

OFFICE OF THE COMPTROLLER OF THE CURRENCY
Washington, D.C. 20219

FORM 10-Q

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

For the quarterly period ended March 31, 2009

OR

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

For the Transition Period from _____ to _____

Community National Bank of the Lakeway Area

(Exact name of small business issuer as specified in its charter)

United States

6021

27-0031825

(State or jurisdiction of
incorporation or organization)

(Primary Standard Industrial
Classification Code Number)

(I.R.S. Employer
Identification No.)

225 West First North Street, Morristown, Tennessee 37814

(Address of principal executive offices)

(423) 587-2345

(Issuer's telephone number)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 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 or a smaller reporting company. See definitions of "accelerated filer," "large accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date 1,891,426 shares of common stock, \$1.00 par value per share, issued and outstanding as of May 13, 2009.

**Community National Bank of the Lakeway Area
Report on Form 10-Q**

March 31, 2009

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FORWARD LOOKING STATEMENTS

This Report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those projected in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words "may," "would," "could," "will," "expect," "anticipate," "believe," "intend," "plan," and "estimate," as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties include, but are not limited to:

- significant increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment that could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment;
- general economic conditions, either nationally or regionally and especially in our primary service area, becoming less favorable than expected resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in technology;
- changes in monetary and tax policies;
- the level of allowance for loan loss;
- the rate of delinquencies and amounts of charge-offs;
- the rates of loan growth;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- changes in the securities markets; and
- other risks and uncertainties detailed from time to time in our filings with the Office of the Comptroller of the Currency.

PART 1

ITEM 1. FINANCIAL STATEMENTS

The financial statements of Community National Bank of the Lakeway Area are set forth in the following pages.

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Community National Bank of the Lakeway Area
Balance Sheets

	March 31, 2009 (Unaudited)	December 31, 2008
(Dollars in thousands)		
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$ 3,074	\$ 2,476
Federal funds sold	0	604
Total cash and cash equivalents	3,074	3,080
Securities:		
Available for sale, at fair value	24,523	22,686
Held to maturity, at amortized cost	0	3,686
Total securities	24,523	26,372
Equity investments, at cost	917	2,027
Loans, Net of estimated allowance for loan losses of \$1,570 at March 31, 2009 and \$2,522 at December 31, 2008	80,373	81,328
Premises and equipment, net	3,247	3,303
Interest receivable	461	560
Foreclosed assets	1,248	322
Deferred tax benefit	1,029	976
Other assets	152	98
Total assets	\$ 115,024	\$ 118,066
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing	\$ 8,174	\$ 9,479
Interest-bearing	82,053	82,905
Total Deposits	90,227	92,384
Securities sold under agreements to repurchase	3,495	3,265
Advances from Federal Home Loan Bank	7,000	7,000
Interest payable	555	410
Other liabilities	71	94
Total liabilities	101,348	103,153
Stockholders' Equity		
Common stock, par value \$1, authorized 4,000,000 shares; issued and outstanding 1,891,426 shares at March 31, 2009 and December 31, 2008	1,891	1,891
Capital in excess of par value	17,042	17,042
Retained deficit	(5,356)	(4,119)
Accumulated other comprehensive income	99	99
Total stockholders' equity	13,676	14,913
Total liabilities and stockholders' equity	\$ 115,024	\$ 118,066

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

Community National Bank of the Lakeway Area
Income Statements
For the Three Months Ended March 31, 2009 and 2008

	Three Months Ended March 31,	
	2009	2008
	(Unaudited)	(Unaudited)
	(Dollars in thousands except for per share data)	
Interest income:		
Loans, including fees	\$ 1,314	\$ 1,329
Securities	292	242
Federal funds sold and other	13	44
Total interest income	1,619	1,615
Interest Expense:		
Deposits	602	635
Advances	70	121
Other	2	29
Total interest expense	674	785
Net interest income	945	830
Provision for estimated loan losses	88	180
Net interest income after provision for for estimated loan losses	857	650
Noninterest income:		
Service charges on deposit accounts	73	71
Commissions on loans originated for others	1	7
Net gain on sales of securities available for sale	0	7
Other	27	26
Total noninterest income	101	111
Noninterest expense:		
Salaries and employee benefits	450	456
Occupancy costs	198	198
Advertising and promotion	34	53
Office supplies and postage	24	35
Data processing	60	66
Legal and other professional	74	59
Net loss on sales of securities available for sale and impaired equity investments	1,297	0
Other	111	134
Total noninterest expense	2,248	1,001
Net loss before income taxes	(1,290)	(240)
Income tax benefit	53	9
Net loss	\$ (1,237)	\$ (231)
Loss per common share:		
Basic	\$ (0.65)	\$ (0.12)
Diluted	\$ (0.65)	\$ (0.12)

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

Community National Bank of the Lakeway Area
Statements of Comprehensive Income (Loss)
For the Three Months Ended March 31, 2009 and 2008

	Three Months Ended March 31,	
	2009	2008
	(Unaudited – in thousands)	
Net loss	\$ (1,237)	\$ (231)
Other comprehensive income, net of tax:		
Net unrealized gains (losses) on securities available for sale arising during the period	(34)	182
Reclassification adjustment for (gains) losses included in net loss	34	(7)
Deferred income tax expense (benefit) related to net unrealized gains (losses) on securities available for sale, net of valuation allowance	0	57
Other comprehensive income, net of tax effects	0	232
Comprehensive income (loss)	\$ (1,237)	\$ 1

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

Community National Bank of the Lakeway Area
Statement of Changes in Stockholders' Equity
For the Three Months Ended March 31, 2009
(Unaudited)

	Common Stock	Capital in Excess of Par Value	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total
(Dollars in Thousands)					
Balances, December 31, 2008	\$ 1,891	\$ 17,042	\$ (4,119)	\$ 99	\$ 14,913
Net loss	0	0	(1,237)	0	(1,237)
Other comprehensive loss	0	0	0	0	0
Balances, March 31, 2009	<u>\$ 1,891</u>	<u>\$ 17,042</u>	<u>\$ (5,356)</u>	<u>\$ 99</u>	<u>\$ 13,676</u>

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA
STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2009 and 2008 (Unaudited)

	For the three months ended March 31, 2009	2008
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (1,237)	\$ (231)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for estimated loan losses	88	180
Provision for foreclosed assets valuation	0	12
Depreciation	69	71
Federal Home Loan Bank stock dividends	0	(5)
Net amortization/accretion of premiums and discounts on securities	19	7
Net amortization of premiums on purchased loans	3	2
Net (gain) loss on sales of securities available for sale	169	(7)
Loss on impairment of equity investments	1,128	0
Decrease in interest receivable	99	60
Increase in deferred tax benefit	(53)	(9)
Increase in other assets	(54)	(43)
Increase in interest payable	145	179
Decrease in other liabilities	(23)	(25)
Total adjustments	1,590	422
Net cash provided by operating activities	353	191
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Sales and calls	9,706	2,498
Purchases	(12,314)	(10,037)
Principal repayments received	583	549
Securities held to maturity:		
Sales and calls	3,644	0
Principal repayments received	42	199
Purchases of equity investments	(18)	(5)
Net (increase) decrease in loans	(61)	2,835
Purchases of premises and equipment	(13)	(120)
Net cash provided by (used in) financing activities	1,569	(4,081)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in non interest-bearing deposits	(1,306)	593
Net increase (decrease) in interest-bearing deposits (excluding time deposits)	4,712	(647)
Net increase (decrease) in time deposits	(5,564)	4,625
Net increase in repurchase agreements	230	427
Net cash provided by (used in) financing activities	(1,928)	4,998
NET CHANGE IN CASH AND CASH EQUIVALENTS	(6)	1,108
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	3,080	5,320
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 3,074	\$ 6,428

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENT OF CASH FLOWS (Cont.)

(Unaudited)

Supplementary disclosures of cash flow information:

Cash paid during the period for:

Interest	\$	530	\$	606
Income taxes	\$	0	\$	0

Supplementary disclosures for noncash investing activities:

Change in unrealized gains /(losses) on securities available for sale, net	\$	0	\$	175
Change in deferred income taxes associated with unrealized (gains)/ losses on investment securities available for sale	\$	0	\$	57
Change in net unrealized gains/(losses) on securities available for sale, net of tax effects	\$	0	\$	232
Loans moved to foreclosed assets	\$	926	\$	0

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

Community National Bank of the Lakeway Area

Notes to Financial Statements (Unaudited)

NOTE 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations - Community National Bank of the Lakeway Area (the Bank) commenced banking operations on April 9, 2003. The Bank provides a variety of banking services to individuals and businesses primarily in the counties of Hamblen and Jefferson through its main office and branch in Morristown, Tennessee and branch office in Jefferson City, Tennessee. Its primary deposit products are demand deposits and certificates of deposit, and its primary lending products are commercial business, real estate mortgage, and consumer installment loans.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain 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 revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and the valuation of deferred tax assets, and the related allowance.

Comprehensive Income - Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes net unrealized gains and losses on securities available for sale, net of any related tax effects, which is also recognized as a separate component of stockholders' equity.

Cash and Cash Equivalents - For purposes of the statements of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which mature within 90 days.

Cash and Due From Banks - Cash and due from banks includes balances on deposit with one correspondent commercial bank located in the Southeastern United States. The Bank also maintains cash deposits with the Federal Home Loan Bank ("FHLB") of Cincinnati and the Federal Reserve Bank of Nashville. The balances in the accounts at the correspondent commercial bank were not in excess of FDIC insurance limits as of March 31, 2009 and December 31, 2008.

Federal Funds Sold - Federal funds sold consists of an unsecured loan to a correspondent commercial bank located in the Southeastern United States. This loan, plus interest, was repaid on the next business day.

Securities - In accordance with Financial Accounting Standards Board (FASB) Statement No. 115, *"Accounting for Certain Investments in Debt and Equity Securities,"* the Bank has segregated its securities into the following categories:

(a) **Held to Maturity** - Debt securities are classified as held to maturity when management has the positive intent and ability to hold the securities to maturity. Securities held to maturity are carried at amortized cost. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the terms of the securities.

(b) **Available for Sale** - Debt securities not classified as held to maturity are classified as available for sale. Securities available for sale are carried at fair value with unrealized gains and losses reported in other comprehensive income. Realized gains (losses) on securities available for sale are included in net gain/loss on sales of securities available for sale and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Gains and losses on sales of securities are determined on the specific identification method. The amortization of premiums and the accretion of discounts are recognized in interest income using the interest method over the terms of the securities.

Equity Investments - The Bank maintains certain investments with regulatory and other entities with which it has an ongoing business relationship. At March 31, 2009 and December 31, 2008, approximately \$25,000 represents the cash reserve balance required to be on hand by the Federal Reserve Bank of Atlanta. The Bank's equity investments in the FHLB of Cincinnati and the Federal Reserve Bank of Atlanta are carried at cost which approximates fair value based on the stock redemption provisions of each of the entities. The investment in FHLB stock is in part based on the Bank's amount of advances from the FHLB.

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans - The Bank provides real estate, mortgage, commercial, and consumer loans to individuals and businesses primarily in the Hamblen and Jefferson County, Tennessee areas. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the estimated allowance for loan losses, and any deferred fees (if material) or costs on originated loans. Interest income is accrued on the unpaid principal balance.

Recognition of Interest on Loans - Interest on loans is calculated using the simple interest method on the principal outstanding. Accrual of interest is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection.

Securities Sold Under Agreements to Repurchase - Repurchase agreements are treated as financing transactions and are carried at the amounts at which the securities will be subsequently reacquired, as specified in the respective agreements.

Estimated Allowance for Loan Losses - The estimated allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the estimated allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Estimated allowances for impaired loans are generally determined based on collateral values or the present value of estimated future cash flows. Because of uncertainties associated with local, regional, and national economic conditions, collateral values, and future cash flows on impaired loans, it is reasonably possible that management's estimate of credit losses inherent in the loan portfolio, and the related estimated allowance, may change materially in the near term. The estimated allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Changes in the estimated allowance relating to impaired loans are charged or credited to the provision for loan losses.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local, regional, and national economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated allowance for loan losses. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The estimated allowance for loan losses consists of specific and general components. The specific component relates to loans that are classified as doubtful, substandard, or special mention (as defined by the Bank consistent with the definitions given by regulatory agencies). For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and classified loans that are determined not to be impaired by management. The general component is based on historical loss experience adjusted for qualitative factors.

Loan Fees, Discounts, and Premiums - Loan fees on long-term real estate loans, net of initial direct costs related to initiating and closing the loans, will be deferred, if material, and amortized into interest income over the remaining lives of the loans as an adjustment of yield using the interest method. Any discounts and premiums originated in conjunction with the purchase of loans are accreted or amortized into income, principally by the level yield method, over the remaining lives of the loans purchased.

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premises and Equipment - Land is stated at cost. Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the following estimated useful lives:

	Years
Buildings and Improvements	30-40
Furniture, Fixtures, and Equipment	2-15

Advertising and Promotion - Advertising and promotion costs are expensed as incurred.

Foreclosed Assets - Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense. There was a valuation allowance at March 31, 2009 and December 31, 2008 of \$47,800.

Income Taxes - Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the book and tax basis of the estimated allowance for loan losses, accumulated depreciation, net operating loss carryforwards, organizational start-up costs and the conversion from the accrual basis of accounting for financial reporting purposes to the cash basis of accounting for tax reporting. The deferred tax assets and liabilities, which are recorded net of an estimated valuation allowance, represent the future tax return consequences of those differences which will either be taxable or deductible when the assets and liabilities are recovered or settled. The Bank has estimated a 50% valuation allowance at March 31, 2009 to offset the net deferred tax asset resulting from the above timing differences. See Note 10 for additional information.

Stock Options - The Bank has issued stock options to certain organizers, founders, and employees, which are described more fully in Note 7. On January 1, 2006, the Bank adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payments* ("SFAS No. 123R"). This statement supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25), which the Bank had followed until the adoption of SFAS No. 123R. The revised statement addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the ability to account for share-based compensation transactions using APB 25 and requires that the compensation costs relating to such transactions be recognized in the income statement.

Income (Loss) Per Share - Basic income (loss) per share represents earnings attributable to stockholders divided by the weighted-average number of shares outstanding during the period. Diluted earnings (losses) per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to net income (loss) that would result from the assumed issuance. Potential common shares that may be issued by the Bank relate solely to outstanding stock options and are determined using the treasury stock method.

	Three Months Ended March 31,	
	2009	2008
Per Share Information:		
Basic, as Reported	\$ (0.65)	\$ (0.12)
Diluted, as Reported	\$ (0.65)	\$ (0.12)

Income per share is based on the following for the quarters ended March 31:

	2009	2008
Weighted Average Number or Shares Outstanding Used for Basic Calculation	1,891,426	1,891,426
Weighted Average Number or Shares Outstanding Used for Diluted Calculation	1,891,426	1,891,426

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Newly Adopted Accounting Pronouncements - Fair Value Measurement - In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157 ("SFAS 157"), "Fair Value Measurements" — SFAS 157, which defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 applies only to fair-value measurements that are already required or permitted by other accounting standards and is expected to increase the consistency of those measurements. The definition of fair value focuses on the exit price (i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date), not the entry price (i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date). The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. The effective date for SFAS No. 157 is for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Bank partially adopted SFAS 157 effective January 1, 2008. The partial adoption of SFAS 157 had no impact on the financial statements of the Bank. SFAS 157 has not been applied to nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in an entity's financial statements on a recurring basis (at least annually), pursuant to FASB Staff Position (FSP) FAS 157-2. This standard is applicable for nonfinancial assets and liabilities for fiscal periods beginning after November 30, 2008.

In October 2008, the FASB issued FSP No. FAS 157-3 *Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active*. This FSP clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP was effective for the Bank upon issuance, including prior periods for which financial statements have not been issued; and, therefore was effective for the Bank's financial statements as of and for the year ended December 31, 2008. Adoption of FSP No. 157-3 had no impact on the Bank's financial statements.

The Bank has an established process for determining fair values. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models or processes that use primarily market-based or independently-sourced market data, including interest rate yield curves, option volatilities and third party information. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. Furthermore, while the Bank believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Valuation Hierarchy

SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows.

- Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 — inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Assets:

Securities — Where quoted prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and certain other products. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy.

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impaired loans (included with Loans, net of estimated allowance for loan losses) — A loan is considered to be impaired when it is probable the Bank will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Individually identified impaired loans are measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses. Impaired loans are classified within level 3 of the hierarchy.

Foreclosed assets —The carrying amount of foreclosed assets is based on information obtained from third party appraisers and internal evaluations. The Bank reflects these assets within level 3 of the valuation hierarchy.

Liabilities:

At March 31, 2009, the Bank had no liabilities meeting the criteria for disclosure, under guidance established in SFAS No. 157.

The following table presents the financial instruments carried at fair value as of March 31, 2009, by caption on the balance sheets and by SFAS 157 valuation hierarchy (as described above) (dollars in thousands):

Assets measured at fair value on a recurring basis as of March 31, 2009

	Total carrying value in the balance sheet	Quoted market prices In an active market (Level 1)	Internal models with significant observable market parameters (Level 2)	Internal models with significant unobservable Market parameters (Level 3)
Available for sale securities	\$ 24,523	\$ 24,523	\$ 0	\$ 0
Total assets at fair value	\$ 24,523	\$ 24,523	\$ 0	\$ 0

Assets measured at fair value on a nonrecurring basis as of March 31, 2009

	Total carrying value in the consolidated balance sheet	Quoted market prices in an active market (Level 1)	Internal models with significant observable market parameters (Level 2)	Internal models with significant unobservable market parameters (Level 3)
Impaired loans	\$ 3,910	\$ 0	\$ 0	\$ 3,910
Foreclosed assets	1,248	0	0	1,248
Total assets at fair value	\$ 5,158	\$ 0	\$ 0	\$ 5,158

NOTE 2. INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per share represents income (loss) attributable to shareholders divided by the weighted average number of common shares outstanding during the period. Potential shares that may be issued by the Bank relate solely to outstanding stock options, and are determined using the treasury stock method.

Income (Loss) per share has been computed based on the following (unaudited):

NOTE 2. INCOME (LOSS) PER COMMON SHARE (Continued)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Average number of shares outstanding	1,891,426	1,891,426
Effect of dilutive options (see below)	0	0
Average number of shares outstanding used to calculate income (loss) per share	<u>1,891,426</u>	<u>1,891,426</u>

In accordance with FASB Statement No. 128 *Earnings Per Share*, no potential additional shares should be included in the computation of any diluted per share amount when a loss is reported, therefore basic and diluted loss per share amounts are the same for periods reporting a net loss. Additionally, for the three months ended March 31, 2009 outstanding stock options totaling 123,250 with an exercise price of \$13.50 were not included in the computation of diluted earnings per share because such shares would have had an antidilutive effect on earnings per share.

NOTE 3. SECURITIES

The amortized cost and estimated fair value of securities classified as available for sale are as follows:

Amortized Cost	Securities Available for Sale		Estimated Fair Value
	Gross Unrealized Gains	Gross Unrealized Losses	
(Dollars in thousands)			

As of March 31, 2009 (Unaudited):

Debt Securities:

Obligations of U.S. Government Agencies	\$ 7,041	\$ 17	\$ (17)	\$ 7,041
Mortgage-Backed and Related Securities	17,359	142	(19)	17,482
Total Securities Available for Sale	<u>\$ 24,400</u>	<u>\$ 159</u>	<u>\$ (36)</u>	<u>\$ 24,523</u>

As of December 31, 2008:

Debt Securities:

Obligations of U.S. Government Agencies	\$ 9,498	\$ 111	\$ 0	\$ 9,609
Other Corporate Securities	175	0	(60)	115
Mortgage-Backed and Related Securities	12,890	95	(23)	12,962
Total Securities Available for Sale	<u>\$ 22,563</u>	<u>\$ 206</u>	<u>\$ (83)</u>	<u>\$ 22,686</u>

NOTE 3. SECURITIES (Continued)

The amortized cost and estimated fair value of securities classified as held to maturity are as follows:

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
As of December 31, 2008:				
Debt Securities:				
Mortgage-Backed and Related Securities	\$ 3,686	\$ 93	\$ 0	\$ 3,779
Total Securities Held to Maturity	\$ 3,686	\$ 93	\$ 0	\$ 3,779

The amortized cost and estimated fair value of debt securities as of March 31, 2009 (unaudited), by contractual maturity, are as follows:

	Available for Sale	
	Amortized Cost	Estimated Fair Value
(Dollars in thousands)		
Due in One Year or Less	\$ 0	\$ 0
Due After One Year Through Five Years	1,000	1,000
Due After Five Years Through Ten Years	4,041	4,058
Due After Ten Years	2,000	1,983
	<u>7,041</u>	<u>7,041</u>
Mortgage-Backed and Related Securities	17,359	17,482
Total Investments	\$ 24,400	\$ 24,523

The expected maturities of mortgage-backed and related securities will differ from contractual maturities because borrowers may have the right to call or repay obligations without call or prepayment penalties. Therefore, the mortgage-backed and related securities are presented separately in the above table.

Debt securities with a total estimated fair value (which approximates book value) of approximately \$17.7 million as of March 31, 2009 were pledged primarily to secure deposits of public funds, repurchase agreements, and federal funds lines of credit.

There were no securities held to maturity at March 31, 2009 as the Bank sold the held to maturity portfolio consisting of FHLMC and FNMA mortgage backed securities due to deteriorating credit quality. The held to maturity securities were replaced with lower risk GNMA securities and are all held in the Bank's available for sale portfolio.

NOTE 4. ALLOWANCE FOR LOAN LOSSES

Activity in the estimated allowance for loan losses for the three-month periods ended March 31, 2009 and 2008 is as follows:

	March 31, 2009	March 31, 2008
(Dollars in thousands)		
Balance at Beginning of Year	\$ 2,522	\$ 702
Charge-offs	(1,041)	(32)
Recoveries	1	3
Provision-Charged to Expense	88	180
Balance at End of Period	\$ 1,570	\$ 853

NOTE 4. ALLOWANCE FOR LOAN LOSSES (Continued)

The following is a summary of information pertaining to impaired and non-accrual loans:

	At March 31, 2009	At March 31, 2008
	(Dollars in thousands)	
Nonaccrual loans	\$ 3,216	\$ 1,598
Restructured loans	0	0
Total nonperforming loans	<u>3,216</u>	<u>1,598</u>
Foreclosed assets	1,248	493
Total nonperforming assets	<u>\$ 4,464</u>	<u>\$ 2,091</u>
Accruing loans past due 90 days or more	\$ 0	\$ 0
Allowance for loan losses	1,570	853
Nonperforming loans to period end loans	3.92%	2.15%
Allowance for loan losses to period end loans	1.92%	1.15%
Allowance for loan losses to nonperforming loans	48.82%	53.38%
Nonperforming assets to total assets	3.88%	1.87%

NOTE 5. LOANS

A summary of loans as of March 31, 2009 (unaudited) and December 31, 2008 is as follows:

	At March 31, 2009		At December 31, 2008	
	% of Total		% of Total	
	Amount	Loans	Amount	Loans
	(Dollars in thousands)			
Loans secured by real estate:				
Commercial	\$ 21,458	26.2%	\$ 20,440	24.4%
Construction	8,264	10.1%	11,635	13.9%
Residential and other	32,439	39.6%	31,215	37.3%
Commercial and industrial	12,330	15.1%	12,660	15.1%
Consumer and other	4,415	5.4%	4,830	5.8%
Government agency guaranteed	<u>2,908</u>	<u>3.6%</u>	<u>2,939</u>	<u>3.5%</u>
Subtotal	81,814	<u>100.0%</u>	83,719	<u>100.0%</u>
Plus: Unamortized premiums on purchased loans	129		131	
Less: Allowance for loan losses	<u>(1,570)</u>		<u>(2,522)</u>	
Loans, Net	<u>\$ 80,373</u>		<u>\$ 81,328</u>	

NOTE 6. DEPOSITS

A summary of deposits as of March 31, 2009 (unaudited) and December 31, 2008 is as follows:

	March 31, 2009	December 31, 2008
	(Dollars in thousands)	
Noninterest-Bearing Demand Accounts	\$ 8,174	\$ 9,479
Interest-Bearing Accounts		
Checking Accounts	8,354	6,134
Money Market Accounts	12,351	11,469
Savings Accounts	9,896	8,287
Time Deposits:		
Less Than \$100,000	23,030	22,831
\$100,000 or More	28,422	34,184
Total Interest-Bearing Deposits	82,053	82,905
Total Deposits	\$ 90,227	\$ 92,384

Included in the time deposits \$100,000 or more total above is \$5.0 million and \$10.8 million at March 31, 2009 and December 31, 2008, respectively, of brokered certificates of deposit pools.

NOTE 7. STOCK OPTION PLANS

Effective with the organization of the Bank, the Bank's board of directors approved an incentive stock option plan, which was ratified by the Bank's shareholders on April 4, 2003. The plan reserved 141,000 shares of the Bank's common stock for issuance pursuant to the options to be granted. As of March 31, 2009, 123,250 options have been granted and have vested under this plan. The Bank intends to issue new shares when options are exercised under this plan.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. No options were awarded during the three month periods ended March 31, 2009 and 2008.

A summary of the status of the Bank's stock option plans is presented below:

	Three Months Ended March 31, 2009		Three Months Ended March 31, 2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at Beginning of Period	123,250	\$13.50	123,250	\$13.50
Granted	0		0	
Exercised	0		0	
Surrendered	0		0	
Forfeited	0		0	
Outstanding at End of Period	123,250	\$13.50	123,250	\$13.50
Options Exercisable at Period-End	123,250		123,250	
Weighted-Average Fair Value of Options Granted During the Period	N/A		N/A	

NOTE 7. STOCK OPTION PLANS (Continued)

Information pertaining to options outstanding at March 31, 2009 is as follows:

		Options Outstanding		Options Exercisable	
<u>Exercise Price</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$13.50	123,250	1.75 years	\$13.50	123,250	\$13.50

NOTE 8. FEDERAL HOME LOAN BANK ADVANCES

The Bank has two advances from the FHLB of Cincinnati at March 31, 2009 (three in 2008). One advance is for \$5 million and matures in 2015. The second advance obtained in 2007 is for \$2 million and will mature in 2010. The weighted average interest rate on these advances is 4.07%. The FHLB has a one-time option to convert the advances to variable rates. If the FHLB exercises its option and increases the interest rates on these advances, the Bank has the option to pay the advances in full without penalty. Pursuant to a collateral agreement with the FHLB, advances are secured by the Bank's FHLB stock and qualifying first mortgage loans.

The Bank also maintains a federal funds accommodation line of credit through one of its correspondent commercial banks. The accommodation line allows unsecured borrowings up to a maximum amount of \$7,000,000, secured borrowings up to a maximum amount of \$3,100,000 for a total maximum borrowing amount of \$10,100,000. Advances must be repaid on the next business day with interest. No borrowings were outstanding on this line at March 31, 2009 or 2008. Due to the closure of the correspondent (see Note 11) the Bank will have to replace the accommodation lines with another correspondent by June 30, 2009.

NOTE 9. EMPLOYMENT AGREEMENTS

The Bank has entered into employment agreements with five of its officers for a minimum annual salary and other related benefits. The agreements also contain certain non-compete restrictions.

NOTE 10. INCOME TAXES

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the book and tax basis of the allowance for loan losses, accumulated depreciation, net operating loss carryforwards, organizational start-up-costs and the conversion from the accrual basis of accounting for financial reporting purposes to the cash basis of accounting for tax reporting. The net deferred tax assets and liabilities, which are recorded net of a valuation allowance, represent the future tax return consequences of those differences which will either be taxable or deductible when the assets and liabilities are recovered or settled. The Bank has recorded a 50% valuation allowance at March 31, 2009 to offset the net deferred tax asset resulting from the above timing differences. The 50% valuation allowance will be provided until it is more likely than not that any net deferred tax assets will be realized. A 100% valuation allowance was recorded on the capital loss carryforward related to the loss on impaired equity securities. The 100% valuation allowance was recorded because it is unlikely the Bank will have capital gains to offset the loss in the future. Realization of the potential net deferred tax asset is dependent upon whether there will be sufficient taxable income available within the carryforward period under the federal and state tax laws.

The Bank has state and federal net operating loss carryforwards totaling approximately \$6.2 million and \$4.9 million respectively at March 31, 2009. These carryforwards are available to offset tax liabilities on future income through 2028 for federal taxes and 2023 for state.

NOTE 11. SUBSEQUENT EVENTS

Included in the Bank's March 31, 2009 Income Statement in the section titled "Net loss on sales of securities available-for-sale and impaired equity securities" is a \$1.3 million impairment charge related to the Bank's equity investments in Silverton Financial Services, Inc. Silverton Bank, a leading correspondent bank with over 1,400 bank clients, was placed into receivership on May 1, 2009. In accordance with generally accepted accounting principles, the Bank recognized this loss in the first quarter of 2009. The Bank does not have any equity investments in other correspondent banks.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless language in this Item 2 indicates otherwise or the context otherwise requires, the terms "we," "our," "us," or "our bank" refers to Community National Bank of the Lakeway Area.

This item contains "forward-looking statements" relating to, without limitation, future economic performance, plans and objectives of management for future operations, and projections of revenue and other financial items that are based upon the beliefs of our management, as well as assumptions made based upon information currently available to our management. The words "expect," "intend," "believe," and "estimate," as well as similar expressions, are intended to identify forward-looking statements. Our actual results may differ materially from the results discussed in the forward-looking statements, and our operating performance each quarter is subject to various risks and uncertainties that are discussed in detail in our filings with the Office of the Comptroller of the Currency ("OCC"), including the "Risk Factors" section in our Annual Report on Form 10-K for the year ended December 31, 2008.

While the Bank had several positives for the quarter ended March 31, 2009, the operating results were marred by a large write-off of impaired equity investments and trust preferred securities. The Bank posted a net loss of \$(1.2) million or \$(0.65) per share for the first quarter of 2009 compared to a net loss of \$(231) thousand or \$(0.12) per share for the same period in 2008. Included in the Bank's net loss for first quarter of 2009 is a \$1.3 million impairment charge related to the Bank's equity investment in Silverton Financial Services, Inc. Silverton Bank was placed into receivership on May 1, 2009. In accordance with generally accepted accounting principles, we have recognized this loss in the first quarter of 2009. The Bank does not have any equity investments in other correspondent banks. Excluding the impact of this impairment charge and the related tax benefit, the Bank would have recognized a net profit of \$9 thousand or \$0.01 per share for the first quarter of 2009. Some of the highlights of the first quarter were:

- The net interest margin increased to 3.40% for the quarter compared to 3.23% for the same quarter last year;
- Loans declined during the quarter due primarily to the charge off of purchased participation loans and increase in other real estate owned;
- Total deposits declined \$2.2 million during the quarter but core deposits increased \$3.9 million;
- Noninterest expense, excluding securities losses, declined during the first quarter; and
- Capital remains strong.

During the first quarter of 2009 the net interest margin for the Bank increased 17 basis points to 3.40% compared to 3.23% for the first quarter of 2008. The yield on earning assets declined 46 basis points from 6.28% at March 31, 2008 to 5.82% for the quarter ended March 31, 2009. The Bank's cost of funds declined 85 basis points from 3.45% at March 31, 2008 to 2.60% for the quarter ended March 31, 2009. Two factors contributing to the net interest margin increase were an increase in lower cost interest bearing checking and savings deposits which increased \$4.2 million each, and the fact that the Bank had floors on many of the loan products that are tied to indexes. In the declining rate environment during the past year, the floors protected the Bank from a further decline in yield on earning assets.

Gross loans year-to-date declined from \$83.9 million at December 31, 2008 to \$81.9 million at March 31, 2009. While demand was soft for the quarter, the decline in the portfolio was due primarily to the charge off of two purchased participation loans and the resulting increase in other real estate for the carrying value of the loans. The two participations totaled \$1.38 million with \$886 thousand being charged off and \$496 carried in other real estate owned at net realizable value. In addition, two local credits totaling \$430 thousand were charged off and added to other real estate owned during the first quarter. These properties are being actively marketed and will hopefully be sold in the near future.

Deposits for the first quarter of 2009 declined 2.3% to \$90.2 million as compared to \$92.4 million at December 31, 2008. The decline in deposits was primarily due to the maturity of \$6.0 million of brokered deposits during the first quarter, which the Bank elected not to renew given the Bank's ability to obtain lower cost funding through local core deposits. Core deposits for the first quarter increased by approximately \$3.9 million with the majority of the increase coming in the savings and NOW accounts. Savings accounts increased \$1.6 million during the quarter while NOW accounts increased \$2.2 million. The higher yielding Super Saver and Rewards Checking accounts were responsible for the increases. Local time deposits (total time deposits less brokered deposits) increased \$460 thousand during the first quarter.

Management continues to focus on reducing noninterest expense. Noninterest expense excluding securities losses for the first quarter of 2009 was \$951 thousand compared to \$1.0 million for the quarter ended March 31, 2008. There have been several expenses eliminated for 2009 including NASDAQ membership fees (the Bank is now traded over the counter), director's fees, and 401k matching contributions. Hopefully the cuts will keep pace with increases in health insurance, blanket bond insurance and FDIC deposit insurance premiums. The FDIC has scheduled a special assessment for September of 2009 of 10 to 20 basis points on the qualifying deposit base. Based on the current deposit levels of the Bank, the assessment is estimated to be \$90 thousand to \$180 thousand.

Subsequent to the end of the quarter, the OCC closed Silverton Bank of Atlanta, Georgia, which was the Bank's primary correspondent. As a result of the closure, Silverton's stock has been deemed worthless and was written off by the Bank as of March 31, 2009. The Bank held \$1.1 million of common stock and \$175 thousand of trust preferred securities.

In spite of the unexpected loss taken during the quarter related to the closing of Silverton Bank, the Bank remains well capitalized. Tier 1 capital at March 31, 2009 was 11.59% and total risk-based capital was 19.02%, both well in excess of the 5.00% and 10.00%, respectively, required by the regulatory authorities to be considered well capitalized. The strong capital position of the Bank will help weather the tough economic conditions that currently prevail.

Samuel F. Grigsby, Jr., CEO of Community National Bank of the Lakeway Area, commented, "Community National Bank and our customers continue to be affected by the economic crisis facing our community, state, nation and world. Except for the closing of Silverton Bank of Atlanta, Georgia, which resulted in a large write-off, the Bank would have been profitable the first quarter. We continue to see positive trends in net interest margin, non interest expense, and organic growth. We are cautiously optimistic that the worst of the economic crisis is behind us and better days are ahead. Given our very strong capital position, we should be able to grow the balance sheet and increase earnings substantially as the economy improves."

Comparison of Financial Condition at March 31, 2009 and December 31, 2008

Community National Bank of the Lakeway Area's total assets at March 31, 2009 were \$115.0 million, a decrease of \$3.1 million from the \$118.1 million recorded at December 31, 2008. The decline in assets was primarily in the held-to-maturity investment portfolio which was sold in its entirety as part of a restructuring of the investment portfolio. During the fourth quarter of 2008 and first quarter of 2009, the Bank sold its existing mortgage-backed investment portfolio comprised of FNMA and FHLMC securities, as a result of deteriorating credit worthiness, and replaced it with lower risk weighted GNMA securities.

Net loans for the period declined from \$81.3 million at December 31, 2008 to \$80.4 million at March 31, 2009. This represents a decline during the three-month period of approximately 1.2%. While loan demand for the first quarter has been soft, the net loan decline year-to-date was due to the charge off of \$1.0 million of loans during the period. Purchased participations that were reserved for in 2008 made up \$886 thousand of the charge off. Net loans to deposits at March 31, 2009 were 89.1% compared to 88.0% at December 31, 2008.

The estimated allowance for loan losses at March 31, 2009 was \$1.6 million or 1.92% of gross loans. This compares to \$2.5 million or 3.01% of gross loans at December 31, 2008. The substantial decline in the estimated allowance for loan losses was anticipated based on the large provision made in 2008 for four purchased participation loans. The change during the period consisted of a provision to the allowance account of \$88 thousand and net charged-off loans of \$1.0 million. Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses. Provisions are made to the allowance to maintain a level adequate to absorb anticipated loan losses.

There were \$4.5 million of nonperforming assets at March 31, 2009. This was comprised of \$3.2 million of nonaccrual loans and \$1.3 million of foreclosed assets. At December 31, 2008, the Bank had \$4.0 million in nonaccrual loans and \$322 thousand in foreclosed assets. Nonaccrual loans declined and other real estate owned increased primarily due to the repossession and of two additional purchased participation loans totaling \$886 thousand. Based on the current information analyzed by the Bank's management there should be sufficient collateral to avoid additional significant losses. Management continues to monitor the loans and will review updated appraisals as they become available. The six foreclosed properties comprising the \$1.3 million of foreclosed assets are currently being marketed and will hopefully be disposed of in the near future.

Total investments at March 31, 2009 were \$24.5 million as compared to \$26.3 million at December 31, 2008. During the quarter the Bank purchased \$12.3 million in new securities, had \$13.4 million called or sold, and received principal repayments on mortgage backed securities of \$625 thousand. After the restructuring of the portfolio, the entire portfolio is classified as available-for-sale. The \$24.5 million in the available for sale portfolio is reported at fair value and consist of approximately 28.7% U.S. Government Agencies and 71.3% Mortgage-Backed Securities. Many of the U.S. Agency securities are callable and the Bank has experienced, and will probably continue to experience, calls of the higher yielding securities during 2009. The reinvestment of these funds in comparable securities could have a negative impact on future earnings. Hopefully loan demand will improve which would potentially allow the Bank to invest in higher yielding assets.

Total equity investments which are carried at cost, declined from \$2.0 million at December 31, 2008 to \$917 thousand at March 31, 2009. On May 1, 2009, the Office of the Comptroller of the Currency (OCC) closed Silverton Bank, a leading correspondent bank in the Southeast. As a result of the closing, the common stock and trust preferred securities held by stockholders were deemed worthless. The Bank owned \$1.1 million of common stock and \$175 thousand of trust preferred securities. Since the impairment in these securities existed at March 31, 2009, the Bank took the loss of \$1.3 million in the first quarter of 2009.

Interest receivable, foreclosed assets and other assets increased during the period from \$2.0 million at December 31, 2008 to \$2.9 million at March 31, 2009. The increase was primarily attributable to the Bank foreclosing on three commercial properties and one residential property with combined carrying values of \$926 thousand.

Net fixed assets, decreased during the three months ended March 31, 2009. The Bank had depreciation expense for the period totaling \$69 thousand and new equipment purchases and leasehold improvements of \$13 thousand, for a net decline of \$56 thousand.

Deposits at March 31, 2009 declined by \$2.2 million to \$90.2 million from \$92.4 million at December 31, 2008. Noninterest bearing demand deposits declined during the three month period ended March 31, 2009 \$1.3 million or 13.8%, and time deposits declined \$5.6 million or 9.8%. Increasing for the quarter were savings accounts which increased \$1.6 million or 19.4%, NOW accounts which increased \$2.2 million or 36.2%, and money market accounts which increased \$882 thousand or 7.7%. The decline in time deposits was planned with \$6 million in brokered deposits maturing during the quarter ended March 31, 2009. The strong increase in NOW accounts is attributable to the successful introduction of a new high yielding account that rewards customers for using electronic banking.

Stockholders' equity declined during the first three months of 2009 due to the recording of a net loss of \$(1.2) million for the quarter. Accumulated comprehensive income was \$99 thousand at both March 31, 2009 and December 31, 2008. Total equity was \$13.7 million at March 31, 2009 compared to \$14.9 Million at December 31, 2008.

Discussion of Results of Operations for the Three Months Ended March 31, 2009 and Comparative Results for the Three Months Ended March 31, 2008.

The Bank posted a net loss of \$(1.2) million or \$(0.65) per share for the quarter ended March 31, 2009 as compared to \$(231) thousand loss or \$(0.12) per share for the same period last year. The loss was attributable to the write-off of impaired equity investments and trust preferred securities totaling \$1.3 million that were held in a large southeastern correspondent bank. On May 1, 2009, the Office of the Comptroller of the Currency closed Silverton Bank of Atlanta, Georgia, a regional bankers' bank with over 1,400 clients, rendering the shares worthless. While the closure did not occur until the second quarter, the impairment in the securities existed at March 31, 2009; thus the loss was recognized by the Bank in the first quarter of 2009.

Interest income for the three months ended March 31, 2009 remained flat at \$1.6 million compared to the quarter ended March 31, 2008. Interest income on loans declined \$15 thousand for the quarter when compared to the first quarter of 2008. While the average volume of loans increased, the decline in rates more than offset the increased volume. Interest income on the investment portfolio increased \$50 thousand from \$242 thousand at March 31, 2008 to \$292 thousand at March 31, 2009. This increase was primarily attributable to increased volume; however, an increase in portfolio yield also contributed to the additional income. Interest income on federal funds sold and other interest bearing deposit accounts declined from \$44 thousand for the quarter ended March 31, 2008 to \$13 thousand for the same period during the current year. This decline was due both to the declining rate environment and a lower volume invested for the first quarter of 2009 as compared to 2008. With yields on federal funds sold declining significantly, the Bank shifted strategy during the first quarter of 2009, opting to leave excess funds in our correspondent bank account where the funds were fully insured. This resulted in the Bank receiving a 0.25% earnings credit against charges from our correspondent rather than earning roughly half that amount in the federal funds market.

Interest expense for the three month period ended March 31, 2009 was \$674 thousand as compared to \$785 thousand for the same period in 2008. The \$111 thousand decline was both volume and rate driven.

The following chart summarizes changes in interest income and expense for the three-month periods ended March 31, 2009 and 2008:

	Three Months Ended March 31,		\$ Change	% Change
	2009	2008		
	(Dollars in thousands)			
Interest income:				
Loans	\$ 1,314	\$ 1,329	\$ (15)	(1.1)%
Securities	292	242	50	20.7%
Federal funds sold and other	13	44	(31)	(70.5)%
Total interest income	1,619	1,615	4	0.2%
Interest expense:				
Deposits	602	635	(33)	(5.2)%
Borrowings	72	150	(78)	(52.0)%
Total interest expense	674	785	(111)	(14.1)%
Net interest income	\$ 945	\$ 830	\$ 115	13.9%

Net interest income before loan loss provision increased \$115 thousand for the three months ended March 31, 2009 compared to the same period in 2008. The interest spread and net interest margin for the quarter ended March 31, 2009 were 3.22% and 3.40% respectively, compared to 2.82% and 3.23% for the same period in 2008. The average yield on earning assets for the quarter ended March 31, 2009 declined 46 basis points to 5.82% and the average volume of earning assets increased \$8.3 million, to \$111.2 million for the three months ended March 31, 2009 compared to the same period in 2008. The average rate paid on interest-bearing liabilities declined 85 basis points to 2.60%, while the average volume of interest-bearing liabilities increased \$12.6 million, to \$103.5 million for the three months ended March 31, 2009 compared to the same period in 2008.

The increase in interest rate spread and net interest margin from March 31, 2008 to March 31, 2009 is primarily attributable to the significant decline in the Bank's cost of funds. The rate on Federal Home Loan Bank advances remained stable, while repurchase agreements, money market and savings deposits, and time deposit yields have all followed the declining rate environment and repriced at much lower rates than existed at March 31, 2008.

The following chart summarizes the average balances and yields on interest earning assets and interest costing liabilities for the quarters ended March 31, 2009 and 2008 respectively:

	Three Months Ended March 31,			
	2009		2008	
	Average Balance	Yield/ Cost	Average Balance	Yield/ Cost
	(Dollars in thousands)			
Loans, net	\$80,939	6.49%	\$75,485	7.04%
Securities	24,083	4.85%	20,826	4.65%
Federal funds sold and other	3,397	1.41%	5,889	2.99%
Deposits	92,935	2.59%	74,667	3.40%
Borrowings	10,600	2.72%	16,230	3.70%

The following table sets forth the effects of changing rates and volumes on our net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, change attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Three Months Ended March 31, 2009 Compared to 2008		
	Increase (Decrease)		
	Due To		
	Volume	Rate	Net
	(Dollars in thousands)		
Interest Income:			
Loans	\$ 192	\$ (207)	\$ (15)
Securities	39	11	50
Other	(13)	(18)	(31)
Total interest-earning assets	<u>218</u>	<u>(214)</u>	<u>4</u>
Interest Expense:			
Deposits	(1,274)	1,241	(33)
Borrowings	(44)	(34)	(78)
Total interest bearing liabilities	<u>(1,318)</u>	<u>1,207</u>	<u>(111)</u>
Net change in interest income	<u>\$ 1,536</u>	<u>\$ (1,421)</u>	<u>\$ 115</u>

For the three months ended March 31, 2009 the Bank recorded \$88 thousand to the provision for loan losses as compared to \$180 thousand for the same period in 2008. Management reviews the loan portfolio each month to determine the appropriate reserve level. Provisions are made to maintain a level adequate to absorb anticipated loan losses. Currently, the allowance for loan losses is 1.92% of gross loans reflecting the decline in asset quality from the 1.15% reported for the same period in 2008.

Noninterest income for the three months ended March 31, 2009 was \$101 thousand compared to \$111 thousand for the same period in 2008. The decline was primarily due to less origination fees on loans sold in the secondary market. The Bank received \$7 thousand for the first quarter of 2008 compared to \$1 thousand for same period in 2009.

Noninterest expense for the three months ended March 31, 2009 was \$951 thousand, excluding the loss on impaired equity investments, compared to \$1 million for the same period in 2008. Management continues to look at operating expenses and has made and will continue to make cuts to operating expenses wherever possible. Several operating expenses have been eliminated for 2009 including director's fees, 401k matching contributions, and NASDAQ membership fees to mention a few. Unfortunately, FDIC insurance premiums have increased and there will likely be a special assessment in September of 2009 of 10 to 20 basis points on qualifying deposits. This assessment will likely cost the Bank between \$90 thousand and \$180 thousand. In addition, employee insurance and blanket bond insurance continue to increase for the Bank as they have for most industries.

Off-Balance Sheet Arrangements

In the normal course of business, to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance-sheet risks. These financial instruments consist of commitments to extend credit and standby letters of credit. 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. Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. Most letters of credit are extended for one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The Bank's exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument.

Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Collateral held for commitments to extend credit varies but may include unimproved and improved real estate, certificates of deposit or personal property.

The following table summarizes our off-balance-sheet financial instruments whose contract amounts represent credit risk as of March 31, 2009:

Commitments to extend credit	\$ 9,756,003
Stand-by letters of credit	\$ 451,300

Capital Requirements

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) establishes a system of "prompt corrective action" to resolve the problems of undercapitalized institutions. Under this system, which became effective in December 1992, the federal banking regulators are required to establish five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized) and to take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions in the three undercapitalized categories, the severity of which will depend upon the capital category in which the institution is placed. Generally, subject to a narrow exception, FDICIA requires the appropriate banking regulator to appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category.

The following table lists the criteria for a well-capitalized bank as compared to Community National Bank at March 31, 2009:

	Total Risk-Based Capital Ratio	Tier I Risk-Based Capital Ratio	Leverage Ratio
Well-capitalized	10.00% or above	6.00% or above	5.00% or above
Community National Bank	19.02%	17.74%	11.59%

The Bank was a well-capitalized institution under the above criteria as of March 31, 2009.

Liquidity and Interest Rate Sensitivity

Net interest income, our Bank's primary source of earnings, will fluctuate with significant interest rate movements. To lessen the impact of these fluctuations, we attempt to structure the balance sheet so that repricing opportunities exist for both assets and liabilities in roughly equal amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

Interest rate sensitivity refers to the responsiveness of interest-bearing assets and liabilities to a change in market interest rates. The rate sensitive position, or "gap," is the difference in the volume of rate sensitive assets and liabilities at a given time interval. The general objective of gap management is to actively manage rate sensitive assets and liabilities in order to reduce the impact of interest rate fluctuations on the net interest margin. We generally attempt to maintain a balance between rate sensitive assets and liabilities as the exposure period is lengthened to minimize our overall interest rate risk.

An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to adversely affect net interest income.

We regularly evaluate the balance sheet's asset mix in terms of several variables:

- yield;
- credit quality;
- appropriate funding sources; and
- liquidity.

To effectively manage the balance sheet's liability mix, we focus on expanding our deposit base and converting assets to cash as necessary.

As our Bank grows, we will continuously structure its rate sensitivity position in an effort to hedge against rapidly rising or falling interest rates. Our risk management committee meets on a monthly basis to develop a strategy for the upcoming period.

Liquidity represents the ability to provide steady sources of funds for loan commitments and investment activities, as well as to maintain sufficient funds to cover deposit withdrawals and payment of debt and operating obligations. We can obtain these funds by converting assets to cash or by attracting new deposits. Our Bank's ability to maintain and increase deposits serves as its primary source of liquidity. Secondary sources of liquidity for the Bank are Federal Funds Accommodation lines with Silverton Bank of Atlanta, Georgia and advances from the Federal Home Loan Bank of Cincinnati, Ohio. At March 31, 2009 Community National Bank of the Lakeway Area had a \$7 million dollar unsecured line and a \$3.1 million dollar secured line with Silverton Bank, neither of which had an outstanding balance. Due to the OCC closing Silverton Bank on May 1, 2009, the Bank is currently in the process of placing the accommodation lines with another correspondent.

The Bank has two advances from the FHLB of Cincinnati at March 31, 2009 (three in 2008). One advance is for \$5 million and matures in 2015. The second advance obtained in 2007 is for \$2 million and will mature in 2010. The weighted average interest rate on these advances is 4.07%. The FHLB has a one time option to convert the advances to variable rates. If the FHLB exercises its option and increases the interest rates on these advances, the Bank has the option to pay the advances in full without penalty. Pursuant to a collateral agreement with the FHLB, advances are secured by the Bank's FHLB stock and qualifying first mortgage loans.

The Bank had unused lines of credit and loan commitments at March 31, 2009 totaling \$9.8 million. We know of no other trends, demands, commitments, events, or uncertainties that should result in or are reasonably likely to result in our Bank's liquidity increasing or decreasing in any material way in the foreseeable future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Pursuant to the revised disclosure requirements for smaller reporting companies effective February 4, 2008, no disclosure under this Item is required.

ITEM 4T. CONTROLS AND PROCEDURES

As of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer have evaluated the effectiveness of our “disclosure controls and procedures” (“Disclosure Controls”). Disclosure Controls, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Office of the Comptroller of the Currency’s rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Our management, including the CEO and CFO, does not expect that our Disclosure Controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based upon their controls evaluation, our CEO and CFO have concluded that our Disclosure Controls are effective at a reasonable assurance level.

There have been no changes in our internal controls over financial reporting during our first quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As of the date hereof, there are no material pending legal proceedings to which we are a party or of which any of our properties are subject nor are there any proceedings known to us to be contemplated by a governmental authority.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in "Part I, Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Not applicable.
- (b) Not applicable.
- (c) Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibits

- 31.1 Certification Pursuant to Rule 13a-14(a) - Chief Executive Officer
- 31.2 Certification Pursuant to Rule 13a-14(a) - Chief Financial Officer / Chief Accounting Officer
- 32.1 Certification Pursuant to Section 1350 - Chief Executive Officer
- 32.2 Certification Pursuant to Section 1350 - Chief Financial Officer / Chief Accounting Officer

SIGNATURES

In accordance with the requirements of the National Banking Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

BY: _____
Samuel F. Grigsby, Jr.
Chairman, Chief Executive Officer, and Director

BY: _____
Darwin K. Kilday
Chief Financial Officer, Chief Accounting Officer, and Director

