
Chief Executive Officer

By /s/ Robert A. Hagemann  
Robert A. Hagemann  
Senior Vice President and  
Chief Financial Officer