

**UNITED STATES
OFFICE OF THE COMPTROLLER OF THE CURRENCY
WASHINGTON, D.C. 20219**

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 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 Registrant as Specified in Its Charter)

Tennessee

(State of Incorporation or Organization)

27-0031825

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

225 West First North Street, Morristown, Tennessee

(Address of Principal Executive Offices)

37814

(Zip Code)

(423) 587-2345

(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

None.

Securities Registered Pursuant to Section 12(g) of the Act:

Title of Each Class

Common Stock, \$1.00 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and 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 during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition 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 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

The aggregate market value of the registrant's outstanding common stock held by nonaffiliates of the registrant as of December 31, 2009, was approximately \$4.4 million, based on the registrant's closing sales price as reported on the Pink Sheets and the Over the Counter Bulletin Board (OTCBB). There were 1,891,426 shares of the registrant's common stock outstanding as of December 31, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Document

Parts Into Which Incorporated

Annual Report to Shareholders for the Year Ended December 31, 2009

Part II

Proxy Statement for the Annual Meeting of Shareholders to be held June 21, 2010

Part III

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PART I

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.

The terms “we,” “us,” “our” and similar terms refer to Community National Bank of the Lakeway Area.

ITEM 1. BUSINESS

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

On April 8, 2003, the Bank received final approval from the Office of the Comptroller of the Currency to commence banking operations. The Bank began operations as a national bank under the laws of the United States on April 9, 2003. Our primary purpose is to serve the banking needs of individuals and businesses in Grainger, Hamblen and Jefferson Counties. We emphasize personalized service, access to decision makers and a quick response on lending decisions. We have been, and intend to remain, a community-focused financial institution offering a full range of financial services to small- to medium-sized businesses, professionals and individual consumers in our community. We offer a wide range of banking services including checking and savings accounts; commercial, installment, mortgage and personal loans; safe deposit boxes; and other associated services.

Community National Bank of the Lakeway Area is a member of the Federal Home Loan Bank of Cincinnati and our deposits are insured up to applicable limits by the Bank Insurance Fund of the Federal Deposit Insurance Corporation. The address of our headquarters is 225 West First North Street, Morristown, Tennessee 37814, and our telephone number is (423) 587-2345. Our website is located at <http://www.cnbla.com>.

Our Strategy

We established our bank with the objective of becoming a vital, long-term player in our market area with a reputation for quality customer service provided by a financially-sound organization. Our business strategy is to operate as an institution that is:

- Well-capitalized;
- Strong in asset quality;
- Profitable;
- Independent;
- Customer-oriented; and
- Connected to our community.

A commitment to customer service is at the foundation of our approach. Our commitment is to put our customers first and we believe it differentiates us from our competitors. Making good quality, profitable loans, which result in a long-standing relationship with our borrowers, will continue to be a cornerstone of our strategy. We intend to leverage the core relationships we build by providing a variety of services to our customers. With that focus, we target:

- Small- and medium-sized businesses and the owners and managers of these entities;
- Professional and middle managers of locally-based companies;
- Residential real estate developers; and
- Individual consumers.

We intend to grow our franchise through new and existing relationships developed by our management team, by taking advantage of the opportunity to acquire new relationships resulting from recent significant consolidation among banks in our markets, and by expanding to contiguous areas through de novo entry and branch acquisitions that make strategic and economic sense.

Key aspects of our strategy and mission include:

- To provide community-oriented banking services by delivering a broad range of financial services to our customers through responsive service and communication;
- To form a partnership with our customers whereby our decision making and product offerings are geared toward their best long-term interests;
- To be recognized in our community as a long-term player with employees, shareholders and board members committed to that effort; and
- To be progressive in our adoption of new technology so that we can provide our customers access to products and services that meet their needs for convenience and efficiency.

Our belief is that this way of doing business will build a profitable corporation and shareholder value. We want to consistently reward our shareholders for their investment and trust in us.

Market Area and Competition

We consider our primary market area to be the Morristown Metropolitan Statistical Area (MSA) which consists of Grainger, Hamblen and Jefferson counties. Our extended market area includes Knoxville and the counties of Knox, Sevier, Cocke and Greene.

Commercial banking in east Tennessee is extremely competitive due to state laws that allow statewide branching. As of June 30, 2009, there were 47 branches in Grainger, Hamblen and Jefferson Counties operated by 16 commercial banks, including us. On that date, approximately \$927.0 million in deposits were located in Hamblen County and our deposits were approximately \$56.6 million; while approximately \$528.7 million in deposits were located in Jefferson County and our deposits were approximately \$30.9 million. As such, we have significant competition in our market for deposits and loans from other depository institutions. Many of our depository institution competitors have substantially greater resources, broader geographic markets and higher lending limits than ours and are also able to provide more services and make greater use of media advertising.

We compete not only with financial institutions based in Tennessee, but also with out-of-state banks and bank holding companies and other out-of-state financial institutions that have an established market presence in both the state as a whole and in Grainger, Hamblen and Jefferson Counties. Many of the financial institutions operating in Tennessee are engaged in local, regional, national and international operations, and they have more assets and personnel than us. We compete with the major super-regional bank holding companies. Because of their greater resources, those institutions are able to perform certain functions for their customers, including trust and investment banking services, that we are not equipped to offer directly, although we do offer some of those services through our correspondent banks.

We also compete with credit unions, insurance companies, money market mutual funds and other financial institutions, some of which are not subject to the same degree of regulation and restrictions as ours, in attracting deposits and making loans.

Lending Activities

General. We make a variety of types of consumer and commercial loans to individuals and small- and medium-sized businesses for various personal and business purposes, including term and installment loans, equity lines of credit and overdraft checking credit. For financial reporting purposes, our loan portfolio generally is divided into (1) real estate loans, (2) commercial loans, (3) consumer loans and (4) purchased government guarantee loans. Those categories are discussed further below. We also make credit card services available to our customers through a correspondent bank.

Real Estate-Secured Loans. We make commercial real estate loans, residential real estate loans and construction and development loans. Our real estate loans include commercial loans in which we take a security interest in real estate as supplemental, but not principal, collateral for the loan. Home equity loans and lines of credit are classified as consumer loans rather than real estate loans. As of December 31, 2009, real estate loans comprised 78.6% of our total loan portfolio. Of those loans, loans totaling approximately 30.3% of our loan portfolio were classified as commercial real estate loans, 3.9% were classified as construction loans and 44.4% were secured by residential and other real estate loans.

Commercial Real Estate. Commercial real estate loan terms generally are limited to five years or less, although payments may be structured on a longer amortization basis. Interest rates may be fixed or adjustable, although rates typically are not fixed for a period exceeding 60 months. We generally charge an origination fee of one percent. We attempt to reduce credit risk on our commercial real estate loans by emphasizing loans on owner-occupied office and retail buildings where the ratio of the loan principal to

the value of the collateral as established by independent appraisal does not exceed 80% and net projected cash flow available for debt service is greater than or equal to 120% of the debt service requirement. In addition, we generally require personal guarantees from the principal owners of the property supported by a review by our management of the principal owners' personal financial statements. Risks associated with commercial real estate loans include fluctuations in the value of real estate, new job creation trends, tenant vacancy rates and the quality of the borrower's management. We attempt to limit this risk by analyzing borrowers' cash flow and collateral value on an ongoing basis.

Residential Real Estate. Our residential real estate loans consist of first mortgage products and construction loans. We offer fixed and variable rates on our mortgages with the amortization of the loan generally not exceeding 30 years and the rates generally not being fixed or "booked" for a period over 60 months. These loans are made in accordance with our appraisal policy and with the ratio of the loan principal to the value of collateral as established by independent appraisal generally not exceeding 90%. We believe that these loan-to-value ratios are sufficient to compensate for fluctuations in real estate market value and to minimize losses that could result from a downturn in the residential real estate market.

Construction and Development Loans. We offer single-family residential construction loans to borrowers for construction of one to four family residences in our primary service area. Generally, we limit our construction lending to construction loans and construction/permanent loans to individuals building their primary residences and, to a lesser extent, construction loans to select local builders to build single-family dwellings for sale. These loans have fixed or adjustable interest rates and are underwritten in accordance with the same standards as permanent real estate loans, except for the fact that these loans generally provide for disbursement in stages during a construction period of up to twelve months. During the construction period, the borrower is generally required to make monthly payments of accrued interest on the outstanding loan balance. Construction loans generally have a maximum loan to value ratio of 80%. Individual borrowers must satisfy all credit requirements that would apply to permanent real estate loans made by us. While our construction and construction/permanent loans generally are converted to permanent loans following construction, the construction loans made to builders generally require repayment in full upon completion of construction, or may be assumed by the purchaser of the dwelling and converted to a permanent loan.

Construction lending affords us the opportunity to achieve higher interest rates and fees with shorter terms to maturity compared to permanent mortgage lending. Construction lending is generally considered to involve a higher degree of risk than single-family permanent mortgage lending because of the inherent difficulty in estimating both the property value at completion of construction and the estimated cost of construction. The nature of these loans is such that they are generally more difficult to evaluate and monitor. If our estimate of construction costs proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If our estimate of value upon completion proves inaccurate, we may be confronted at, or prior to, maturity of the loan with a project whose value is insufficient to insure full repayment. Construction projects may also be jeopardized by disagreements between borrowers and builders and the failure of builders to pay subcontractors. Loans to builders to construct homes for which no purchaser has been identified carry more risk because the payoff of the loan is dependent upon the builder's ability to sell the property prior to the time that the construction loan is due. We address these risks by adhering to strict underwriting policies, disbursement procedures and monitoring practices.

Commercial Loans. Loans for commercial clients in various lines of businesses are one of the primary components of our loan portfolio. The terms of these loans vary by purpose and by type of any underlying collateral. As of December 31, 2009, commercial loans comprised 13.1% of our total loan portfolio.

Equipment Loans. We typically make equipment loans for a term of five years or less at fixed or variable rates, with the loan fully amortized over the term. Equipment loans generally are secured by the financed equipment and the ratio of the loan principal to the value of the financed equipment or other collateral is generally 75% or less. We expect these loan-to-value ratios to be sufficient to compensate for fluctuations in the market value of the equipment and to help minimize losses that could result from poor maintenance or the introduction of updated equipment models into the market.

Working Capital Loans. Loans to support working capital typically have terms not exceeding one year and are usually secured by accounts receivable, inventory, or personal guarantees of the principals of the business. For loans secured by accounts receivable or inventory, principal must typically be repaid as the assets securing the loan are converted into cash, and for loans secured with other types of collateral, principal typically is due at maturity. The quality of the commercial borrower's management and its ability both to properly evaluate changes in the supply and demand characteristics affecting its markets for products and services and to effectively respond to such changes are significant factors in a commercial borrower's creditworthiness. General risks affecting a commercial borrower's ability to repay include interest, inflation and the demand for the commercial borrower's products and/or services, as well as other factors affecting a borrower's customers, suppliers and employees.

Consumer Loans. We make a variety of loans to individuals for personal, family and household purposes, including secured and unsecured installment and term loans, home equity loans and home equity lines of credit. Consumer loan repayments depend upon the borrower's financial stability and are more likely to be adversely affected by divorce, job loss, illness and personal hardships. Because many consumer loans are secured by depreciable assets such as boats, cars and trailers, the loan should be amortized over the useful life of the asset. To minimize these risks, the loan officer reviews the borrower's past credit history, past income level, debt history and, when applicable, cash flow, and determines the impact of all of these factors on the ability of the borrower to make future payments as agreed. The principal competitors for consumer loans are the established banks in our primary service area. As of December 31, 2009, consumer loans comprised 5.2% of our total loan portfolio.

Purchased Government Guaranteed Loans. During the year ended December 31, 2005 we purchased government guaranteed loans for the loan portfolio. These loans are unconditionally guaranteed as to principal and interest by the full faith and credit of the United States Government. Most of the loans carry a variable rate and are tied to the national prime rate. As of December 31, 2009, purchased government guaranteed loans comprised 3.2% of our total loan portfolio.

Loan Administration and Underwriting. Like most community banks, we make loans based, to a great extent, on our assessment of borrowers' income, cash flow, character and abilities to repay. So, the principal risk associated with each of the categories of our loans is the creditworthiness of our borrowers, and our loans may be viewed as involving a higher degree of credit risk than is the case with some other types of loans, such as long-term residential mortgage loans, where greater emphasis is placed on collateral values. To manage this risk, we have adopted written loan policies and procedures, and our loan portfolio is administered under a defined process. That process includes guidelines for loan underwriting standards and risk assessment, procedures for loan approvals, loan grading, ongoing identification and management of credit deterioration, and portfolio reviews to assess loss exposure and to test our compliance with our credit policies and procedures.

The underwriting standards that we employ for loans includes an evaluation of various factors, including a loan applicant's income, cash flow, payment history on other debts and an assessment of ability to meet existing obligations and payments on the proposed loan. Though creditworthiness of the applicant is a primary consideration in the loan approval process, in the case of secured loans the

underwriting process also includes an analysis of the value of the proposed collateral in relation to the proposed loan amount. We consider the value of collateral, the degree to which that value is ascertainable with any certainty, the marketability of the collateral in the event of foreclosure or repossession and the likelihood of depreciation in the collateral value.

Our policy is to avoid concentrations of loans to a single industry or secured by a single type of collateral. Our loan approval policies provide for various levels of officer lending authority. When the amount of total loans to a single borrower exceeds an individual officer's lending authority, an officer with a higher lending limit or our risk management committee determines whether to approve the loan request.

Our lending activities are subject to a variety of lending limits imposed by federal law. Differing limits apply based upon the type of loan or the nature of the borrower, including the borrower's relationship to us. In general, we are able to loan to any one borrower a maximum amount equal to either 15% of our capital and surplus or 25% of our capital and surplus if the amount that exceeds 15% is fully secured by readily marketable collateral. These legal limits increase or decrease as our capital increases or decreases as a result of our earnings or losses, among other reasons. However, we may sell participations in our loans to other financial institutions in order to meet all of the lending needs of our customers requiring extensions of credits above these limits.

Our Board of Directors has approved levels of lending authority for lending personnel based on our aggregate credit exposure to a borrower and the secured or unsecured status of a loan proposed to be made. A loan that is within a lending officer's assigned authority may be approved by that officer. These lending authorities vary by officer. Our Chief Executive Officer, our President, our Regional President, our Executive Vice President of Lending, our Senior Vice President of Lending, and our Chief Financial Officer have individual lending authorities of \$250,000 for both secured and unsecured loans; individual lending authorities for other lenders do not exceed \$100,000 for a secured loan, and \$50,000 for an unsecured loan. A Senior Loan Committee, consisting of the five executive officers, has authority to make a loan up to \$750,000 for both secured and unsecured loans. The Risk Management Committee of the Board of Directors, consisting of six outside Board members and our five executive officers, can approve a loan up to our legal lending limit.

At the time a loan is proposed to be made or renewed, the loan officer assigns a grade to the loan based on various underwriting and other criteria. During the life of each loan, its grade is reviewed and validated or modified to reflect changes in circumstances and risk. Loans generally are placed on non-accrual status if they become 90 days past due or whenever we believe that collection has become doubtful. Loans are charged off when the collection of principal and interest has become doubtful and the loans no longer can be considered sound collectible assets (or, in the case of unsecured loans, when they become 90 days past due).

Allowance for Loan Losses. Our Board of Directors reviews all impaired loans at least monthly, and our management meets regularly to review asset quality trends and to discuss loan policy issues. Based on these reviews and our current judgments about the credit quality of our loan portfolio and other relevant internal and external factors, we have established an allowance for loan losses. The adequacy of the allowance is assessed by our management and reviewed by our Board of Directors each month. On December 31, 2009, our allowance was \$1.4 million and amounted to approximately 1.86% of our total loans and approximately 46.4% of our nonperforming loans.

On December 31, 2009, our nonperforming loans amounted to approximately \$3.1 million and consisted of our nonaccruing loans and troubled debt restructurings. On that date, we had \$2.0 million in nonaccruing loans and \$1.1 million of loans considered to be troubled debt restructurings that were

performing in compliance with their restructured terms. We also had \$1.8 million of foreclosed assets. The Bank did not have any loans 90 days or more past due but still accruing interest at December 31, 2009.

Asset and Liability Management

Our asset liability committee (ALCO) manages our assets and liabilities and strives to provide a stable, optimized net interest margin, adequate liquidity and a profitable after-tax return on assets and return on equity. The committee conducts these management functions within the framework of written loan and investment policies adopted by the Board of Directors. The committee attempts to maintain a balanced position between rate sensitive assets and rate sensitive liabilities. Specifically, it charts assets and liabilities on a matrix by maturity, effective duration and interest adjustment period and attempts to manage any gaps in maturity ranges.

Deposit Activities

We seek to establish a broad base of core deposits, including savings, checking, interest-bearing checking, money market and IRA accounts, as well as a variety of certificates of deposit. To attract deposits, we employ an aggressive marketing plan in our primary service area and feature a broad product line and competitive rates and services. The primary sources of deposits are residents of, and businesses and their employees located in, our primary service area. We obtain these deposits through personal solicitation by our officers and directors, direct mail solicitations and advertisements published in the local media. To attract our deposit base, we are offering higher interest rates on various deposit accounts.

On December 31, 2009, 51.2% of our total deposits consisted of time deposit accounts, 7.3% consisted of statement savings accounts, 32.4% consisted of money market and NOW accounts and 9.1% consisted of noninterest-bearing transaction accounts. Our time deposits of \$100,000 or more amounted to approximately \$25.2 million, or approximately 25.5% of our total deposits at December 31, 2009. There was no brokered certificate of deposit pools included in the totals for time deposits of \$100,000 or more at December 31, 2009 and \$10.8 million outstanding at December 31, 2008. The Bank's dependence on these pools declined during 2009.

Investment Portfolio

In addition to loans, we make other investments primarily in obligations of the United States, obligations guaranteed as to principal and interest by the United States and other taxable securities. No investment in any of these instruments exceeds any applicable limitation imposed by law or regulation. Our risk management committee reviews the investment portfolio on an ongoing basis to ensure that the investments conform to our policy as set by the Board of Directors.

Other Banking Services

Given customer demand for increased convenience in accessing banking and investment services, we also offer a broad array of convenience-centered products and services, including debit cards, credit cards, direct deposit and cash management services for small- to medium-sized businesses. Additionally, we are associated with several nationwide networks of automated teller machines that our customers may use throughout Tennessee and other regions. We also offer MasterCard-Registered Trademark and VISA-Registered Trademark credit card services through a correspondent bank as our agent. We do not plan to exercise trust powers during our initial years of operation. We may in the future offer a full-service trust department, but cannot do so without the prior approval of the Office of the Comptroller of the Currency (OCC).

Employees

As of December 31, 2009, we had 35 full-time equivalent employees. None of these employees are covered by a collective bargaining agreement. We consider relations with our employees to be good.

SUPERVISION AND REGULATION

The Bank is subject to extensive federal banking regulations that impose restrictions on and provide for general regulatory oversight of our operations. These laws generally are intended to protect depositors and not shareholders. Legislation and regulations authorized by legislation influence, among other things:

- how, when and where we may expand geographically;
- into what product or service market we may enter; and
- how we must manage our assets.

Set forth below is an explanation of the major pieces of legislation affecting our industry and how that legislation affects our actions. The following summary is qualified by reference to the statutory and regulatory provisions discussed. Changes in applicable laws or regulations may have a material effect on our business and prospects, and legislative changes and the policies of various regulatory authorities may significantly affect our operations. We cannot predict the effect that fiscal or monetary policies, or new federal or state legislation, may have on our business and earnings in the future.

Since the Bank is chartered as a national bank, it is primarily subject to the supervision, examination and reporting requirements of the National Bank Act and the regulations of the Office of the Comptroller of the Currency. The Office of the Comptroller of the Currency regularly examines the Bank's operations and has the authority to approve or disapprove mergers, the establishment of branches and similar corporate actions. The Office of the Comptroller of the Currency also has the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law. Because the Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) to the maximum extent provided by law, the Bank is also subject to certain FDIC regulations. The Bank is also subject to numerous state and federal statutes and regulations that affect its business, activities and operations.

Change in Bank Control. The Change in Bank Control Act, with related regulations, requires Office of the Comptroller of the Currency approval prior to any person or company acquiring "control" of a bank. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of a bank. Control is rebuttably presumed to exist if a person or company acquires 10% or more, but less than 25%, of any class of voting securities of the Bank. The regulations provide a procedure for challenging any rebuttable presumption of control.

Branching. National banks are required by the National Bank Act to adhere to branching laws applicable to state banks in the states in which they are located. Under current Tennessee law, the Bank may open branch offices throughout Tennessee with the prior approval of the Office of the Comptroller of the Currency. In addition, with prior regulatory approval, the Bank may acquire branches of existing banks located in Tennessee. The Bank and any other national or state-chartered bank generally may

branch across state lines by merging with banks in other states if allowed by the applicable states' laws. Tennessee law, with limited exceptions, currently permits branching across state lines through interstate mergers.

Under the Federal Deposit Insurance Act, states may “opt-in” and allow out-of-state banks to branch into their state by establishing a new start-up branch in the state. Currently, Tennessee has opted-in to this provision on a reciprocal basis, meaning that an out-of-state bank may establish a new start-up branch only if its home state has also elected to opt in.

Prompt Corrective Action. The Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories in which all institutions are placed: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

As a bank's capital condition deteriorates, federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The three most significant categories, however, are well capitalized, adequately capitalized, and undercapitalized. At December 31, 2009, the Bank was categorized as well capitalized.

A “well capitalized” bank is one that is not subject to any written agreement, order or capital directive to meet and maintain a specific capital level for any capital measure, and that maintains a total risk-based capital ratio of at least 10%, a tier 1 risk-based capital ratio of at least 6% and a tier 1 leverage ratio of at least 5%. Generally, a classification as well capitalized will place a bank outside of the regulatory zone for purposes of prompt corrective action. However, a well capitalized bank may be reclassified as “adequately capitalized” based on criteria other than capital, if the federal regulator determines that a bank requires certain remedial action.

An “adequately capitalized” bank is one that maintains a total risk-based capital ratio of at least 8%, a tier 1 risk-based capital ratio of at least 4% and a tier 1 leverage ratio of at least 4%. A bank that is adequately capitalized is prohibited from directly or indirectly accepting, renewing or rolling over any brokered deposits, absent applying for and receiving a waiver from the FDIC, and is subject to rate restrictions on the level of interest that it can pay on deposits. In addition, an adequately capitalized bank may be required by its federal regulator to comply with operating restrictions similar to those placed on undercapitalized banks.

An “undercapitalized” bank is one that fails to meet the required minimum level for any capital measure required to be deemed adequately capitalized. A bank that reaches the undercapitalized level is subject to enhanced monitoring by federal regulators, restrictions on asset growth, acquisitions, branching and engaging in new lines of business, and is required to submit a capital restoration plan. In addition, an undercapitalized institution is subject to discretionary safeguards whereby the primary federal regulator can:

- prohibit capital distributions;
- prohibit payment of management fees to a controlling person;

- require sale of securities, or, if grounds for conservatorship or receivership exist, direct the bank to merge or be acquired;
- restrict affiliate transactions;
- restrict or prohibit all activities that are determined to pose an excessive risk to the bank;
- require the institution to elect new directors, dismiss directors or senior executive officers or employ qualified senior executive officers to improve management;
- prohibit the acceptance of deposits from correspondent banks;
- require prior approval of capital distributions by holding companies;
- require holding company divestiture of the bank, bank divestiture of subsidiaries, and/or holding company divestiture of other affiliates;
- require the bank to take any other action the federal regulator determines will “better achieve” prompt corrective action objectives;
- prohibit material transactions outside the usual course of business;
- prohibit amending the bylaws/charter of the bank;
- prohibit any material changes in accounting methods; and
- prohibit golden parachute payments, excessive compensation and bonuses.

FDIC Insurance Assessments. Our deposits are insured by the Deposit Insurance Fund (the “DIF”) of the FDIC up to the amount permitted by law. We are thus subject to FDIC deposit insurance premium assessments. The FDIC uses a risk-based assessment system that assigns insured depository institutions to one of four risk categories based on three primary sources of information—supervisory risk ratings for all institutions, financial ratios for most institutions, including the Bank, and long-term debt issuer ratings for large institutions that have such ratings. In February 2009, the FDIC issued new risk-based assessment rates that took effect April 1, 2009. For insured depository institutions in the lowest risk category, the annual assessment rate ranges from 7 to 24 cents for every \$100 of domestic deposits. For institutions assigned to higher risk categories, the new assessment rates range from 17 to 77.5 cents per \$100 of domestic deposits. These ranges reflect a possible downward adjustment for unsecured debt outstanding and possible upward adjustments for secured liabilities and, in the case of institutions outside the lowest risk category, brokered deposits.

The FDIC’s assessment rates are intended to result in a reserve ratio of at least 1.15%. As of December 31, 2008, the ratio had fallen well below this floor. The FDIC is required to return the DIF to its statutorily mandated minimum reserve ratio of 1.15% within eight years. On September 30, 2009, the FDIC collected a one-time special assessment of five basis points of an institution’s assets minus tier 1 capital as of June 30, 2009. The amount of the special assessment could not exceed ten basis points times the institution’s assessment base for the second quarter of 2009. On November 12, 2009, the FDIC adopted a final rule that required nearly all FDIC- insured depository institutions to prepay their DIF assessments for the fourth quarter of 2009 and for the next three years. This prepayment did not affect our

net income. The FDIC has indicated that the prepayment of DIF assessments would be in lieu of additional special assessments.

The FDIC also collects a deposit-based assessment from insured financial institutions on behalf of The Financing Corporation (FICO). The funds from these assessments are used to service debt issued by FICO in its capacity as a financial vehicle for the Federal Savings & Loan Insurance Corporation. The FICO assessment rate is set quarterly and in 2009 ranged from 1.02 cents to 1.14 cents per \$100 of assessable deposits. These assessments will continue until the debt matures in 2017 through 2019.

The FDIC may, without further notice-and-comment rulemaking, adopt rates that are higher or lower than the stated base assessment rates, provided that the FDIC cannot (i) increase or decrease the total rates from one quarter to the next by more than three basis points, or (ii) deviate by more than three basis points from the stated assessment rates. The FDIC has proposed maintaining current assessment rates through December 31, 2010, followed by a uniform increase in risk-based assessment rates of three basis points effective January 1, 2011.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC.

FDIC Temporary Liquidity Guarantee Program. On October 14, 2008, the FDIC announced that its Board of Directors, under the authority to prevent “systemic risk” in the U.S. banking system, approved the Temporary Liquidity Guarantee Program (“TLGP”). The purpose of the TLGP is to strengthen confidence and encourage liquidity in the banking system. The TLGP is composed of two components, the Debt Guarantee Program and the Transaction Account Guarantee Program, and institutions had the opportunity, prior to December 5, 2008, to opt out of either or both components of the TLGP.

The Debt Guarantee Program: Under the TLGP, the FDIC guarantees certain newly issued senior unsecured debt issued through October 31, 2009 by participating financial institutions. The Bank did not opt out of the TLGP.

The Transaction Account Guarantee Program: Under the TLGP, the FDIC fully guarantees funds in non-interest bearing deposit accounts held at participating FDIC-insured institutions, regardless of dollar amount. The temporary guarantee originally was scheduled to expire at the end of 2009. On August 26, 2009, the FDIC extended the program through June 30, 2010. During the original period, the FDIC imposed a 10 basis point annual rate surcharge which was applied to noninterest-bearing transaction deposit amounts over \$250,000. For the extension period, this surcharge will be between 15 and 25 basis points on an annualized basis. Institutions will not be assessed on amounts that are otherwise insured. The Bank did not opt out of the original or extension periods of the Transaction Account Guarantee component of the TLGP.

Allowance for Loan and Lease Losses. The Allowance for Loan and Lease Losses represents one of the most significant estimates in the Bank’s financial statements and regulatory reports. Because of its significance, the Bank has developed a system by which it develops, maintains and documents a comprehensive, systematic and consistently applied process for determining the amounts of the Allowance for Loan and Lease Losses and the provision for loan and lease losses. The Interagency Policy Statement on the Allowance for Loan and Lease Losses, issued on December 13, 2006, encourages all banks to ensure controls are in place to consistently determine the Allowance for Loan and Lease Losses in accordance with GAAP, the Bank’s stated policies and procedures, management’s best judgment and relevant supervisory guidance. Consistent with supervisory guidance, the Bank maintains a prudent and

conservative, but not excessive, Allowance for Loan and Lease Losses, that is at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired as well as estimated credit losses inherent in the remainder of the loan and lease portfolio. The Bank's estimate of credit losses reflects consideration of all significant factors that affect the collectability of the portfolio as of the evaluation date.

Commercial Real Estate Lending. Our lending operations may be subject to enhanced scrutiny by federal banking regulators based on our concentration of commercial real estate loans. On December 6, 2006, the federal banking regulators issued final guidance to remind financial institutions of the risk posed by commercial real estate (CRE) lending concentrations. CRE loans generally include land development, construction loans and loans secured by multifamily property, and nonfarm, nonresidential real property where the primary source of repayment is derived from rental income associated with the property. The guidance prescribes the following guidelines for examiners to help identify institutions that are potentially exposed to significant CRE risk and may warrant greater supervisory scrutiny:

- total reported loans for construction, land development and other land represent 100% or more of the institutions total capital, or
- total commercial real estate loans represent 300% or more of the institution's total capital, and the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50% or more during the prior 36 months.

Community Reinvestment Act. The Community Reinvestment Act requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Board of Governors of the Federal Reserve, the FDIC, or the Office of the Comptroller of the Currency, shall evaluate the record of each financial institution in meeting the credit needs of its local community, including low and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on the Bank. Since the Bank's aggregate assets are not more than \$250 million, under the Gramm-Leach-Bliley Act, we are generally subject to a Community Reinvestment Act examination only once every 60 months if we receive an "outstanding" rating, once every 48 months if we receive a "satisfactory" rating and as needed if our rating is "less than satisfactory." Additionally, we must publicly disclose the terms of various Community Reinvestment Act-related agreements.

Other Regulations. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. For example, under the Soldiers' and Sailors' Civil Relief Act of 1940, a lender is generally prohibited from charging an annual interest rate in excess of 6% on any obligation of a borrower who is on active duty with the United States military.

The Bank's loan operations are also subject to federal laws applicable to credit transactions, such as the following:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

- Fair Credit Reporting Act of 1978, as amended by the Fair and Accurate Credit Transactions Act, governing the use and provision of information to credit reporting agencies, certain identity theft protections and certain credit and other disclosures;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Soldiers' and Sailors' Civil Relief Act of 1940, as amended by the Servicemembers Civil Relief Act, governing the repayment terms of, and property rights underlying, secured obligations of persons currently on active duty with the United States military;
- Talent Amendment in the 2007 Defense Authorization Act, establishing a 36% annual percentage rate ceiling, which includes a variety of charges including late fees, for certain types of consumer loans to military service members and their dependents; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

The Bank's deposit operations are also subject to federal laws applicable to deposit transactions, such as the following:

- Truth in Savings Act, requiring certain disclosures for consumer deposit accounts;
- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board to implement that act, governing automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

Capital Adequacy

The Bank is required to comply with the capital adequacy standards established by the Office of the Comptroller of the Currency. The Bank is also subject to risk-based and leverage capital requirements adopted by the Office of the Comptroller of the Currency.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letters of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

The minimum guideline for the ratio of total capital to risk-weighted assets is 8%. Total capital consists of two components, Tier 1 Capital and Tier 2 Capital. Tier 1 Capital generally consists of common stock, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, and a limited amount of qualifying cumulative perpetual preferred stock, less goodwill and other specified intangible assets. Tier 1 Capital must equal at least 4% of risk-weighted assets and must also equal 4% of average assets. Tier 2 Capital generally consists of subordinated debt, other preferred stock, and a limited amount of loan loss reserves. The total amount of Tier 2 Capital is

limited to 100% of Tier 1 Capital. At December 31, 2009 our ratio of total capital to risk-weighted assets was 16.2%, our ratio of Tier 1 Capital to risk-weighted assets was 14.9% and Tier 1 Capital to average assets was 9.0%.

Failure to meet capital guidelines could subject a bank to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and certain other restrictions on its business. As described above, significant additional restrictions can be imposed on FDIC-insured depository institutions that fail to meet applicable capital requirements. See “Prompt Corrective Action.”

Payment of Dividends

The Bank is required by federal law to obtain prior approval of the Office of the Comptroller of the Currency for payments of dividends if the total of all dividends declared by our Board of Directors in any year will exceed (1) the total of the Bank’s net profits for that year, plus (2) the Bank’s retained net profits of the preceding two years, less any required transfers to surplus. In addition, the National Bank Act prohibits the Bank from paying any dividends until the Bank becomes cumulatively profitable.

The payment of dividends by the Bank may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. If, in the opinion of the Office of the Comptroller of the Currency, the Bank were engaged in or about to engage in an unsafe or unsound practice, the Office of the Comptroller of the Currency could require, after notice and a hearing, that the Bank stop or refrain from engaging in the practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution’s capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. See “Prompt Corrective Action.”

Restrictions on Transactions with Affiliates

The Bank is subject to restrictions on extensions of credit to its executive officers, directors, and principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

Proposed Legislation and Regulatory Action

New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating and doing business in the United States. We cannot predict whether, or in what form any, proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

Effect of Governmental Monetary Policies

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Board’s monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks

through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve Board affect the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

ITEM 1A. RISK FACTORS

An investment in our common stock involves risks. If any of the following risks or other risks, which have not been identified or which we may believe are immaterial or unlikely, actually occur, our business, financial condition and results of operations could be harmed. In such a case, the trading price of our common stock could decline, and you may lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

The impact of the current economic environment on performance of other financial institutions in our primary market area, actions taken by our competitors to address the current economic downturn, and public perception of and confidence in the economy generally, and the banking industry specifically, may present significant challenges for us and could adversely affect our performance.

We are operating in a challenging and uncertain economic environment, including generally uncertain national conditions and local conditions in our markets. Financial institutions continue to be affected by sharp declines in the real estate market and constrained financial markets. While we are taking steps to decrease and limit our exposure to real estate construction loans, we nonetheless retain direct exposure to the real estate markets, and we are affected by these events. Continued declines in real estate values and financial stress on borrowers as a result of the uncertain economic environment, including job losses, could have an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations.

The impact of recent events relating to housing and commercial real estate markets has not been limited to those directly involved in the real estate industry, but rather it has impacted a number of related businesses such as building materials suppliers, equipment leasing firms, and real estate attorneys, among others. All of these affected businesses have banking relationships and when their businesses suffer from a recession, the banking relationship suffers as well.

In addition, the market value of the real estate securing our loans as collateral has been adversely affected by the slowing economy and unfavorable changes in economic conditions in our market areas and could be further adversely affected in the future. As of December 31, 2009, approximately 78.6% of our loans receivable were secured by real estate. Any sustained period of increased payment delinquencies, foreclosures or losses caused by the adverse market and economic conditions, including the downturn in the real estate market, in our markets will continue to adversely affect the value of our assets, results of operations and financial condition. Currently, we are experiencing such an economic downturn, and if it continues, our earnings could be further adversely affected.

We are subject to extensive regulation that could limit or restrict our activities.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various regulatory agencies. Our compliance with these regulations is costly and restricts certain of our activities, including the declaration and payment of cash dividends to common shareholders, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid

on deposits, and locations of offices. We are also subject to capitalization guidelines established by our regulators, which require us to maintain adequate capital to support our growth and operations.

The laws and regulations applicable to the banking industry have recently changed and may continue to change, and we cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably.

On June 17, 2009, the Obama administration announced a comprehensive plan for regulatory reform of the financial services industry. The plan set forth five separate initiatives that will be the focus of the regulatory reform, including requiring strong supervision and appropriate regulation of all financial firms, strengthening regulation of core markets and market infrastructure, strengthening consumer protection, strengthening regulatory powers to effectively manage failing institutions and improving international regulatory standards and cooperation. The implications of this plan on our business are unclear at this time, but the plan may adversely affect our business, results of operations and the underlying value of our common stock.

Congress is likely to consider additional proposals to substantially change the financial institution regulatory system and to expand or contract the powers of banking institutions and bank holding companies. Such legislation may change existing banking statutes and regulations, as well as our current operating environment, significantly. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand our permissible activities, or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We cannot predict whether new legislation will be enacted and, if enacted, the effect that it, or any regulations, would have on our business, financial condition, or results of operations.

Our financial condition and results of operations are affected by credit policies of monetary authorities, particularly the Federal Reserve Board. Actions by monetary and fiscal authorities, including the Federal Reserve, could have an adverse effect on our deposit levels, loan demand or business and earnings.

There can be no assurance that these government actions will achieve their purpose. The failure of the financial markets to stabilize, or a continuation or worsening of the current financial market conditions, could have a material adverse effect on our business, our financial condition, the financial condition of our customers, our common stock trading price, as well as our ability to access credit. It could also result in declines in our investment portfolio which could be other-than-temporary impairments.

We may experience increased delinquencies and credit losses, which could have a material adverse effect on our capital, financial condition and results of operations.

Like other lenders, we face the risk that our customers will not repay their loans. A customer's failure to repay us is usually preceded by missed monthly payments. In some instances, however, a customer may declare bankruptcy prior to missing payments, and, following a borrower filing bankruptcy, a lender's recovery of the credit extended is often limited. Since our loans are secured by collateral, we may attempt to seize the collateral when and if customers default on their loans. However, the value of the collateral may not equal the amount of the unpaid loan, and we may be unsuccessful in recovering the remaining balance from our customers. Rising delinquencies and rising rates of bankruptcy in our market area generally and among our customers specifically can be precursors of future charge-offs and may require us to increase our allowance for loan and lease losses. Higher charge-off rates and an increase in

our allowance for loan and lease losses may hurt our overall financial performance if we are unable to increase interest income to compensate for these losses and may also increase our cost of funds.

Continued weakness in residential property values and mortgage loan markets could adversely affect us.

We have a significant number of one-to-four family residential loans, which are secured principally by single-family residences. Loans of this type are generally smaller in size and geographically dispersed throughout our market area. Losses on our residential loan portfolio are difficult to predict because of a number of variables, including interest rates, the unemployment rate, economic conditions, and collateral values. Continued weakness in the secondary market for residential lending could have an adverse impact on our profitability. Pricing may change rapidly, impacting the value of loans in our portfolio. This weakness has been most pronounced in residential construction and development loans; however, turmoil in the mortgage markets, combined with the ongoing correction in real estate markets, could result in further price reductions in single-family home prices and lack of liquidity in refinancing markets. These factors could adversely impact the quality of our residential construction and residential mortgage portfolio in various ways, including creating discrepancies in the value between the original appraisal and the value at time of sale, and decreasing the value of the collateral securing our mortgage loans.

The deterioration in the residential mortgage market may continue to spread to commercial real estate credits, which may result in increased financial and regulatory risks and greater losses and non-performing assets, each of which may have an adverse effect on our business operations.

The losses that were initially associated with subprime residential mortgages rapidly spread into the residential mortgage market. If the losses in the residential mortgage market continue to spread to commercial real estate credits, then we may be forced to take greater losses or retain more non-performing assets. In addition, commercial real estate, or CRE, is cyclical and poses risks of possible loss due to concentration levels and similar risks. As of December 31, 2009, approximately 30.9% of our loan portfolio consisted of CRE loans.

We are subject to liquidity risk in our operations.

Liquidity risk is the possibility of being unable, at a reasonable cost and within acceptable risk tolerances, to pay obligations as they come due, to capitalize on growth opportunities as they arise, or to pay regular dividends because of an inability to liquidate assets or obtain adequate funding on a timely basis. Liquidity is required to fund various obligations, including credit obligations to borrowers, mortgage originations, withdrawals by depositors, repayment of debt, dividends to shareholders, operating expenses, and capital expenditures. Liquidity is derived primarily from retail deposit growth and retention, principal and interest payments on loans and investment securities, net cash provided from operations, and access to other funding sources. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally affect our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption in the financial markets or negative views and expectations about the prospects for the financial services industry as a whole, given the recent turmoil faced by banking organizations in the domestic and worldwide credit markets.

Our decisions regarding credit risk and allowances for loan losses may materially and adversely affect our business.

Making loans and other extensions of credit is an essential element of our business. Although we seek to mitigate risks inherent in lending by adhering to specific underwriting practices, our loans and other extensions of credit may not be repaid. The risk of nonpayment is affected by a number of factors, including:

- the duration of the credit;
- credit risks of a particular customer;
- changes in economic and industry conditions; and
- in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

We attempt to maintain an appropriate allowance for loan losses to provide for potential losses in our loan portfolio. On a quarterly basis, we determine the amount needed in the allowance based on consideration of several factors, including:

- an ongoing review of the quality, mix, and size of our overall loan portfolio;
- our historical loan loss experience;
- evaluation of economic conditions;
- regular reviews of loan delinquencies and loan portfolio quality; and
- the amount and quality of collateral, including guarantees, securing the loans.

There is no precise method of predicting credit losses; therefore, we face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. Additions to the allowance for loan losses would result in a decrease of our net income, and possibly our capital.

Our allowance for loan losses may not be adequate to cover actual loan losses, which may require us to materially increase our allowance, which would adversely impact our financial condition and results of operations.

We maintain an allowance for estimated loan losses that we believe is adequate for absorbing any probable losses in our loan portfolio. Management determines the provision for loan losses based upon an analysis of general market conditions, credit quality of our loan portfolio, and performance of our customers relative to their financial obligations with us. The Bank increased the allowance significantly in 2008 to prepare for the probable losses associated with the purchased participation loans held by the Bank. The majority of the purchased participation loans were charged off during 2009 and are now carried as foreclosed assets on the Bank's balance sheet. Even though we remain in a difficult real estate market and the deterioration of asset quality continues, our allowance has declined from 3.01% of gross loans as of December 31, 2008 to 1.86% as of December 31, 2009 due to the increased charge-offs taken during 2009. Estimates, including the allowance for loan losses, are subject to change in the near term. The determination of the appropriate level of the allowance for loan and lease losses involves a high degree of subjectivity and requires that significant estimates of current risk be made, using existing qualitative and quantitative information, all of which may undergo material changes. The amount of future losses is susceptible to changes in economic, operating, and other conditions, including changes in interest rates, that may be beyond our control, and such losses may exceed the allowance for estimated

loan losses. Additionally, the Office of the Comptroller of the Currency, as an integral part of its supervisory function, periodically reviews the allowance for estimated loan losses. If the Office of the Comptroller of the Currency should require us to increase the allowance for estimated loan losses, it would have a negative effect on our results of operations and financial condition. Although management believes that the allowance for estimated loan losses is adequate to absorb any probable losses on existing loans that may become uncollectible, we routinely adjust our loan portfolio and underwriting standards to reflect current market conditions. We can provide no assurance that our methodology will not change or that the allowance will be sufficient to cover actual loan losses in the future.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.

A significant portion of our loan portfolio is secured by real estate. As of December 31, 2009, approximately 78.66% of our loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A continued weakening of the real estate market in our primary market area could result in an increased number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Acts of nature, including hurricanes, tornados, earthquakes, fires and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition.

We have a high concentration of construction and development loans in our loan portfolio which carry a higher degree of risk than long-term financing of existing properties.

As of December 31, 2009, total construction and development loans amounted to approximately \$3.0 million, or 3.9%, of our total loan portfolio. Included in the \$3.0 million was \$1.4 million outstanding under construction loan facilities, or 46.6% of our construction and development loan portfolio, that were made to commercial construction developers. Construction and development loans generally carry a higher degree of risk than long-term financing of existing properties because repayment depends on the ultimate completion of the project or home and usually on the sale of the property or permanent financing. Specific risks include:

- cost overruns;
- mismanaged construction;
- inferior or improper construction techniques;
- economic changes or downturns during construction;
- rising interest rates that may prevent sale of the property; and
- failure to sell completed projects or units in a timely manner.

The occurrence of any of the preceding risks could result in the deterioration of one or more of these loans which could significantly increase our percentage of non-performing assets. An increase in non-performing loans may result in a loss of earnings from these loans, an increase in the related provision for loan losses, and an increase in charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

Our use of appraisals in deciding whether to make a loan on or secured by real property or how to value such loan in the future may not accurately describe the net value of the real property collateral that we can realize.

In considering whether to make a loan secured by real property, we generally require an appraisal of the property. However, an appraisal is only an estimate of the value of the property at the time the appraisal is made, and, as real estate values in our market area have experienced changes in value in relatively short periods of time, this estimate might not accurately describe the net value of the real property collateral after the loan has been closed. If the appraisal does not reflect the amount that may be obtained upon any sale or foreclosure of the property, we may not realize an amount equal to the indebtedness secured by the property. The valuation of the property may negatively impact the continuing value of such loans and could adversely affect our operating results and financial condition.

Continuation of the economic downturn could reduce our customer base, our level of deposits, and demand for financial products such as loans.

Our success significantly depends upon the growth in population, income levels, deposits, and housing starts in our markets. The current economic downturn has negatively affected the markets in which we operate and, in turn, the quality of our loan portfolio. If the communities in which we operate do not grow or if prevailing economic conditions locally or nationally remain unfavorable, our business may not succeed. A continuation of the economic downturn or prolonged recession would likely result in the continued deterioration of the quality of our loan portfolio and reduce our level of deposits, which in turn would hurt our business. Interest received on loans represented approximately 84.4% of our interest income for the year ended December 31, 2009. If the economic downturn continues or a prolonged economic recession occurs in the economy as a whole, borrowers will be less likely to repay their loans as scheduled. Moreover, in many cases the value of real estate or other collateral that secures our loans has been adversely affected by the economic conditions and could continue to be negatively affected. Unlike many larger institutions, we are not able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. A continued economic downturn could, therefore, result in losses that materially and adversely affect our business.

Our small- to medium-sized business target markets may have fewer financial resources to weather a downturn in the economy.

We target the banking and financial services needs of small- and medium-sized businesses. These businesses generally have fewer financial resources in terms of capital borrowing capacity than larger entities. If general economic conditions continue to negatively impact these businesses in the markets in which we operate, our business, financial condition, and results of operation may be adversely affected.

The FDIC Deposit Insurance assessments that we are required to pay may continue to materially increase in the future, which would have an adverse effect on our earnings.

As a member institution of the FDIC, we are assessed a quarterly deposit insurance premium. Failed banks nationwide have significantly depleted the insurance fund and reduced the ratio of reserves to insured deposits. As a result, we may be required to pay significantly higher premiums or additional special assessments that could adversely affect our earnings.

On April 1, 2009, the FDIC modified the risk-based assessments to account for each institution's unsecured debt, secured liabilities and use of brokered deposits. Starting with the second quarter of 2009, assessment rates were increased and currently range from 7 to 77.5 basis points (annualized).

On September 29, 2009, the FDIC announced a uniform three basis points increase effective January 1, 2011, and on November 12, 2009, adopted a rule requiring depository institutions to prepay, in lieu of further special assessments, their assessments for the fourth quarter 2009 and the three years thereafter. Due to the recent increases in the assessment rates and the required prepayment, at the end of 2009, we were required to pay approximately \$586 thousand to the DIF on December 30, 2009.

Further increased FDIC assessment premiums, whether due to our risk classification, emergency assessments, or another uniform increase, could adversely impact our earnings.

If we fail to retain our key employees, our growth and profitability could be adversely affected.

Our success is, and is expected to remain, highly dependent on our executive management team, consisting of Samuel F. Grigsby, Jr., our Chairman and Chief Executive Officer, Charles A. Hughes, our President, Darwin K. Kilday, our Executive Vice President and Chief Financial Officer, and M. Edward Stiner, Jr., our Jefferson County Regional President. This is particularly true because, as a community bank, we depend on our management team's ties to the community to generate business for us. Our growth will continue to place significant demands on our management, and the loss of any such person's services may have an adverse effect upon our growth and profitability.

We face strong competition for customers, which could prevent us from obtaining customers and may cause us to pay higher interest rates to attract customers.

The banking business is highly competitive, and we experience competition in our market from many other financial institutions. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other mutual funds, as well as other super-regional, national, and international financial institutions that operate offices in our primary market areas and elsewhere. We compete with these institutions both in attracting deposits and in making loans. In addition, we have to attract our client base from other existing financial institutions and from new residents. Many of our competitors are well-established, larger financial institutions. These institutions offer some services, such as extensive and established branch networks, that we do not currently provide. Also, a number of community banks are entering our primary service area. They include de novo banks and branches of established banking operations, both headquartered in-market as well as out-of-market. As is the case with other financial service providers, they are attracted to our primary service area's demographic trends and growing deposit base. There is a risk that we will not be able to compete successfully with other financial institutions in our market, and that we may have to pay higher interest rates to attract deposits, resulting in reduced profitability. In addition, competitors that are not depository institutions are generally not subject to the extensive regulations that apply to us.

We are subject to extensive regulation that could limit or restrict our activities. This regulation is for protection of the Bank's depositors and not for the investors.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various regulatory agencies. Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits, and locations of offices. We are also subject to capitalization guidelines established by our regulators, which require us to maintain adequate capital to support our growth.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability. Because government

regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably.

Although we are subject to extensive and comprehensive regulation by the OCC, the OCC's purpose is to protect and insure the interests and deposits of our depositors, and does not consider preserving or maximizing the investment made by the Bank's investors when regulating the Bank's activities.

We will face risks with respect to future expansion and acquisitions or mergers.

Although we do not have any current plans to do so, we may seek to acquire other financial institutions or parts of those institutions. We may also expand into new markets or lines of business or offer new products or services. These activities would involve a number of risks, including:

- taking additional time and creating expense associated with identifying and evaluating potential acquisitions and merger partners;
- using inaccurate estimates and judgments to evaluate credit, operations, management, and market risks with respect to the target institution or assets;
- diluting our existing shareholders in an acquisition;
- taking additional time and creating expense associated with evaluating new markets for expansion, hiring experienced local management, and opening new offices, as there may be a substantial time lag between these activities before we generate sufficient assets and deposits to support the costs of the expansion;
- taking a significant amount of time negotiating a transaction or working on expansion plans, resulting in management's attention being diverted from the operation of our existing business;
- taking time and creating expense integrating the operations and personnel of the combined businesses;
- creating an adverse short-term effect on our results of operations; and
- losing key employees and customers as a result of an acquisition that is poorly received.

We have never acquired another institution before, so we lack experience in handling any of these risks. There is also a risk that any expansion effort will not be successful.

Changes in the interest rate environment could reduce our net interest income, which could reduce our profitability.

As a financial institution, our earnings significantly depend on our net interest income, which is the difference between the interest income that we earn on interest-earning assets, such as investment securities and loans, and the interest expense that we pay on interest-bearing liabilities, such as deposits and borrowings. Therefore, any change in general market interest rates, including changes in the Federal Reserve Board's fiscal and monetary policies, affects us more than non-financial institutions and can have a significant effect on our net interest income and total income. Our assets and liabilities may react differently to changes in overall market rates or conditions because there may be mismatches between the repricing or maturity characteristics of the assets and liabilities. As a result, an increase or decrease in market interest rates could have material adverse effects on our net interest margin and results of operations.

In addition, we cannot predict whether interest rates will continue to remain at present levels. Changes in interest rates may cause significant changes in our net interest income. Depending on our portfolio of loans and investments, our results of operations may be adversely affected by changes in interest rates. In addition, any significant increase in prevailing interest rates could adversely affect our mortgage banking business because higher interest rates could cause customers to request fewer refinancings and purchase money mortgage originations.

Our ability to pay dividends is limited and we may be unable to pay future dividends. As a result, capital appreciation, if any, of our common stock may be your sole opportunity for gains on your investment for the foreseeable future.

We make no assurances that we will pay any dividends in the future. Any future determination relating to dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition, future prospects, regulatory restrictions and other factors that our Board of Directors may deem relevant. The holders of our common stock are entitled to receive dividends when, and if, declared by our Board of Directors out of funds legally available for that purpose. As part of our consideration to pay cash dividends, we intend to retain adequate funds from future earnings to support the development and growth of our business. In addition, our ability to pay dividends is restricted by federal policies and regulations. Under federal law, approval of the Office of the Comptroller of the Currency is required prior to paying dividends in any year that would exceed the total of our net profit for that year plus our retained net profits for the two preceding years. Under the National Bank Act, we cannot pay any dividends until and unless we obtain cumulative profitability.

Our directors and executive officers own a significant portion of our common stock and can influence stockholder decisions.

Our directors and executive officers, as a group, beneficially owned approximately 25% of our fully diluted outstanding common stock as of December 31, 2009. As a result of their ownership, the directors and executive officers would have the ability, if they voted their shares in concert, to influence the outcome of all matters submitted to our shareholders for approval, including the election of directors. We cannot assure you that the interests of our directors and executive officers will always align precisely with your interests as a holder of our common stock.

Environmental liability associated with lending activities could result in losses.

In the course of our business, we may foreclose on and take title to properties securing our loans. If hazardous substances are discovered on any of these properties, we may be liable to governmental entities or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether we knew of, or were responsible for, the contamination. In addition, if we arrange for the disposal of hazardous or toxic substances at another site, we may be liable for the costs of cleaning up and removing those substances from the site, even if we neither own nor operate the disposal site. Environmental laws may require us to incur substantial expenses and may materially limit the use of properties that we acquire through foreclosure, reduce their value or limit our ability to sell them in the event of a default on the loans they secure. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability.

We are exposed to the possibility of technology failure.

We rely on our computer systems and the technology of outside service providers. Our daily operations depend on the operational effectiveness of their technology. We rely on our systems to accurately track and record our assets and liabilities. If our computer systems or outside technology sources become unreliable, fail, or experience a breach of security, our ability to maintain accurate financial records may be impaired, which could materially affect our business operations and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTY

The following table summarizes information about our offices as of December 31, 2009.

<u>Office Location</u>	<u>Year Opened</u>	<u>Approximate Square Footage</u>	<u>Owned Or Leased</u>
<u>Main Office</u> 225 West First North Street Morristown, Tennessee 37816	2003	11,000	Leased
<u>Jefferson City Branch</u> 156 East Broadway Jefferson City, Tennessee 37760	2003	5,000	Owned
<u>Morristown Branch</u> 2640 West Andrew Johnson Highway P.O. Box 1919 Morristown, Tennessee 37816	2008	2,800	Owned

Other than normal real estate commercial lending activities, the acquisition of mortgage-related securities the Bank may hold in its investment securities portfolio, the ownership of branch office facilities and consumer mortgage lending, the Bank does not invest in real estate, interests in real estate, or securities of or interests in persons primarily engaged in real estate activities.

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which the Bank is a party or of which any of its properties are subject, nor are there material proceedings known to the Bank to be contemplated by any governmental authority. Additionally, the Bank is unaware of any material proceedings, pending or contemplated, in which any existing or proposed director, officer or affiliate, or any principal security holder of the Bank or any associate of any of the foregoing, is a party or has an interest adverse to the Bank.

ITEM 4. [RESERVED]

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The response to this Item is included in the Bank's 2009 Annual Report to Shareholders under the heading "Market for our Common Equity and Related Matters" and is incorporated herein by reference. The 2009 Annual Report to Shareholders is included as Exhibit 13.1 to this Annual Report on Form 10-K.

ITEM 6. SELECTED FINANCIAL DATA

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

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The response to this Item is included in the Bank's 2009 Annual Report to Shareholders under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

ITEM 7A. 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 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements, schedule and related reports are included in the Bank's 2009 Annual Report to Shareholders, and are incorporated herein by reference:

1. Report of Independent Registered Accounting Firm
2. Financial Statements:
 - (a) Balance Sheet dated as of December 31, 2009 and 2008.
 - (b) Statements of Operations for the years ended December 31, 2009 and 2008.
 - (c) Statements of Comprehensive Loss for the years ended December 31, 2009 and 2008.
 - (d) Statements of Changes in Stockholders' Equity for the years ended December 31, 2009 and 2008.
 - (e) Statements of Cash Flows for the years ended December 31, 2009 and 2008.
 - (f) Notes to Financial Statements.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A(T). CONTROLS AND PROCEDURES

Disclosure Controls

As of the end of the period covered by this Annual Report on Form 10-K, 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 Annual 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 error 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.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition, transactions are executed in accordance with appropriate management authorization and accounting records are reliable for the preparation of financial statements in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. Management based this assessment on criteria for effective internal control over financial reporting described in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management’s assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting.

Based on this assessment, management believes that Community National Bank of the Lakeway Area maintained effective internal control over financial reporting as of December 31, 2009.

This annual report does not include an attestation report of the Bank's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission and the Office of the Comptroller of the Currency that permit the Bank to provide only management's report in this annual report.

Changes to Internal Control Over Financial Reporting

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

ITEM 9B. OTHER INFORMATION

Not Applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The response to this Item is partially included in the Bank's Proxy Statement for the Annual Meeting of Shareholders to be held June 21, 2010 under the headings "Proposal Three: Electing Directors," "Information about Community National Bank -- Section 16(a) Beneficial Ownership Reporting Compliance," and "Information about Community National Bank -- Executive Officers" and is incorporated herein by reference.

The Bank has adopted a Code of Ethics that applies to its employees, directors and principal executive, financial and accounting officers. The Code of Ethics has been posted to the Bank's website at www.cnbla.com. A copy may also be obtained, without charge, upon written request addressed to Community National Bank of the Lakeway Area, 225 West First North Street, Morristown, Tennessee, 37814, Attn: Bank Secretary. The request may be delivered by letter to the address set forth above or by fax to the attention of the Bank's Secretary at (423) 317-3250.

ITEM 11. EXECUTIVE COMPENSATION

The response to this Item is included in the Bank's Proxy Statement for the Annual Meeting of Shareholders to be held June 21, 2010 under the headings "Information about Community National Bank -- Executive Compensation" and "Proposal Three: Electing Directors -- Director Compensation" and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The response to this Item is partially included in the Bank's Proxy Statement for the Annual Meeting of Shareholders to be held June 21, 2010 under the heading "Information about Community

National Bank -- Security Ownership of Certain Beneficial Owners and Management” and is incorporated herein by reference.

The table below sets forth information regarding shares of the Bank’s common stock authorized for issuance under the 2002 Stock Incentive Plan, as of December 31, 2009. The 2002 Stock Incentive Plan was approved by shareholders on April 4, 2003.

Equity Compensation Plan Information			
Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding outstanding options, warrants and rights)
Equity compensation plans approved by security holders	123,250	\$13.50	17,750
Equity compensation plans not approved by security holders	--	--	-0-
Total	123,250	\$13.50	17,750

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The response to this Item is included in the Bank’s Proxy Statement for the Annual Meeting of Shareholders to be held June 21, 2010 under the headings “Information about Community National Bank -- Related Party Transactions” and “Proposal Three: Electing Directors – Director Independence” and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The response to this Item is included in the Bank’s Proxy Statement for the Annual Meeting of Shareholders to be held June 21, 2010, under the heading “Audit Committee Matters –Audit Fees” and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS

The following documents are filed as part of this report:

Exhibit Number	Description
3.1	Articles of Association ¹
3.2	Articles of Amendment to the Articles of Association ²
3.3	Amended and Restated Bylaws ³

¹ Incorporated by reference to the Registrant’s Registration Statement on Form SB-2 (File No. 2002-SE-01-008).

² Incorporated by reference to Exhibit 3.2 of the Registrant’s Annual Report on Form 10-K for the Year Ended December 31, 2007.

³ Incorporated by reference to the Registrant’s Current Report on Form 8-K, dated August 20, 2007.

- 4.1 Form of Stock Certificate ¹
- 4.2 See Exhibits 3.1, 3.2, and 3.3 for provisions of the Articles of Association and Bylaws defining rights of holders of the Common Stock
- 10.1 [†] Employment Agreement with Samuel F. Grigsby, Jr. ⁴
- 10.2 [†] Employment Agreement with Charles A. Hughes ⁵
- 10.3 [†] Employment Agreement with Darwin Kilday ⁶
- 10.4 [†] Employment Agreement with Edward Stiner ⁷
- 10.5 [†] Employment Agreement with Thomas D. Rush, Jr. ⁸
- 10.6 [†] 2002 Stock Option Plan ¹
- 10.7 [†] Incentive Stock Option Agreement ¹
- 10.8 [†] Non-Statutory Stock Option Agreement ¹
- 10.9 Stock Option Agreement for Organizers who will be Directors ¹
- 10.10 Stock Option Agreement for Founders and Organizers who will not be Directors ¹
- 13.1 Community National Bank of the Lakeway Area's 2009 Annual Report to Shareholders. Except with respect to those portions specifically incorporated by reference into this Report, the Annual Report to Shareholders is not deemed to be filed as part of this Report.
- 23.1 Consent of Pershing Yoakley & Associates, P.C.
- 24.1 Power of Attorney (filed as part of the signature page).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a)
- 32.1 Certifications pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

[†] Indicates management contract or compensatory plan or arrangement.

⁴ Incorporated by reference to Exhibit 10.1 of the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 2008.

⁵ Incorporated by reference to Exhibit 10.2 of the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 2008.

⁶ Incorporated by reference to Exhibit 10.3 of the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 2008.

⁷ Incorporated by reference to Exhibit 10.4 of the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 2008.

⁸ Incorporated by reference to Exhibit 10.5 of the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 2008.

/s/ Thomas D. Rush, Jr.
Thomas D. Rush, Jr.

Director

/s/ M. Edward Stiner, Jr.
M. Edward Stiner, Jr.

Director

/s/ Eric N. Ward
Eric N. Ward

Director

/s/ Donald Watson
Donald Watson

Director

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**Excerpts from
Community National Bank of the Lakeway Area
Annual Report**

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following presents management's discussion and analysis of our financial condition and results of operations. You should read this discussion in conjunction with our financial statements and related notes that are included elsewhere in this Annual Report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ significantly from those described in the forward-looking statements as a result of various factors, including those discussed under the caption "Risk Factors" continued in our Annual Report on Form 10-K and "Special Note Regarding Forward-Looking Statements" in this Annual Report. This discussion is intended to assist in understanding our financial condition and results of operations. The data presented for the periods ended December 31, 2009 and 2008 are derived from our audited financial statements and include, in the opinion of management, all adjustments necessary to present fairly the data for such periods.

Forward-Looking Statements

This Annual 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," "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.

Critical Accounting Policies and Estimates

The accounting and reporting policies of the Bank are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. Our significant accounting policies are discussed in detail in Note 1 in the “Notes to Financial Statements.” Critical accounting policies include the initial adoption of an accounting policy that has a material impact on the financial presentation and accounting estimates reflected in the financial statements that require the Bank to make assumptions about matters that were highly uncertain at the time of estimation. Disclosure about critical estimates is required if different estimates that the Bank reasonably could have used in the current period would have a material impact on the presentation of the Bank’s financial condition, changes in financial condition or results of operations.

The Bank’s calculation related to the allowance for loan losses represents a critical accounting estimate. The allowance for loan losses is established and maintained at levels management deems adequate to cover probable losses inherent in the portfolio as of the balance sheet date. The level is based on past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay, underlying estimated values of collateral securing loans, current economic conditions, regulatory requirements and other factors. Should any of these factors change, the estimate of credit losses in the loan portfolio and the related allowance would also change. For further discussion regarding our methodology for the allowance for loan and lease losses, see the “Allowance and Provisions for Loan Losses” section of this management’s discussion and analysis.

Results of Operations for the Years Ended December 31, 2009 and 2008

Overview. The Bank reported a loss of \$(2.38) million or \$(1.26) per share for the year ended December 31, 2009. This compares to a loss of \$(1.66) million or \$(0.88) per share for the year ended December 31, 2008. The loss for 2009 was attributable to a large provision for loan losses during the year of \$1.1 million; and the write down of other real estate owned by the Bank of \$397 thousand. In addition to the large loan loss provision and the write down of foreclosed properties incurred during the second quarter, the Bank incurred a loss of \$1.3 million due to the impairment charge related to the Bank’s equity investment in Silverton Financial Services, Inc. (Silverton Bank), which was placed into receivership on May 1, 2009, and losses associated with trust preferred securities issued by Silverton Bank classified as available for sale securities by the Bank. The Bank does not have any equity investments in other correspondent banks.

Net Interest Income. For the years ended December 31, 2009 and December 31, 2008, net interest income totaled \$3.7 million (including loan fees). The largest component of interest income is interest income from loans, including loan fees, which totaled \$5.3 million, representing a yield of 6.66% for 2009, and \$5.4 million, representing a yield of 6.96% for 2008. Interest expense for the year ended December 31, 2009 totaled \$2.6 million. For the year ended December 31, 2008 interest expense totaled \$2.9 million. The net interest margin realized on earning assets and the interest rate spread were 3.35% and 3.05% respectively, for the year ended December 31, 2009 as compared to 3.48% and 2.88%, respectively, for the year ended December 31, 2008. Net interest income declined approximately \$46 thousand during 2009.

While the net change in interest income for the year was minimal, there were several fluctuations in the individual components making up net interest income. Interest income on loans was down for the year approximately \$92 thousand primarily because of declining demand. Interest received on investment securities also declined \$263 thousand from \$1.2 million for the year ended December 31, 2008 to \$916 thousand for the year ended December 31, 2009. The decline in investment interest is rate driven as the Bank has had excess liquidity and chose to invest primarily in short-term agency securities. The actual balance in investment securities available for sale was up significantly for the year. The third component of interest income was interest on Federal Funds Sold. Again, balances were up for 2009 versus 2008, but income was down \$70 thousand, from \$124 thousand in 2008 to \$54 thousand in 2009. During the year ended December 31, 2009, daily overnight rates have averaged around 0.25%.

Like interest income, the components of interest expense also had several fluctuations from 2008 to 2009. Deposit interest declined from \$2.4 million for the year ended December 31, 2008 to \$2.2 million for the same period in 2009. Deposit balances increased during the year; however, overall rates declined significantly. Time deposit yields declined from 4.07% for the year ended December 31, 2008 to 3.16% for the year ended December 31, 2009. Likewise, savings and money market deposits declined from 2.10% to 1.25%, FHLB Advances from 4.07% to 3.57% and other deposits from 1.84% to 0.25% for the same period. The yield on interest-bearing demand accounts increased from 0.43% for the year ended December 31, 2008 to 2.68% for the year ended December 31, 2009. This was a result of the introduction of a new Community Rewards Checking product during the year.

Provision for Loan Losses. The provision for loan losses is the charge to operating earnings that management estimates is necessary to maintain the allowance for loan losses at an adequate level. The provision charged to expense was \$1.1 million for the year ended December 31, 2009 as compared to \$1.9 million for the year ended December 31, 2008. The provision is a result of management's efforts to increase the allowance to match the risk in the loan portfolio. The provision for 2009 was primarily due to increased charge offs of several purchased participations, which the Bank had partially prepared for with a large loss provision in 2008. Due to the uncertain economic environment, management increased the amount of allowance on classified credits in an effort to adequately reserve for potential/existing problem credits. The allowance for loan losses was 1.86% of gross loans at December 31, 2009 as compared to 3.01% at December 31, 2008.

There are risks inherent in making all loans, including risks with respect to the period of time over which loans may be repaid, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers, and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral. We anticipate maintaining an allowance for loan losses based on, among other things, historical experience, an evaluation of economic conditions, and regular reviews of delinquencies and loan portfolio quality. Our judgment about the adequacy of the allowance is based upon a number of assumptions about future events, which we believe to be reasonable, but which may not prove to be accurate. Thus, there is a risk that charge-offs in future periods could exceed the allowance for loan losses or that substantial additional increases in the allowance for loan losses could be required. Additions to the allowance for loan losses resulted in a decrease in our net income and our capital. The Bank had net charge-offs for 2009 of \$2.2 million as compared to \$125.0 thousand for 2008. Of the \$2.2 million charged off, \$1.9 million related to purchased participation loans while \$277 thousand related to Bank originated loans. There were no loans over ninety days past due and still accruing interest at December 31, 2009. The Bank had one loan totaling \$174 thousand ninety days or more past due and still accruing interest at December 31, 2008. The Bank also had foreclosed real estate at December 31, 2009 with a carrying value of \$1.8 million compared to \$322 thousand at December 31, 2008.

Noninterest Income. The Bank's noninterest income is composed of several components, some of which may vary significantly between quarterly and annual periods. Service charges on deposit accounts and other noninterest income generally will reflect the growth of the Bank while other areas, such as secondary market loan origination fees, will depend on market conditions.

The following is the makeup of our noninterest income for the years ended December 31, 2009 and 2008:

	Years Ended December 31,		2009-2008 Percent Increase (Decrease)
	2009	2008	
Noninterest income:	(Dollars in thousands)		
Service charges on deposit accounts	\$ 344	\$ 300	14.7%
Commissions on loans originated for others	30	35	(14.3)%
Net gain on sales of securities available for sale and equity investments	0	52	(100.0)%
Other noninterest income:			
Merchant credit card fees	1	3	(66.7)%
Credit insurance fees	6	10	(40.0)%
Network interchange fees	94	63	49.2%
Safe deposit box rental fees	7	7	0.0%
Rental income	9	8	12.5%
Other noninterest income	20	17	17.6%
Total noninterest income	<u>\$ 511</u>	<u>\$ 495</u>	<u>3.2%</u>

Noninterest income increased \$16 thousand, or 3.2% for the year ended December 31, 2009 compared to \$92 thousand, or 22.8% for the year ended December 31, 2008. The increase was primarily attributable to increases in service charges on deposit accounts which increased \$44 thousand or 14.7% over 2008. Network interchange fees also increased for the year by \$31 thousand or 49.2%. The major component of the service charges on deposit accounts is insufficient funds fees, which totaled \$297 thousand or 58.1% of total noninterest income.

Through the associations with various mortgage-lending companies, the Bank originates and sells, on the secondary market, fixed and variable rate residential and commercial long-term mortgages, earning fees for the loans originated. Fees on secondary market loans sold were down \$5 thousand or 14.3% from the \$35 thousand reported in 2008. While rates have remained low for fixed rate mortgage products, the demand in the local market continued to be weak for 2009.

During 2009, the Bank had a net loss on the sale of securities available for sale and held to maturity of \$91 thousand compared to \$52 thousand in gains for the year ended December 31, 2008. The Bank recorded an impairment loss relating to an equity investment in Silverton Bank of \$1.1 million during 2009. These losses are discussed in the noninterest expense section below. Management sold the majority of the mortgage backed securities portfolio comprised of FNMA and FHLMC securities and replaced them with GNMA securities that carry a lower capital risk weighting.

Noninterest Expenses. Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, and other operating expenses. The following is the makeup of our noninterest expense for the years ended December 31, 2009 and 2008:

	Years Ended December 31,		2009-2008 Percent Increase (Decrease)
	2009	2008	
Noninterest expense:	(Dollars in thousands)		
Salaries and employee benefits			
Salaries	\$ 1,483	\$ 1,527	(2.9)%
Payroll taxes	124	125	(0.8)%
Group insurance	150	169	(11.2)%
Other employee benefits	44	71	(38.0)%
Total salaries and employee benefits	<u>1,801</u>	<u>1,892</u>	<u>(4.8)%</u>
Occupancy expense	778	759	2.5%
Data processing	302	259	16.6%
Office supplies and postage	93	128	(27.3)%
Advertising and promotion	99	318	(68.9)%
Legal and other professional	352	309	13.9%
Net loss on the sales of securities available for sale and held to maturity	91	0	100.0%
Loss on impaired equity investments	1,129	0	100.0%
Loss on the sale of foreclosed assets	73	14	80.8%
Other noninterest expense:			
Directors' fees	0	101	(100.0)%
Loan related expenses	171	127	34.6%
Foreclosed assets valuation allowance	397	48	727.1%
Insurance, including FDIC assessments	243	125	94.4%
Other noninterest expense	234	196	11.4%
Total other noninterest expense	<u>1,045</u>	<u>597</u>	<u>71.0%</u>
Total noninterest expense	<u>\$ 5,763</u>	<u>\$ 4,276</u>	<u>34.8%</u>

Total noninterest expense increased from \$4.3 million in 2008 to \$5.8 million in 2009. The largest dollar increase in noninterest expense was in the loss on impaired equity investments. This line item was \$1.1 million for 2009 and related to the Bank's impaired equity investment in Silverton Bank. Another significant increase during the year was in the foreclosed assets valuation allowance which increased from \$48 thousand in 2008 to \$397 thousand in 2009. This expense was incurred as a result of lowering carrying values on certain Bank owned properties. Insurance, including FDIC assessments, also increased from \$125 thousand for the year ended December 31, 2008 to \$243 thousand for 2009. This increase was primarily the result of a special assessment to help recapitalize the insurance fund due to bank closures during the year.

Management has and continues to work on reducing controllable expenses. Salaries have declined slightly and should continue to do so in 2010 through attrition. Also, directors' fees have been eliminated for the foreseeable future. Advertising declined from \$318 thousand in 2008 to \$99 thousand for the year ended December 31, 2009.

Occupancy costs increased approximately \$19 thousand from \$759 thousand in 2008 to \$778 thousand in 2009. The largest increase in occupancy expense was in depreciation expense associated with the new West Morristown branch. Depreciation increased \$31 thousand, from \$241 thousand in 2008 to \$273 thousand in 2009. Maintenance contract expense also increased \$12 thousand from \$91 thousand in

2008 to \$103 thousand in 2009. Several components of occupancy expense declined during the year; the largest decline being in rent expense as a result of the completion of the new branch which eliminated the rental of a temporary facility.

Legal and Professional fees also increased \$43 thousand during the year, from \$309 thousand in 2008 to \$352 thousand in 2009. The majority of the increase in this category was in legal fees, which increased \$71 thousand during 2009. The increase in legal fees stemmed primarily from increased expenses relating to our nonperforming assets and from expense relating to the Board's consideration of several strategic alternatives over the past year. The \$43 thousand increase in legal fees was partially offset by a decline in outside service fees of \$24 thousand. The decline in outside service fees was primarily due to the contract cancellation on a loan pricing system.

Advertising and promotional expense declined \$219 thousand for the year ended December 31, 2009 to \$99 thousand from \$318 thousand for the year ended December 31, 2008. Every component of the marketing budget was cut for 2009, including advertising by \$187 thousand, promotions by \$23 thousand, charitable contributions by \$4 thousand, and entertainment by \$5 thousand.

The Bank incurred approximately \$397 thousand in expense as a result of establishing a valuation allowance which lowered the carrying values of other real estate owned (OREO) based on current contractual or market information. This compares to \$48 thousand for 2008. Other noninterest expense increased \$97 thousand during the year from \$551 thousand in 2008 to \$648 thousand in 2009. There were several components that had significant increases during the year. The expense of maintaining the OREO increased from \$20 thousand in 2008 to \$82 thousand in 2009. Other large increases were in the FDIC insurance assessment which increased \$114 thousand from \$64 thousand in 2008 to \$178 thousand in 2009. This increase was a result of higher insurance rates for 2009 and a special assessment to help restore the insurance fund totaling \$49 thousand paid September 30, 2009.

Several items declined to help offset the increases in noninterest expense listed above. Directors' fees were suspended, resulting in a savings of \$101 thousand dollars for the year. Supplies and postage declined \$35 thousand for year from \$128 thousand in 2008 to \$93 thousand in 2009.

One area of concern for 2010 and beyond is the costs associated with compliance, especially with Sarbanes-Oxley (SOX) legislation. While SEC non-accelerated filers such as the Bank have been granted additional time to comply with the regulations, the Bank had to provide management's assessment of the effectiveness of internal controls over financial reporting as of December 31, 2007, and the Bank's external audit firm will have to provide its opinion of management's assertion regarding the effectiveness of internal controls over financial reporting when SOX section 404(b) becomes effective for non-accelerated filers. On December 2, 2009, the SEC amended temporary rules related to the effective date for non-accelerated filers to comply with SOX Section 404(b), making this section effective for the year ending December 31, 2010, unless the SEC provides further extensions. The Bank has been able to keep the costs of compliance to a relatively low level to date, but this could increase significantly going forward.

Barring any special assessments, noninterest expense should decline in 2010. Management continues to look at all operating costs to determine where cuts can be made.

Provision for Income Taxes. During the year ended December 31, 2009 the Bank recorded a deferred tax benefit of \$331 thousand as compared to \$345 thousand during 2008. The Bank had state and federal net operating loss carryforwards of \$7.6 million and \$6.5 million, respectively at December 31, 2009. These carryforwards resulted from start-up expenses of the Bank and net operating losses in the first few years of operation as well as the years ended December 31, 2008 and 2009. The decision to record the deferred tax benefit is based on management's belief that the Bank will have future taxable income sufficient to utilize the tax benefit within the carryforward period under federal and state laws. Management maintained a 56% valuation allowance of \$1.7 million, related to the net deferred tax asset, at the end of 2009, and will continue to maintain a valuation allowance until it is more likely than not that future earnings will be sufficient to use the tax benefit in the required time frame. At December 31, 2008,

management maintained a 50% valuation allowance or \$976 thousand. For a further explanation of the deferred tax benefit see note 8 in the financial statements.

Discussion of Financial Condition at December 31, 2009 and 2008

Community National Bank of the Lakeway Area's total assets at December 31, 2009 were \$124.8 million, an increase of \$6.7 million or 5.7% from December 31, 2008. The majority of the asset growth was in the Bank's investment portfolio.

Total securities at December 31, 2009 were \$33.6 million as compared to \$26.4 million at December 31, 2008. The portfolio is classified as either available for sale or held to maturity. At December 31, 2009 the Bank did not have any investments classified as held to maturity. The held to maturity portfolio at December 31, 2008 was reported at amortized cost and consisted of \$3.7 million of mortgage-backed securities. The available for sale portfolio at December 31, 2009 was \$33.6 million compared to \$22.7 million for 2008. The \$33.6 million is comprised of 53.8% U.S. Government Agency securities and 46.2% GNMA asset-backed securities. The portfolio increased during the year as a result of increased funding from the deposit portfolio and unexpected early payments in the loan portfolio. The Bank began a restructuring of the investment portfolio during the fourth quarter of 2008 which was completed during the first quarter of 2009. This restructuring removed the mortgage-backed security portfolio comprised of FNMA and FHLMC securities, and replaced them with GNMA securities with lower capital risk weightings. Investment securities are an important tool used to manage the interest rate sensitivity and liquidity of the Bank.

Net loans for the period ended December 31, 2009 decreased \$5.5 million to \$75.8 million as compared to \$81.3 million at December 31, 2008. This represents a decline during the period of approximately 6.8%. Gross loans for the period decreased 7.9% to \$77.2 million from \$83.8 million at December 31, 2008. Lower demand, coupled with the movement of a portion of the portfolio into OREO, accounted for the decline. Much of the decline in gross loans was reallocated into other assets, including our available for sale securities.

The allowance for loan losses at December 31, 2009 was \$1.4 million or 1.86% of gross loans. This compares to \$2.5 million or 3.01% of gross loans at December 31, 2008. The decline in both dollar and percentage of gross loans was a result of the Bank preparing in 2008 for the charge-off of several purchased participations that occurred in 2009. Also, nonaccrual loans declined from \$4.0 million as of December 31, 2008 to \$2.0 million as of December 31, 2009. Actual net charge-offs for the year were \$2.2 million, up significantly from the \$125 thousand reported in 2008. Of the \$2.2 million in net charge-offs during 2009, \$1.9 million was related to purchased participations while \$277 thousand was attributable to the locally generated portfolio. Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses. Provisions are made to the allowance in order to maintain a level adequate to absorb anticipated loan losses.

The \$2.0 million of nonaccrual loans at December 31, 2009 was comprised of \$1.1 million in Bank originated loans and \$888 thousand in purchased participations that are real estate secured and located in the market area. With declines in the local, regional, and national economies, it will most likely take an extensive period of time to work out the nonaccrual loans. Management continues to receive monthly updates from the lead banks on the purchased participations and adjusts the allowance for loan losses accordingly as collateral values and conditions change.

Interest receivable, deferred tax benefit, foreclosed assets, prepaid banking agency assessments and other assets increased during the period from \$2.0 million at December 31, 2008 to \$4.5 million at December 31, 2009. The increase is primarily due to the recording of the net deferred tax benefit of \$353 thousand related to the current year's loss, an increase in foreclosed properties of \$1.5 million primarily related to the foreclosure of purchased participations, and an increase in prepaid banking agency assessments of \$586 thousand comprised of the new prepaid FDIC assessment. Equity investments for the period declined from \$2.0 million to \$830 thousand primarily due to the \$1.1 million loss recorded as a result of the write-off of the Silverton Bank stock.

Premises and equipment declined during the year from \$3.3 million to \$3.0 million. The nearly \$300 thousand decrease is primarily the result of depreciation expense of \$273 thousand during the year.

At December 31, 2009, deposits totaled \$98.9 million, an increase of \$6.5 million from the \$92.4 million reported in 2008. Noninterest-bearing demand deposits were \$9.0 million or 9.1% of total deposits and interest-bearing deposits were \$89.9 million or 90.9% of total deposits. The deposit mix changed during the year as a result of the introduction of a new Community Rewards Checking product. Interest-bearing checking accounts increased during the year from \$6.1 million in 2008 to \$22.9 million in 2009. Time deposits greater than \$100 thousand declined \$9.0 million due to brokered certificates of deposit maturing but not being renewed.

The Community Rewards Checking product was introduced during the fourth quarter of 2008. The Bank was the first in the local market to introduce the new Community Rewards Checking product. This checking product paid a rate of 4.51% on balances up to \$25,000 initially. The customer is rewarded with the higher rate for taking advantage of various electronic banking elements that afford the Bank significant savings in operating costs. The product has been very popular and has become the main source of deposit growth for the Bank. The Bank informed customers that the rate would be reduced beginning in January 2010 to 3.76%. Since the end of 2008, similar products have been introduced by competitors.

Stockholders' equity totaled \$12.4 million at December 31, 2009, a decline of \$2.5 million from the \$14.9 million reported at December 31, 2008. The Bank recorded a net loss of \$(2.4) million for the year ended December 31, 2009 and other comprehensive loss, net of tax, of \$(94) thousand. This compares to a net loss for the year ended December 31, 2008 of \$(1.7) million and other comprehensive income, net of tax, of \$307 thousand.

Net Interest Income

Like most financial institutions, the primary component of earnings for the Bank is net interest income. Net interest income is the difference between interest income, principally from loan and investment securities portfolios, and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume, spread and margin. For this purpose, volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities, as well as levels of noninterest-bearing liabilities and capital.

Average Balances and Average Rates Earned and Paid. The following table sets forth, for the periods indicated, information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities, resultant yields or costs, net interest income, net interest spread, net interest margin and ratio of average interest-earning assets to average interest-bearing liabilities. Nonaccrual loans have been included in determining average loans.

	2009			2008		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
Assets:						
Interest-earning assets:						
Loans	\$ 79,063,129	\$ 5,267,460	6.66%	\$ 77,055,437	\$ 5,359,415	6.96%
Investment securities	25,620,161	916,270	3.58%	24,629,903	1,179,646	4.79%
Federal funds sold	3,030,178	6,991	0.23%	2,777,551	56,672	2.04%
Other	1,909,005	47,188	2.47%	2,429,588	67,091	2.76%
Total interest earning assets	\$ 109,622,473	\$ 6,237,909	5.69%	\$ 106,892,479	\$ 6,662,824	6.23%
Other noninterest earning assets	9,682,356			6,342,177		
Total assets	\$ <u>119,304,829</u>			\$ <u>113,234,656</u>		
Liabilities and stockholders' equity:						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand	\$ 13,553,792	\$ 362,799	2.68%	\$ 4,666,660	\$ 20,123	0.43%
Savings and money market	19,427,925	242,349	1.25%	18,616,327	391,505	2.10%
Time	51,648,190	1,629,725	3.16%	49,901,328	2,030,717	4.07%
Advances	8,876,712	316,896	3.57%	10,346,995	420,807	4.07%
Other	3,329,424	8,465	0.25%	4,134,391	75,891	1.84%
Total interest-bearing liabilities	\$ <u>96,836,043</u>	\$ <u>2,560,233</u>	2.64%	\$ <u>87,665,701</u>	\$ <u>2,939,043</u>	3.35%
Other noninterest-bearing liabilities	8,738,112			9,462,494		
Stockholders' equity	<u>13,730,674</u>			<u>16,106,461</u>		
Total liabilities and stockholders' equity	\$ <u>119,304,829</u>			\$ <u>113,234,656</u>		
Excess of interest-earning assets over interest-bearing liabilities	\$ <u>12,786,430</u>			\$ <u>19,226,778</u>		
Ratio of interest-earning assets over interest-bearing liabilities	113%			122%		
Net interest income		\$ <u>3,677,676</u>			\$ <u>3,723,781</u>	
Net interest spread			3.05%			2.88%
Net interest margin			3.35%			3.48%

Rate/Volume Analysis

The following table analyzes the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. The table distinguishes between (i) changes attributable to volume (changes in volume multiplied by the prior period's rate), (ii) changes attributable to rate (changes in rate multiplied by the prior period's volume), and (iii) net change (the sum of the previous columns). The change attributable to both rate and volume (changes in rate multiplied by changes in volume) has been allocated equally to both the changes attributable to volume and the changes attributable to rate:

	Year Ended 2009 Versus 2008 Increase (Decrease)		
	Due to		
	Volume	Rate	Net
	(Dollars in thousands)		
Interest Income:			
Loans	\$ 28	\$ (120)	\$ (92)
Investment securities	(35)	(228)	(263)
Federal funds sold and other	363	(433)	(70)
Total interest-earning assets	<u>356</u>	<u>(781)</u>	<u>(425)</u>
Interest Expense:			
Deposits	152	(359)	(207)
Borrowings and Other	(52)	(120)	(172)
Total interest-bearing liabilities	<u>100</u>	<u>(479)</u>	<u>(379)</u>
Net change in interest income	<u>\$ 256</u>	<u>\$ (302)</u>	<u>\$ (46)</u>

Interest Rate Sensitivity

Interest rate sensitivity measures the timing and magnitude of the repricing of assets compared with the repricing of liabilities and is an important part of asset/liability management of a financial institution. The objective of interest rate sensitivity management is to generate stable growth in net interest income, and to control the risks associated with interest rate movements. Management frequently reviews interest rate risk exposure and the expected interest rate environment so that adjustments in interest rate sensitivity can be made in a timely fashion. Since the assets and liabilities of a bank are primarily monetary in nature (payable in fixed, determinable amounts), the performance of a bank is affected more by changes in interest rates than by inflation. Interest rates generally increase as the rate of inflation increases, but the magnitude of the change in rates may not be the same.

Net interest income is the primary component of net income for financial institutions. Net interest income is affected by the timing and magnitude of repricing of as well as the mix of interest sensitive and noninterest sensitive assets and liabilities. "Gap" is a static measurement of the difference between the contractual maturities or repricing dates of interest sensitive assets and interest sensitive liabilities within the following twelve months. Gap is an attempt to predict the behavior of the Bank's net interest income in general terms during periods of movement in interest rates. In general, if the Bank is asset sensitive, more of its interest sensitive assets are expected to reprice within twelve months than its interest sensitive liabilities over the same period. In a rising interest rate environment, assets repricing more quickly is expected to enhance net interest income. Alternatively, decreasing interest rates would be expected to have the opposite effect on net interest income since assets would theoretically be repricing at lower interest rates more quickly than interest sensitive liabilities. Although it can be used as a general predictor, Gap as a predictor of movements in net interest income has limitations due to the static nature of its definition and due to its inherent assumption that all assets will reprice immediately and fully at the contractually designated time. At December 31, 2009, the Bank, as measured by Gap, was in a liability sensitive position. Management has several tools available to evaluate and control interest rate risk, including deposit pricing policies and changes in the mix of various types of assets and liabilities.

The following table summarizes the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2009 that are expected to mature, prepay, or reprice in each of the future time periods shown. Except as stated below, the amount of assets or liabilities that mature or reprice during a particular period were determined in accordance with the contractual terms of the assets or liabilities. Adjustable rate loans are included in the period in which interest rates are next scheduled to adjust rather than in the period in which they are due, and fixed rate loans and mortgage-backed securities are included in the periods in which they are anticipated to be repaid based on scheduled maturities. The Bank's savings accounts and interest-bearing demand accounts (NOW and money market deposit accounts), are subject to immediate withdrawal; however, historical experience has proven these deposits to be more

stable over the course of a year. For the purposes of the gap analysis below, approximately twenty-five percent of the savings and interest-bearing demand deposits are shown repricing in one year or less with the remainder repricing in the one to five year category.

AT DECEMBER 31, 2009
MATURING OR REPRICING IN

	3 MONTHS OR LESS	4 MONTHS TO 12 MONTHS	1 TO 5 YEARS	OVER 5 YEARS	TOTAL
(Dollars in Thousands)					
Interest-earning assets:					
Federal funds sold	\$ 4,590	\$ 0	\$ 0	\$ 0	\$ 4,590
Debt securities	0	0	15,769	17,788	33,557
Loans, Gross (excluding nonaccrual loans)	15,934	5,608	41,628	12,039	75,209
Other interest earning assets	981	500	0	0	1,481
Total interest-earning assets	<u>21,505</u>	<u>6,108</u>	<u>57,397</u>	<u>29,827</u>	<u>114,837</u>
Interest-bearing liabilities:					
Deposits:					
Interest Bearing Savings, MMA and Demand	2,423	7,266	29,097	423	39,209
Time deposits	9,554	36,600	4,517	0	50,671
Advances	0	2,000	8,500	0	10,500
Repurchase Agreements	2,584	0	0	0	2,584
Total interest-bearing liabilities	<u>14,561</u>	<u>45,866</u>	<u>42,114</u>	<u>423</u>	<u>102,964</u>
Interest sensitivity difference per period	<u>\$ 6,944</u>	<u>\$ (39,758)</u>	<u>\$ 15,283</u>	<u>\$ 29,404</u>	<u>\$ 11,873</u>
Cumulative interest sensitivity difference	<u>\$ 6,944</u>	<u>\$ (32,814)</u>	<u>\$ (17,531)</u>	<u>\$ 11,873</u>	
Cumulative difference to total interest-earning assets	<u>6.05%</u>	<u>(28.57)%</u>	<u>(15.27)%</u>	<u>10.34%</u>	

At December 31, 2009, the difference between the Bank's liabilities and assets repricing or maturing within one year was \$32.8 million. Due to an excess of liabilities repricing or maturing within one year, an increase in interest rates could cause the Bank's net interest income to decrease.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may reflect changes in market interest rates differently. Additionally, certain assets, such as adjustable-rate mortgages, have features that restrict changes in interest rates, both on a short-term basis and over the life of the asset. Other factors that may affect the assumptions made in the table include changes in interest rates, pre-payment rates, early withdrawal levels, and the ability of borrowers to service their debt.

Capital Resources

Future growth and expansion of the Bank is dictated by the ability to create capital, which is generated principally by earnings. Adequacy of the Bank's capital is also monitored to ensure compliance with regulatory requirements. One of management's primary objectives is to maintain a strong capital position in order to warrant confidence from customers, investors, bank regulators and stockholders. A measure of capital position is capital adequacy, defined as the amount of capital needed to maintain future asset growth and absorb unforeseen losses. Regulators consider a variety of factors in determining an institution's capital adequacy, including quality and stability of earnings, asset quality, guidance and expertise and liquidity. Regulatory guidelines place an emphasis on stockholders' equity in relation to total assets adjusted for risk. As of December 31, 2009, the Bank's tier 1 capital to risk-weighted assets ratio was 14.9%, its total capital to risk-weighted assets ratio was 16.2% and its leverage ratio was 9.0%.

Management considers the Bank to be well-capitalized and expects to be able to meet future needs caused by growth and expansion, as well as current and future capital requirements implemented by the regulatory agencies.

Management is not aware of any current recommendations by the regulatory authorities, which, if implemented, would have a material effect on liquidity, capital resources or operations.

The following table summarizes the Bank's risk-based capital ratios at December 31, 2009 and 2008 respectively:

	December 31,	
	2009	2008
Total capital (to risk-weighted assets)	16.2%	19.6%
Tier 1 capital (to risk-weighted assets)	14.9%	18.3%
Tier 1 capital (to average assets)	9.0%	12.5%

The Bank was considered to be well-capitalized at December 31, 2009 by regulatory standards.

Liquidity

The Bank's liquidity is a measure of its ability to fund loans, withdrawals and maturities of deposits, and other cash outflows in a cost effective manner. The Bank's principal sources of liquidity are deposits, scheduled payments and prepayments of loan principal, maturities of investment securities, access to liquid assets, and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Liquid assets, which consist of cash and due from banks, federal funds sold and investment securities classified as available for sale, comprised 32.6% and 21.8% of total assets at December 31, 2009 and December 31, 2008, respectively.

The increase in liquid assets is a result of an increase in investment securities available for sale and federal funds sold. The increase in deposits and FHLB Advances during 2009, coupled with a decline in the loan portfolio, provided the funds for the increased liquidity. During 2009, the Bank sold and purchased federal funds depending on liquidity needs. At December 31, 2009, the Bank had \$4.6 million in federal funds sold compared to \$604 thousand at December 31, 2008. Should the need arise, the Bank would have the capability to sell securities classified as available for sale or to borrow funds as necessary. The Bank has established credit lines with three correspondent banks to borrow up to \$8.5 million secured. There were no borrowings outstanding against these credit lines at December 31, 2009 and December 31, 2008, respectively. The Bank also had the capacity to borrow from the Federal Home Loan Bank of Cincinnati. At December 31, 2009, the Bank had an application in process with the Federal Reserve Bank of Atlanta to gain access to the discount window.

Total deposits were \$98.9 million and \$92.4 million, respectively for the periods ended December 31, 2009 and 2008. Time deposits, which are the only deposit accounts that have stated maturity dates, are generally considered to be rate sensitive. Time deposits represented 51.3% and 61.7% of total deposits at December 31, 2009 and 2008, respectively. Time deposits of \$100 thousand or more represented 25.5% and 37.0% of the Bank's total deposits at December 31, 2009 and 2008, respectively. At December 31, 2009 and 2008, the Bank had brokered time and savings deposits totaling \$836 thousand and \$10.8 million, respectively. Management accepts time deposits from outside the Bank's local market area when such funding sources are necessary to fund growth if the rates paid are comparable to rates offered to retail customers or lower. Management believes most of the Bank's time deposits are relationship-oriented. While the Bank will need to pay competitive rates to retain these local deposits at their maturities, there are other subjective factors that will determine their continued retention. Based upon prior experience, the Bank anticipates that a substantial portion of outstanding certificates of deposit will renew upon maturity.

In 2009, operating activities of the Bank provided \$70 thousand of cash flows, reflecting a net loss of \$(2.4) million and deducting non-cash operating expenses including provision for loan losses of \$1.1 million and depreciation of \$272.5 thousand.

Investing activities, including lending, utilized \$5.3 million of the Bank's cash flow in 2009. This represents a decrease of \$10.1 million from the \$15.4 million used in 2008. The primary uses of cash were the excess of purchases of investment securities over payments, maturities, sales and calls, totaling \$7.7 million. This was somewhat offset by the net decrease in loans of \$1.8 million, and the proceeds from the sale of foreclosed assets of \$653 thousand.

Net additional cash flows of \$9.3 million were provided by financing activities, a decrease of \$3.8 million from the \$13.1 million reported in 2008. Cash flow provided from the net change in deposits was \$6.5 million, while cash provided by advances was \$3.5 million. These increases were partially offset by a decline in repurchase agreements of \$681 thousand.

Loan Portfolio

The Bank's primary source of revenue is interest and fee income from its lending activities. These lending activities consist principally of originating commercial operating and working capital loans, residential mortgage loans, home equity lines of credit, other consumer loans and loans secured by commercial real estate. The Bank's current lending strategy is to establish greater market share throughout Hamblen, Jefferson and Grainger Counties in east Tennessee. Through other banks and investment groups, the Bank also purchases participations in loans outside its primary lending area. These loans are underwritten using the same care and standards used for originated loans. The Bank has a diversified loan portfolio with no significant concentrations to any one borrower or industry.

The following table sets forth, at the dates indicated, our loan portfolio composition by type of loan.

	<u>At December 31,</u>	
	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Loans secured by real estate:		
Commercial properties	\$ 23,373	\$ 20,440
Construction and land development	2,998	11,635
Residential and other properties	34,277	31,215
Total loans secured by real estate	<u>60,648</u>	<u>63,290</u>
Commercial and industrial loans	10,106	12,660
Consumer loans and other	3,986	4,830
Government agency guaranteed	2,365	2,939
Total gross loans	<u>77,105</u>	<u>83,719</u>
Plus: Unamortized premiums on purchased loans	94	131
Less: Allowance for loan losses	<u>(1,439)</u>	<u>(2,522)</u>
Total loans receivable, net	<u>\$ 75,760</u>	<u>\$ 81,328</u>

Maturities and Sensitivities of Loans to Changes in Interest Rates

As of December 31, 2009, maturities of gross loans in the indicated classifications were as follows (amounts are presented in thousands):

	<u>Within 1 Year</u>	<u>1 to 5 Years</u>	<u>Over 5 Years</u>
Commercial properties & construction and land development	\$ 10,736	\$ 10,319	\$ 5,316
Residential and other properties	9,753	17,483	7,040
Commercial and industrial loans	5,908	3,820	378
Consumer loans and other	1,141	2,768	77
Purchased government guaranteed loans	0	450	2,009
Totals	<u>\$ 27,538</u>	<u>\$ 34,840</u>	<u>\$ 14,820</u>

As of December 31, 2009, the interest terms of loans in the indicated classification for the indicated maturity ranges are as follows (amounts are presented in thousands):

	<u>Fixed Interest Rates</u>	<u>Variable Interest Rates</u>	<u>Total</u>
Commercial properties and construction & land development	\$ 17,439	\$ 8,932	\$ 26,371
Residential and other	13,336	20,940	34,276
Commercial and industrial	7,832	2,274	10,106
Consumer loans and other	3,770	216	3,986
Government agency guaranteed	1,903	556	2,459
Totals	<u>\$ 44,280</u>	<u>\$ 32,918</u>	<u>\$ 77,198</u>

As of December 31, 2009, the Bank had non-accrual loans totaling \$1.99 million compared to \$3.98 million at December 31, 2008. In addition, the Bank had \$174 thousand in loans 90 or more days past due and still accruing interest as of December 31, 2008. There were no loans over 90 days past due and still accruing interest at December 31, 2009.

Allowance and Provision for Loan Losses

The allowance for loan losses represents management's estimate of an amount adequate to provide for potential losses inherent in the loan portfolio. Management determines the allowance for loan losses based on a number of factors, including a review and evaluation of the Bank's loan portfolio, historical losses, and current and projected economic conditions locally and nationally. The allowance is monitored and analyzed in conjunction with the Bank's loan analysis and grading program, and provisions for loan losses are made to maintain an adequate allowance for loan losses. The allowance for loan losses is created by direct charges to operations. Losses on loans are charged against the allowance for loan losses in the accounting period in which they are determined by management to be necessary and are established based on the amount that management has determined to be adequate to provide for potential losses inherent in the loan portfolio. The Bank made provisions for loan losses of \$1.1 million for the year ended December 31, 2009 as compared to \$1.9 million for the year ended December 31, 2008. The provision for loan losses did decline in 2009 from the 2008 level, but was still a significant amount when compared to earlier years' provisions. The Bank had increased the provision for loan losses in 2008 to reserve for several purchased participations that were classified at December 31, 2008. The participations were charged off during 2009 and are being carried in OREO.

Management realizes that general economic trends greatly affect loan losses, and no assurances can be made that future charges to the loan loss allowance may not be significant in relation to the amount provided during a particular period, or that future evaluations of the loan portfolio based on conditions then prevailing will not require sizable additions to the allowance, thus necessitating similarly sizable charges to income. Based on its best judgment, evaluation, and analysis of the loan portfolio, management considers the allowance for loan losses to be adequate for the reporting periods.

Management believes that the loans classified for regulatory purposes as loss, doubtful, substandard, or special mention, and the loans classified as troubled debt restructurings, are the only loans in the portfolio that represent material credits about which management is aware of any information that causes management to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms; however, in the current economy, there could be additional classified loans.

Interest accrual on loans is discontinued when management believes, after consideration of economic and business conditions and collection efforts, that collection of interest is doubtful. Additionally, all loans contractually past due 90 days or more and not in the process of collection or adequately secured are placed on nonaccrual status.

Nonperforming Assets. The following table sets forth information with respect to the Bank's nonaccrual loans, restructured loans, total nonperforming loans (nonaccrual plus restructured loans), and total nonperforming assets.

	At December 31,	
	2009	2008
	(Dollars in thousands)	
Nonaccrual loans	\$ 1,990	\$ 3,978
Restructured loans	1,112	0
Total nonperforming loans	<u>3,102</u>	<u>3,978</u>
Real estate owned	1,827	322
Total nonperforming assets	<u>\$ 4,929</u>	<u>\$ 4,300</u>
Accruing loans past due 90 days or more	\$ 0	\$ 174
Allowance for loan loss	\$ 1,439	\$ 2,522
Nonperforming loans to period end loans	4.02%	4.74%
Allowance for loan losses to period end loans	1.86%	3.01%
Allowance for loan losses to nonperforming loans	46.39%	63.40%
Nonperforming assets to total assets	3.95%	3.64%

Allowance for Loan Losses. The following table shows the allocation of our allowance for loan losses at the dates indicated. The allocation is based on an evaluation of defined loan problems, historical ratios of loan losses and other factors that may affect future loan losses in the categories of loans shown.

	At December 31,			
	2009		2008	
	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)
	(Dollars in thousands)			
Balance applicable to:				
Commercial real estate	\$ 440	30.3%	\$ 516	24.4%
Construction	190	3.9%	1,280	13.9%
Residential and other	396	44.4%	247	37.2%
Commercial and industrial	339	13.1%	404	15.1%
Consumer	74	5.1%	75	5.8%
Government guaranteed	0	3.2%	0	3.6%
		100.0%		100.0%
Unallocated	0		0	
Total	<u>\$ 1,439</u>		<u>\$ 2,522</u>	

(1) Represents total of all outstanding loans in each category as a percent of total loans outstanding.

The following table presents activity in the allowance for loan losses for the periods indicated:

	December 31,	
	2009	2008
	(Dollars in thousands)	
Balance at beginning of period	\$ 2,522	\$ 702
Charge-offs:		
Consumer and other	(94)	(78)
Construction and land development	(1,128)	0
Commercial and industrial	(416)	(17)
Commercial real estate	(532)	0
1-4 family residential	(32)	
Home equity lines of credit	(26)	(58)
Total charge-offs	<u>(2,228)</u>	<u>(153)</u>
Recoveries:		
Consumer and other	6	27
Commercial real estate	0	0
Residential 1-4 family	0	1
Total recoveries	<u>6</u>	<u>28</u>
Net charge-offs	(2,222)	(125)
Provision for loan losses charged to operations	<u>1,139</u>	<u>1,945</u>
Balance at end of period	<u>\$ 1,439</u>	<u>\$ 2,522</u>
Ratio of net loan charge-offs to average loans outstanding	2.81%	0.16%
Ratio of allowance for loan losses to loans outstanding at period-end	1.86%	3.01%

Investment Securities

The investment portfolio of the Bank can be classified as either available for sale or held to maturity. At December 31, 2009 the Bank did not have any securities in the held to maturity portfolio. The fair value of investment securities available for sale totaled \$33.6 million at December 31, 2009 compared to \$22.7 million at December 31, 2008. This is an increase of \$10.9 million or 48.0%, due primarily to the use of excess liquidity resulting from a significant increase in deposits and a decline in the loan portfolio during the year. The available for sale portfolio consists of approximately 53.8% Obligations of U.S. Government Agencies and 46.2% Mortgage-backed securities. The mix has changed from 42.3% Obligations of U.S. Government Agencies, 57.1% Mortgage-backed securities, and 0.6% Corporate securities at December 31, 2008. The change in mix during the year resulted in the Bank achieving a lower portfolio yield. As a result of restructuring the portfolio by selling FNMA and FHLMC mortgage-backed securities and replacing them with U.S. Government guaranteed GNMA securities, the average life of the portfolio increased.

The held to maturity portfolio had a carrying value of \$3.7 million at December 31, 2008. The securities in this classification were purchased as part of a leveraged transaction on September 1, 2005 and were comprised 100% of mortgaged-backed securities. As part of the overall restructuring of the investment portfolio, the held to maturity portfolio was sold during the fourth quarter of 2008 and the first quarter of 2009 and replaced with higher quality GNMA securities.

The combined portfolios have an average life of 8.26 years and a weighted average yield at December 31, 2008 of 3.39%. This compares to an average life of 7.0 years and weighted average yield of 5.04% at December 31, 2008. The Bank had \$6.6 million of the portfolio pledged to secure federal funds lines of credit, the state collateral pool and repurchase agreements.

The following tables present the maturities of investment securities classified as available for sale at their carrying values and the weighted average yields for each range of maturities presented. The actual maturities of mortgage-backed securities may differ from the contractual maturities presented in the table below due to prepayments.

Maturities at December 31, 2009	Within One Year	After One through Five Years	After Five through Ten Years	After Ten Years	Total
	(Dollars in thousands)				
Obligations of U.S. Government Agencies	\$ 0	\$ 6,030	\$ 5,012	\$ 7,221	\$ 18,263
Mortgage-Backed Securities	0	9,557	1,027	4,705	15,289
Subtotal	0	15,587	6,039	11,926	33,552
Market value adjustment on Available for sale securities	0	182	(6)	(170)	6
Total	\$ 0	\$ 15,769	\$ 6,033	\$ 11,756	\$ 33,558
Weighted Average Yield	0	3.32%	3.09%	3.64%	3.39%

Maturities at December 31, 2008	Within	After One	After Five	After	Total
	One Year	through Five Years	through Ten Years	Ten Years	
(Dollars in thousands)					
Obligations of U.S. Government					
Agencies	\$ 0	\$ 0	\$ 7,499	\$ 1,999	\$ 9,498
Corporate Securities	0	0	0	175	175
Mortgage-Backed Securities	98	0	800	11,992	12,890
Subtotal	98	0	8,299	14,166	22,563
Market value adjustment on Available for sale securities	0	0	116	7	123
Total	\$ 98	\$ 0	\$ 8,415	\$ 14,173	\$ 22,686
Weighted Average Yield	3.39%	0.00%	4.86%	5.21%	5.07%

The following tables present the maturities of investment securities classified as held to maturity at their carrying values and the weighted average yields for each range of maturities presented. The actual maturities of mortgage-backed securities may differ from the contractual maturities presented in the table below due to prepayments.

Maturities at December 31, 2008	Obligations of U.S.		Mortgage- Backed Securities	Weighted- Average Yield
	Government Corporations and Agencies	Weighted- Average Yield		
Five to ten years	\$ 0	0	\$ 2,117,841	4.78%
After ten years	0	0	1,568,083	4.98%
Totals	\$ 0	0	\$ 3,685,924	4.87%

There were no held to maturity securities at December 31, 2009.

Deposits

The Bank relies on deposits generated in its market area to provide the majority of funds needed to support lending activities and for investment in liquid assets. The Bank's balance sheet growth is largely determined by the availability of deposits in its market area, the cost of attracting the deposits, and prospects of profitably utilizing the available deposits by increasing the loan or investment portfolios. The Bank continuously monitors market pricing, competition, rates and internal interest rate spreads to work toward growth and profitability. Because deposits are the principal source of funds for continued growth, the Bank attempts to structure rates so as to promote deposit and asset growth, while at the same time increasing the overall profitability of the Bank.

The daily average amounts of deposits and the average rates paid for each major category of deposits for the periods indicated are summarized below:

	For the Year Ended December 31,			
	2009		2008	
	Amount	Rate	Amount	Rate
	(Dollars in thousands)			
Savings, NOW, and money market	\$ 32,982	1.83%	\$ 23,283	1.77%
Time deposits over \$100,000	26,605	3.21%	27,464	4.04%
Other time deposits	25,043	3.10%	22,437	4.11%
 Total interest-bearing deposits	 84,630	 2.64%	 73,184	 3.34%
Non-interest bearing deposits	8,164		8,879	
 Total deposits	 \$ 92,794	 2.41%	 \$ 82,063	 2.98%

The following table sets forth the amounts and maturities of our certificates of deposit.

	At December 31, 2009				
	3 Months Or Less	Over 3 to 12 Months	Over 1 to 3 Years	Over 3 Years	Total
	(Dollars in thousands)				
Certificates of deposit:					
Less than \$100,000	\$ 4,599	\$ 18,582	\$ 1,891	\$ 399	\$ 25,471
\$100,000 or more	3,660	19,469	1,961	110	25,200
 Total	 \$ 8,259	 \$ 38,051	 \$ 3,852	 \$ 509	 \$ 50,671

Off-Balance Sheet Arrangements

In order to meet the financing needs of our customers in the normal course of business, 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 extend for one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending any other type of loan 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:

	December 31, 2009	December 31, 2008
	(Dollars in thousands)	
Commitments to extend credit	\$ 7,909	\$ 10,622
Stand-by letters of credit	\$ 49	\$ 451

Effect of Governmental Policies

We are affected by the policies of regulatory authorities, including the Federal Reserve Board, and the OCC. An important function of the Federal Reserve Board is to regulate the national money supply. Among the instruments of monetary policy used by the Federal Reserve Board are: purchases and sales of U.S. Government securities in the marketplace; changes in the discount rate, which is the rate any depository institution must pay to borrow from the Federal Reserve; and changes in the reserve requirements of depository institutions. These instruments are effective in influencing economic and monetary growth, interest rate levels and inflation.

The monetary policies of the Federal Reserve Board and other governmental policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. Because of changing conditions in the national and international economy and in the money markets, as well as the result of actions by monetary and fiscal authorities, it is not possible to predict with certainty future changes in interest rates, deposit levels or loan demand or whether the changing economic conditions will have a positive or negative effect on operations and earnings.

Legislation from time to time is introduced in the United States Congress and the Tennessee General Assembly and other state legislatures, and regulations are proposed by the regulatory agencies that could affect our business. It cannot be predicted whether or in what form any of these proposals will be adopted or the extent to which our business may be affected thereby.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

AUDITED FINANCIAL STATEMENTS

Years Ended December 31, 2009 and 2008

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

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CERTIFIED PUBLIC ACCOUNTANTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Community National Bank of the Lakeway Area:

We have audited the accompanying balance sheets of Community National Bank of the Lakeway Area (the Bank) as of December 31, 2009 and 2008 and the related statements of operations, comprehensive loss, changes in stockholders' equity, and cash flows for each of the years then ended. The Bank's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Bank is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community National Bank of the Lakeway Area as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America.

Pershing Yoakley & Associates, P.C.

Knoxville, Tennessee
March 29, 2010

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

BALANCE SHEETS

	As of December 31,	2009	2008
ASSETS			
Cash and Cash Equivalents:			
Cash and Due From Banks	\$	2,596,412	\$ 2,475,510
Federal Funds Sold		4,590,000	604,000
Total Cash and Cash Equivalents		<u>7,186,412</u>	<u>3,079,510</u>
Securities:			
Available for Sale, at Fair Value		33,557,505	22,685,722
Held to Maturity, at Amortized Cost		0	3,685,924
Total Securities		<u>33,557,505</u>	<u>26,371,646</u>
Equity Investments, at Cost		829,900	2,027,342
Loans, Net of Estimated Allowance for Loan Losses of \$1,438,566 in 2009 and \$2,521,744 in 2008		75,759,650	81,328,038
Premises and Equipment, Net		3,048,394	3,303,461
Interest Receivable		542,335	559,845
Foreclosed Assets		1,827,445	322,200
Deferred Tax Benefit		1,329,484	976,387
Prepaid Banking Agency Assessments		585,998	0
Other Assets		179,168	98,098
TOTAL ASSETS	\$	<u>124,846,291</u>	<u>\$ 118,066,527</u>
LIABILITIES AND STOCKHOLDERS' EQUITY			
LIABILITIES:			
Deposits:			
Noninterest-bearing	\$	8,974,590	\$ 9,479,658
Interest-bearing		89,879,819	82,904,756
Total Deposits		<u>98,854,409</u>	<u>92,384,414</u>
Securities Sold Under Agreements to Repurchase		2,583,891	3,264,788
Advances from Federal Home Loan Bank		10,500,000	7,000,000
Interest Payable		346,071	409,779
Other Liabilities		125,240	93,699
Total Liabilities		<u>112,409,611</u>	<u>103,152,680</u>
STOCKHOLDERS' EQUITY			
Common Stock, Par Value \$1, Authorized 4,000,000 Shares; Issued and Outstanding 1,891,426 Shares at December 31, 2009 and 2008		1,891,426	1,891,426
Capital in Excess of Par Value		17,041,955	17,041,955
Retained Deficit		(6,501,606)	(4,118,706)
Accumulated Other Comprehensive Income		4,905	99,172
Total Stockholders' Equity		<u>12,436,680</u>	<u>14,913,847</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$	<u>124,846,291</u>	<u>\$ 118,066,527</u>

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF OPERATIONS

	For the Years Ended December 31,	2009	2008
		<u> </u>	<u> </u>
INTEREST INCOME			
Loans, Including Fees		\$ 5,267,460	\$ 5,359,415
Securities		916,270	1,179,646
Federal Funds Sold and Other		54,179	123,763
Total Interest Income		<u>6,237,909</u>	<u>6,662,824</u>
INTEREST EXPENSE			
Deposits		2,234,872	2,442,345
Advances		316,896	420,807
Other		8,465	75,891
Total Interest Expense		<u>2,560,233</u>	<u>2,939,043</u>
NET INTEREST INCOME		3,677,676	3,723,781
PROVISION FOR ESTIMATED LOAN LOSSES		<u>1,138,937</u>	<u>1,944,626</u>
NET INTEREST INCOME AFTER PROVISION FOR ESTIMATED LOAN LOSSES		<u>2,538,739</u>	<u>1,779,155</u>
NONINTEREST INCOME			
Service Charges on Deposit Accounts		344,052	299,773
Net Gain on Sales of Securities		0	51,830
Commissions on Loans Originated for Others		30,233	35,488
Other		136,361	107,588
Total Noninterest Income		<u>510,646</u>	<u>494,679</u>
NONINTEREST EXPENSE			
Salaries and Employee Benefits		1,801,138	1,891,617
Occupancy Costs		778,237	758,567
Data Processing		302,309	259,084
Office Supplies and Postage		92,870	127,742
Advertising and Promotion		98,608	317,613
Legal and Other Professional		352,374	308,831
Net Loss on the Sale of Foreclosed Assets		72,802	13,621
Loss on Impaired Equity Investments		1,128,642	0
Net Loss on Sales of Securities		90,990	0
Foreclosed Assets Valuation Expense		396,734	47,800
Other		648,357	550,926
Total Noninterest Expense		<u>5,763,061</u>	<u>4,275,801</u>
NET LOSS BEFORE INCOME TAXES		(2,713,676)	(2,001,967)
INCOME TAX BENEFIT (Note 8)		<u>(330,776)</u>	<u>(344,799)</u>
NET LOSS		<u>\$ (2,382,900)</u>	<u>\$ (1,657,168)</u>

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF OPERATIONS (Continued)

	For the Years Ended December 31,	<u>2009</u>	<u>2008</u>
LOSS PER SHARE			
Basic		\$ <u>(1.26)</u>	\$ <u>(0.88)</u>
Diluted		\$ <u>(1.26)</u>	\$ <u>(0.88)</u>

The accompany footnotes are an integral part of these financial statements.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF COMPREHENSIVE LOSS

	For the Years Ended December 31,	<u>2009</u>	<u>2008</u>
NET LOSS		<u>\$ (2,382,900)</u>	<u>\$ (1,657,168)</u>
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX EFFECTS			
Net Unrealized Gains (Losses) on Securities Available for Sale Arising During the Year		(258,003)	308,826
Reclassification Adjustment for Net Realized (Gains) Losses Included in Net Loss		141,415	(41,716)
Deferred Income Tax Expense Related to Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Valuation Allowance		22,321	39,533
Other Comprehensive Income (Loss), Net of Tax Effects		<u>(94,267)</u>	<u>306,643</u>
COMPREHENSIVE LOSS		<u><u>\$ (2,477,167)</u></u>	<u><u>\$ (1,350,525)</u></u>

The accompany footnotes are an integral part of these financial statements.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock	Capital in Excess of Par Value	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
BALANCES, JANUARY 1, 2008	\$ 1,891,426	\$ 17,041,955	\$ (2,461,538)	\$ (207,471)	\$ 16,264,372
Net Loss	0	0	(1,657,168)	0	(1,657,168)
Other Comprehensive Income	0	0	0	306,643	306,643
BALANCES, DECEMBER 31, 2008	1,891,426	17,041,955	(4,118,706)	99,172	14,913,847
Net Loss	0	0	(2,382,900)	0	(2,382,900)
Other Comprehensive Loss	0	0	0	(94,267)	(94,267)
BALANCES, DECEMBER 31, 2009	<u>\$ 1,891,426</u>	<u>\$ 17,041,955</u>	<u>\$ (6,501,606)</u>	<u>\$ 4,905</u>	<u>\$ 12,436,680</u>

The accompany footnotes are an integral part of these financial statements.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF CASH FLOWS

	For the Year Ended December 31,	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Loss	\$	(2,382,900)	\$ (1,657,168)
Adjustments to Reconcile Net Loss to Net Cash Provided by Operating Activities:			
Provision for Estimated Loan Losses		1,138,937	1,944,626
Provision for Foreclosed Assets Valuation		396,734	47,800
Depreciation		272,536	241,278
Federal Home Loan Bank Stock Dividends		0	(16,000)
Net Amortization of Premiums on Securities		327,690	22,932
Net Amortization of Premiums on Purchased Loans		37,122	9,967
Net Loss (Gain) on Sales of Securities Available for Sale		141,415	(41,716)
Net Gain on Sales of Securities Held to Maturity		(50,425)	(10,114)
Net Loss on the Sale of Foreclosed Assets		72,802	13,621
Loss on Impairment of Equity Investments		1,128,642	0
Decrease (Increase) in Accrued Interest Receivable		17,510	(52,137)
Increase in Deferred Tax Benefit		(330,776)	(344,799)
(Increase) Decrease in Prepaid Expenses and Other Assets		(667,068)	58,423
Decrease in Accrued Interest Payable		(63,708)	(141,414)
Increase in Other Liabilities		31,541	49,625
Total adjustments		<u>2,452,952</u>	<u>1,782,092</u>
Net Cash Provided by Operating Activities		<u>70,052</u>	<u>124,924</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Securities Available for Sale:			
Sales and Calls		21,766,661	9,889,007
Purchases		(39,671,993)	(21,566,081)
Maturities		0	500,000
Principal Repayments Received		6,448,187	2,453,544
Securities Held to Maturity:			
Sales and Calls		3,693,580	757,398
Principal Repayments Received		42,438	771,876
Purchases of Equity Investments		(18,100)	(284,686)
Sales of Equity Investments		86,900	312,741
Proceeds from the Sale of Foreclosed Assets		652,926	5,450
Net (Increase) Decrease in Loans		1,764,622	(7,124,651)
Purchases of Premises and Equipment		(17,469)	(1,133,592)
Net Cash Used in Investing Activities		<u>(5,252,248)</u>	<u>(15,418,994)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Net (Decrease) Increase in Non-Interest-Bearing Deposits		(505,068)	738,039
Net Increase in Interest-Bearing Deposits (Excluding Time Deposits)		13,318,802	627,451
Net (Decrease) Increase in Time Deposits		(6,343,739)	17,893,467
Proceeds from (Payments on) Advances from Federal Home Loan Bank		3,500,000	(5,000,000)
Net Decrease in Securities Sold Under Agreements to Repurchase		(680,897)	(1,205,877)
Net Cash Provided by Financing Activities		<u>9,289,098</u>	<u>13,053,080</u>

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF CASH FLOWS (Continued)

For the Year Ended December 31,	<u>2009</u>	<u>2008</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	4,106,902	(2,240,990)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>3,079,510</u>	<u>5,320,500</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 7,186,412</u>	<u>\$ 3,079,510</u>
Supplementary Disclosures of Cash Flow Information:		
Cash Paid During the Year for:		
Interest	\$ 2,623,941	\$ 3,080,457
Income Taxes	\$ -	\$ -
Supplementary Disclosures for Noncash Investing Activities:		
Change in Net Unrealized Gains/Losses on Securities Available for Sale	\$ 116,588	\$ 267,110
Change in Deferred Income Tax Tax Benefit Associated with Unrealized Gains/ Losses on Investment Securities Available for Sale	\$ 22,321	\$ 39,533
Change in Net Unrealized Gains/Losses on Securities Available for Sale, Net of Tax Effects	\$ 94,267	\$ 306,643
Loans Moved to Foreclosed Assets	\$ 2,267,707	\$ 191,362

The accompany footnotes are an integral part of these financial statements.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2009 and 2008

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 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 loan losses, valuation of foreclosed assets, the fair value of financial instruments, and the valuation of deferred tax assets, and the related allowance.

Comprehensive Income - Comprehensive income consists of net income/losses and other comprehensive income/losses. 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 correspondent commercial banks located in the Southern 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 banks were not in excess of FDIC insurance limits as of December 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 Southern United States. This loan, plus interest, is required to be repaid on the next business day.

Securities – 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 recorded at amortized cost. The amortization of premiums and accretion of discounts are recognized in interest income using a method approximating the interest method over the terms of these securities.

Securities available for sale are carried at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Realized gains and losses on securities available for sale are included in noninterest income and noninterest expense, respectively, and when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Realized gains and losses on sale of securities are recorded on the trade date and determined using the specific identification method. The amortization of premiums and accretion of discounts are recognized in interest income using the interest method over the terms of the securities.

Prior to a change in accounting guidance on April 1, 2009, in determining whether other-than-temporary impairment existed, management considered (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Declines in the fair value of individual securities below their cost that are deemed to be other-than-temporary were reflected in earnings as realized losses, if applicable.

Effective April 1, 2009, the Bank adopted new accounting guidance related to other-than-temporary impairment of securities. The new guidance amended the criteria for recognizing other-than-temporary impairments of debt securities and expanded the

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

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

disclosure requirements for impairment losses on debt and equity securities. The new guidance specifies that if (1) a company does not have the intent to sell a debt security prior to recovery and (2) it is more likely than not that it will not have to sell the debt security prior to recovery; the security would not be considered other-than-temporarily impaired unless there is a credit loss. The credit loss component is the amount of principal cash flows not expected to be received over the remaining term of the security based on cash flow projections. For debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the non-credit loss is included in accumulated other comprehensive income.

Equity Investments - The Bank maintains certain investments with regulatory and other entities with which it has an ongoing business relationship. At December 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.

Loans - 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.

The 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. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual status or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

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

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 due to regulatory adjustments 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, and special mention (as defined by the Bank consistent with the definitions given by regulatory agencies). For those 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 collectively evaluated for impairment. 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.

Premises and Equipment - Land is stated at cost. Premises and equipment are stated at cost, less accumulated depreciation. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations. Depreciation is computed using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Buildings	40
Furniture, Fixtures, and Equipment	2-15
Leasehold Improvements	5-30

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 estimated 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 December 31, 2009 of \$392,234 and December 31, 2008 of \$47,800.

Income Taxes – The income tax accounting guidance results in two components of income tax expense – current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to taxable income or loss. The Bank determines deferred income taxes using the liability method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities. The Bank's deferred taxes relate primarily to differences between the basis of the allowance for loan losses and accumulated depreciation. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

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

The Bank recognizes deferred tax assets if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The Bank follows the statutory requirements for its income tax accounting and generally avoids risks associated with potentially problematic tax positions that may be challenged upon examination.

The Bank has estimated a 56% valuation allowance at December 31, 2009 to offset the net deferred tax asset resulting from timing differences. See Note 8 for additional information.

Stock Options - The Bank recognizes compensation cost relating to share-based payment transactions based on the fair value of the equity or liability instruments issued. Compensation cost is measured using the fair value of the stock option award on the grant date and is recognized over the employee service period. The Company uses a stock option pricing model to determine the fair value of the award on the grant date.

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.

	Years Ended December 31,	
	2009	2008
Per Share Information:		
Basic, as Reported	\$ (1.26)	\$ (0.88)
Diluted, as Reported	\$ (1.26)	\$ (0.88)

Loss per share is based on the following for the years ended December 31:

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

Accounting Standards Codification - In June 2009, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (GAAP) - a Replacement of FASB Statement No. 162* (the "Codification"). The Codification became the single source of authoritative GAAP to be applied by nongovernmental entities, with the exception of guidance issued by the Securities and Exchange Commission (SEC) and its staff. All guidance contained in the Codification carries an equal level of authority. FASB ASC 105-10, *Generally Accepted Accounting Principles*, became applicable during fiscal year 2009. All accounting references have been updated, and therefore SFAS references have been replaced with, or accompanied by, ASC references.

On August 18, 2009, the SEC issued Interpretive Release No. 33 – 9062A titled *Commission Guidance Regarding the Financial Accounting Standards Board's Accounting Standards of Codification*. In this release, the SEC stated that as of September 15, 2009, references in the SEC's rules and SEC staff guidance to specific standards under U.S. generally accepted accounting principles should be understood to mean the corresponding reference in the Codification. The SEC also stated that the Codification does not supersede any SEC rules or regulations, is not the authoritative source for SEC rules or SEC staff

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

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

guidance, and the inclusion of any SEC rules or SEC staff guidance in the Codification will not affect how such items may be updated in the future by the SEC.

Newly Adopted Accounting Pronouncements - In April 2009, FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that Are Not Orderly* (FSP 157-4) (superceded by ASC 820, *Fair Value Measurements and Disclosures*). FSP 157-4 indicates that if an entity determines that either the volume and/or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. FSP 157-4 is effective for interim and annual periods ended after June 15, 2009, with early adoption permitted. FSP 157-4 must be applied prospectively. The provisions of FSP 157-4 became effective for the Bank's interim period ended on June 30, 2009, and its adoption did not have a significant impact on the Bank's financial statements.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP 107-1 and APB 28-1) (superceded by FASB ASC 825, *Financial Instruments*, and FASB ASC 270, *Interim Reporting*). This FSP requires disclosures about fair value of financial instruments in interim reporting periods of publicly traded companies that were previously only required to be disclosed in annual financial statements. The FSP was effective for interim reporting periods ending after June 15, 2009. As this FSP only amends the disclosure requirements about fair value of financial instruments to require those disclosures in interim periods, the adoption of this FSP had no impact on the Bank's annual financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP 115-2 and 124-2) (superceded by FASB ASC 320, *Investments - Debt and Equity Securities*). FSP 115-2 and 124-2 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These assessments are made before assessing whether the entity will recover the cost basis of the investment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price. In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, FSP 115-2 and 124-2 changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income. FSP 115-2 and 124-2 also requires additional disclosures. The provisions of FSP 115-2 and 124-2 became effective for interim periods ending after June 15, 2009. Adoption of the FSP did not have a material impact on the Bank's financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165) (superceded by FASB ASC 855, *Subsequent Events*). Under FASB ASC 855, companies are required to evaluate events and transactions that occur after the balance sheet date but before the date the financial statements are issued, or available to be issued in the case of non-public entities. FASB ASC 855 requires entities to recognize in the financial statements the effect of all events or transactions that provide additional evidence of conditions that existed at the balance sheet date, including the estimates inherent in the financial preparation process. Entities shall not recognize the impact of events or transactions that provide evidence about conditions that did not exist at the balance sheet date but arose after that date. FASB ASC 855 is effective for interim and annual reporting periods ending after June 15, 2009. The Bank adopted the provisions of FASB ASC 855 during the quarter ended June 30, 2009. The Bank evaluated all events and transactions that occurred after December 31, 2009 through March 29, 2010, the issuance date of

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

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

the financial statements. During this period management did not note any material recognizable subsequent events that required recognition or disclosure in the December 31, 2009 financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* (superceded by FASB ASC 740, *Income Taxes*). FASB ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. FASB ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FASB ASC 740 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FASB ASC 740 is effective for fiscal years beginning after December 15, 2008. Adoption of FASB ASC 740 did not have a material impact on the financial statements of the Bank. The Bank has not taken any material uncertain income tax positions in its previously filed income tax returns or in income tax returns expected to be filed.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05 ("ASU 2009-05"), *Fair Value Measurements and Disclosures* (ASC Topic 820, *Measuring Liabilities at Fair Value*). ASU 2009-05 amends subtopic 820-10, *Fair Value Measurements and Disclosures - Overall*, and provides clarification for the fair value measurement of liabilities. ASU 2009-05 is effective for the first reporting period including interim periods beginning after issuance. The Bank adopted this standard for the year ended December 31, 2009 and its adoption did not have a material impact on its financial statements.

NOTE 2 - FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Home Loan Bank, the Bank is required to maintain stock in an amount equal to .15% of total assets. Federal Home Loan Bank stock is carried at cost and is maintained by the Bank at par value of one hundred dollars per share. The Bank's carrying cost of FHLB stock was \$433,900 and \$415,800 for the years ended December 31, 2009 and 2008, respectively.

NOTE 3 - SECURITIES

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

	Securities Available for Sale			
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Losses	Value	
As of December 31, 2009:				
Debt Securities:				
Obligations of U.S. Government Agencies	\$ 18,262,237	\$ 38,476	\$ (229,890)	\$ 18,070,823
Mortgage-Backed and Related Securities	15,289,202	214,693	(17,213)	15,486,682
Total Securities Available for Sale	\$ 33,551,439	\$ 253,169	\$ (247,103)	\$ 33,557,505

	Securities Available for Sale			
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Losses	Value	
As of December 31, 2008:				
Debt Securities:				
Obligations of U.S. Government Agencies	\$ 9,498,103	\$ 111,122	\$ 0	\$ 9,609,225
Mortgage-Backed and Related Securities	12,889,965	95,310	(23,630)	12,961,645
Corporate Securities	175,000	0	(60,148)	114,852
Total Securities Available for Sale	\$ 22,563,068	\$ 206,432	\$ (83,778)	\$ 22,685,722

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

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:				
Mortgage-Backed Securities	\$ 3,685,924	\$ 92,935	\$ 0	\$ 3,778,859
Total Securities Held to Maturity	<u>\$ 3,685,924</u>	<u>\$ 92,935</u>	<u>\$ 0</u>	<u>\$ 3,778,859</u>

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

	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in One to Five Years	\$ 6,030,154	\$ 6,024,289
Due in Five to Fifteen Years	11,184,036	11,038,097
Due Over Fifteen Years	1,048,047	1,008,437
	<u>18,262,237</u>	<u>18,070,823</u>
Mortgage-Backed Securities	15,289,202	15,486,682
Total Securities	<u>\$ 33,551,439</u>	<u>\$ 33,557,505</u>

The expected maturities of mortgage-backed 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 securities are presented separately in the above table.

Proceeds from sales of securities classified as available for sale totaled \$9,266,661 during the year ended December 31, 2009 (\$7,889,007 in 2008). There were gross gains of \$86,528 realized during the year ended December 31, 2009 (\$49,810 in 2008). Gross losses of \$227,943 (\$8,094 in 2008) were realized by the Bank during the year ended December 31, 2009. Additionally, the Bank sold three securities from the held to maturity portfolio, due to deterioration in the issuer's credit worthiness, and as part of a restructuring of the investment portfolio to zero percent risk weighted investments. The proceeds from the sales from the held to maturity portfolio totaled \$3,693,580 (\$757,398 in 2008), which includes a gain of \$50,425 (\$10,114 in 2008) being recognized for the year ended December 31, 2009.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 3 – SECURITIES (Continued)

The following table shows the Bank's gross unrealized losses and fair value, aggregated by the security category and the length of time that individual securities have been in a continuous loss position.

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2009						
Obligations of U.S. Government						
Agencies	\$ 11,022,698	\$ (229,890)	\$ 0	\$ 0	\$ 11,022,698	\$ (229,890)
Mortgage-Backed Securities	5,469,602	(17,213)	0	0	5,469,602	(17,213)
Total	<u>\$ 16,492,300</u>	<u>\$ (247,103)</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 16,492,300</u>	<u>\$ (247,103)</u>
December 31, 2008						
Mortgage-Backed Securities	\$ 6,312,708	\$ (23,497)	\$ 97,769	\$ (133)	\$ 6,410,477	\$ (23,630)
Corporate Securities	114,852	(60,148)	0	0	114,852	(60,148)
Total	<u>\$ 6,427,560</u>	<u>\$ (83,645)</u>	<u>\$ 97,769</u>	<u>\$ (133)</u>	<u>\$ 6,525,329</u>	<u>\$ (83,778)</u>

Management performs periodic reviews for impairment in accordance with FASB ASC 320.

At December 31, 2009, the 14 securities with unrealized losses have decreased in value 1.48 percent from the Bank's amortized cost basis. At December 31, 2008, the six securities with unrealized losses have decreased in value 1.27 percent from the Bank's amortized cost basis. Most of these securities are guaranteed by either U.S. government agencies or had investment grade ratings upon purchase. Furthermore, the issuers of these securities have not established any cause for default. The unrealized losses associated with these investment securities are primarily driven by changes in interest rates and are not due to the credit quality of the securities. These securities will continue to be monitored as a part of the Bank's ongoing impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond insurers.

FASB ASC 320 requires management to assess whether the Bank has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. Management does not intend to sell these securities and it is more likely than not that management will not be required to sell the securities before the recovery of its amortized cost bases.

In making this determination, management has considered its cash flow and liquidity requirements, capital requirements, economic factors, and contractual or regulatory obligations for indication that these securities will be required to be sold before a forecasted recovery occurs. In management's opinion, all securities that are in an unrealized loss position as of December 31, 2009, are not other-than-temporarily impaired. Therefore, no impairment expense should be recorded as of December 31, 2009.

Debt securities with a total estimated fair value (which approximates book value) of approximately \$6,584,000 as of December 31, 2009 (\$19,458,000 in 2008) were pledged primarily to secure deposits of public funds, repurchase agreements, and federal funds lines of credit.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 4 - LOANS AND ESTIMATED ALLOWANCE FOR LOAN LOSSES

A summary of loans as of December 31, 2009 and 2008 is as follows:

	2009	2008
Loans Secured by Real Estate:		
Commercial Properties	\$ 23,373,394	\$ 20,439,540
Construction and Land Development	2,997,566	11,634,805
Residential and Other Properties	34,276,731	31,215,301
Total Loans Secured by Real Estate	<u>60,647,691</u>	<u>63,289,646</u>
Commercial and Industrial	10,105,982	12,659,657
Consumer and Other	3,985,766	4,830,462
Government Agency Guaranteed	2,364,744	2,938,862
	<u>77,104,183</u>	<u>83,718,627</u>
Plus: Unamortized Premiums on Purchased Loans	94,033	131,155
Less: Estimated Allowance for Loan Losses	(1,438,566)	(2,521,744)
Loans, net	<u>\$ 75,759,650</u>	<u>\$ 81,328,038</u>

Included in Consumer and Other Loans shown above are deposit account balances totaling \$13,803 which were in overdraft status as of December 31, 2009 (\$13,655 in 2008).

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. These financial instruments are recorded in the financial statements when they are funded. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the balance sheet. Outstanding letters of credit were approximately \$49,000 as of December 31, 2009 (\$451,000 at December 31, 2008). Unadvanced lines of credit and commitments to extend credit were approximately \$7,909,000 as of December 31, 2009 (\$10,622,000 at December 31, 2008). Of the total outstanding letters of credit and unadvanced lines and commitments as of December 31, 2009 approximately \$6,518,000 (\$8,779,000 at December 31, 2008) were secured, primarily by real estate. 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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

From time to time, the Bank provides credit to its executive officers, directors, and their affiliates. In management's opinion, such transactions are made on the same terms as those prevailing for comparable transactions with other borrowers and do not represent more than a normal risk of collection. The balance in this category changes based upon disbursements and repayments of loans and changes in directors or executive officers. Loans to executive officers, directors, and their affiliates are as follows:

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 4 - LOANS AND ESTIMATED ALLOWANCE FOR LOAN LOSSES (Continued)

	2009	2008
Balance at Beginning of Year	\$ 742,571	\$ 944,505
Net Disbursements and Other Additions	1,723,933	791,399
Net Repayments and Other Reductions	(419,464)	(993,333)
Balance at End of Year	<u>\$ 2,047,040</u>	<u>\$ 742,571</u>

Activity in the estimated allowance for loan losses is as follows:

	2009	2008
Balance at Beginning of Year	\$ 2,521,744	\$ 702,074
Charge-Offs	(2,228,420)	(153,451)
Recoveries	6,305	28,495
Provision Charged to Expense	1,138,937	1,944,626
Balance at End of Year	<u>\$ 1,438,566</u>	<u>\$ 2,521,744</u>

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

	2009	2008
Impaired Loans without a Specific Valuation Allowance	\$ 6,975,293	\$ 3,099,917
Impaired Loans with a Specific Valuation Allowance	0	3,925,062
Total Impaired Loans	<u>\$ 6,975,293</u>	<u>\$ 7,024,979</u>
Specific Valuation Allowance Related to Impaired Loans	\$ 0	\$ 1,764,961
Past-due Loans Ninety Days or More and Still Accruing Interest	\$ 0	\$ 174,250
Total Non-Accrual Loans	\$ 1,989,687	\$ 3,978,127
Average Investment in Specifically Evaluated Impaired Loans	\$ 2,210,487	\$ 2,475,904
Interest Income Recognized on Impaired Loans	\$ 0	\$ 0
Interest Income Recognized on a Cash Basis on Impaired Loans	\$ 0	\$ 0

Loan impairment and any related valuation allowance is determined under the provisions established by FASB ASC 310. For all periods presented above, impaired loans without a valuation allowance represent loans for which management believes that the estimated collateral value of the property securing the loan is higher than the carrying value of that loan.

Interest income that would have accrued on non-accrual loans if they were on a current basis was \$25,913 and \$176,615 for the years ended December 31, 2009 and 2008, respectively.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 4 - LOANS AND ESTIMATED ALLOWANCE FOR LOAN LOSSES (Continued)

The Bank has four loans at December 31, 2009 with outstanding balances of approximately \$1,112,000 that met the regulatory definition for Troubled Debt Restructurings. All four loans were moved to interest only payments, thus providing the borrower with a concession that would normally not be given. All four loans were reviewed for impairment as of December 31, 2009. One of the loans was not performing in accordance with the modified terms and has been classified as substandard.

Current instabilities in both the local and national economy are contributing to notable deteriorations in real estate values. Such instabilities in the local economy have the potential to impact the underlying value of real estate collateral securing a sizable portion of the Bank's loan portfolio. In addition, unemployment levels remain elevated, both nationally and locally, and established businesses throughout the United States are being forced to lay off employees and/or cease operations due to declining financial performance. Due to these instabilities and uncertainties, current estimates relating to the Bank's allowance for loan losses could change significantly in the near term.

NOTE 5 - PREMISES AND EQUIPMENT

A summary of premises and equipment is as follows as of December 31:

	2009	2008
Land	\$ 448,929	\$ 448,929
Building	742,341	742,341
Leasehold Improvements	1,649,800	1,649,800
Furniture, Fixtures, and Equipment	1,806,642	1,789,173
	<u>4,647,712</u>	<u>4,630,243</u>
Less Accumulated Depreciation	(1,599,318)	(1,326,782)
	<u>\$ 3,048,394</u>	<u>\$ 3,303,461</u>

NOTE 6 - DEPOSITS

A summary of deposits is as follows as of December 31:

	2009	2008
Noninterest-Bearing Demand Accounts	\$ <u>8,974,590</u>	\$ <u>9,479,658</u>
Interest-Bearing Accounts		
Checking Accounts	22,912,639	6,134,219
Money Market Accounts	9,104,142	11,468,915
Savings Accounts	7,191,564	8,286,409
Time Deposits:		
Less Than \$100,000	25,471,952	22,831,277
\$100,000 or More	25,199,522	34,183,936
Total Interest-Bearing Accounts	<u>89,879,819</u>	<u>82,904,756</u>
Total Deposits	<u>\$ 98,854,409</u>	<u>\$ 92,384,414</u>

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 6 – DEPOSITS (Continued)

There were no brokered certificate of deposit pools included in time deposits greater than \$100,000 at December 31, 2009 compared to approximately \$10,806,000 at December 31, 2008.

As of December 31, 2009, the scheduled maturities of time deposits above are as follows:

2010	\$	46,310,714
2011		982,592
2012		2,869,879
2013		283,215
2014		225,074
	\$	<u>50,671,474</u>

The Bank's executive officers, directors, and their affiliates maintain certain deposit accounts with the Bank which are, in management's opinion, offered on the same terms and rates as all other depositors.

NOTE 7 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Bank has sold certain securities under agreements to repurchase, primarily on an overnight basis, to certain commercial depositors. The total of these securities was \$2,583,892 and \$3,264,788 as of December 31, 2009 and 2008, respectively.

Securities sold under agreements to repurchase averaged approximately \$3,312,000 during 2009 (\$4,118,000 during 2008). The maximum amount outstanding at any month-end during 2009 was approximately \$6,089,000 (\$4,898,000 during 2008).

NOTE 8 - INCOME TAXES

The Bank accounts for income taxes in accordance with income tax accounting guidance in FASB ASC 740.

The provision for income taxes charged to income for the years ended December 31, 2009 and 2008 consists of the following:

	2009	2008
Deferred Tax Benefit	\$ (330,776)	\$ (344,799)
Total Tax Benefit	<u>\$ (330,776)</u>	<u>\$ (344,799)</u>

Income taxes as shown in the statements of operations differ from the amounts computed using the statutory federal income tax rate for the following reasons:

	2009		2008	
	Amount	Percent of Pretax Loss	Amount	Percent of Pretax Loss
Federal income tax benefit at statutory rate	\$ (922,650)	(34.0) %	\$ (680,668)	(34.0) %
Change in deferred tax valuation allowance	737,997	27.2	188,932	9.4
Non-deductible items	838	0.0	1,665	0.1
State income (benefit) expense and other, net	(146,961)	(5.4)	145,272	7.3
Total Tax Benefit	<u>\$ (330,776)</u>	<u>(12.2) %</u>	<u>\$ (344,799)</u>	<u>(17.2) %</u>

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 8 – INCOME TAXES (Continued)

Net deferred tax assets consist of the following components as of December 31, 2009 and December 31, 2008:

	2009	2008
Deferred Tax Assets:		
Net Operating Loss Carryforward	\$ 2,551,387	\$ 1,420,468
Capital Loss Carryforward	383,738	0
Allowance for Loan Losses	338,119	904,065
Contribution Carryover	8,208	11,685
Total Deferred Tax Assets	<u>3,281,452</u>	<u>2,336,218</u>
Valuation Allowance	<u>(1,714,384)</u>	<u>(976,387)</u>
	<u>1,567,068</u>	<u>1,359,831</u>
Deferred Tax Liabilities:		
Depreciation	219,726	318,707
Accretion - Investment Securities	156	1,232
Unrealized Holding Gains on Securities Available for Sale	1,161	46,964
FHLB Stock Dividends	16,541	16,541
Total Deferred Tax Liabilities	<u>237,584</u>	<u>383,444</u>
Net Deferred Tax Asset	<u>\$ 1,329,484</u>	<u>\$ 976,387</u>

As of December 31, 2009 and 2008, the Company recorded a valuation allowance of \$1,714,384 and \$976,387, respectively, on the deferred tax assets to reduce the total to an amount that management believes will ultimately be realized. This represents a 56% and 50% valuation allowance on net deferred tax assets as of December 31, 2009 and 2008, respectively. Realization of the deferred tax asset is dependent upon sufficient future taxable income available within the carryforward or reversal period under the federal and state laws. During the year ended December 31, 2009, the Bank increased the valuation allowance by \$737,997. The effect of this increase was recorded as a decrease in the deferred tax benefit included in the accompanying statements of operations. A valuation allowance for the balance of the deferred tax benefit will be maintained until management determines it is more likely than not that future earnings will be sufficient to use the tax benefit in the required time frame.

The Bank has state and federal net operating loss carryforwards totaling approximately \$7,591,872 and \$6,546,165, respectively, at December 31, 2009. These carryforwards are available to offset tax liabilities on future income through 2029 for federal income taxes and 2024 for state income taxes.

As of December 31, 2009, the Bank has accrued no interest and no penalties related to uncertain tax positions. It is the Bank's policy to recognize interest and/or penalties related to income tax matters in income tax expense.

NOTE 9 - FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

The Bank has four advances from the FHLB of Cincinnati at December 31, 2009 (two in 2008). The four advances are for \$5 million, \$2 million, \$3 million and \$500 thousand and mature in 2015, 2010, 2012, and 2013, respectively. The weighted average interest rate on these advances is 3.40%. The FHLB has a one time option to convert the \$5 million advance to a variable rate. If the FHLB exercises its option and increases the interest rate on this advance, the Bank has the option to pay the advance in full without penalty.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 9 - FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS (Continued)

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 three of its correspondent commercial banks (one in 2008). The accommodation line allows secured borrowings up to a maximum amount of \$8,450,000. Advances must be repaid on the next business day with interest. No borrowings were outstanding on these lines at December 31, 2009 or 2008.

NOTE 10 - REGULATORY MATTERS

As a national bank, the Bank is subject to the dividend restrictions set forth by the Comptroller of the Currency. Under such restrictions, the Bank may not, without the prior approval of the Comptroller of the Currency, declare dividends in any one year in excess of the sum of the Bank's current year earnings plus undistributed Bank earnings from the prior two years. The Bank has not paid any dividends to its stockholders to date.

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier I capital (as defined in the regulations) to Risk-Weighted Assets (as defined), and of Tier I capital (as defined) to Average Assets (as defined). Management believes, as of December 31, 2009 and 2008, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2009 and 2008, the Bank is categorized as *well capitalized* under the regulatory framework for prompt corrective action. To be categorized as *well capitalized*, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that date that management believes have changed the institution's category.

The Bank's actual capital amounts and ratios are also presented in the table. All amounts are in thousands of dollars.

	Actual		To Comply With Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2009						
Total Capital (to Risk-Weighted Assets)	\$ 12,186	16.2%	\$ 6,023	8.0%	\$ 7,528	10.0%
Tier I Capital (to Risk-Weighted Assets)	\$ 11,239	14.9%	\$ 3,011	4.0%	\$ 4,517	6.0%
Tier I Capital (to Average Assets)	\$ 11,239	9.0%	\$ 4,969	4.0%	\$ 6,212	5.0%
As of December 31, 2008						
Total Capital (to Risk-Weighted Assets)	\$ 15,846	19.6%	\$ 6,482	8.0%	\$ 8,103	10.0%
Tier I Capital (to Risk-Weighted Assets)	\$ 14,814	18.3%	\$ 3,241	4.0%	\$ 4,862	6.0%
Tier I Capital (to Average Assets)	\$ 14,814	12.5%	\$ 4,722	4.0%	\$ 5,902	5.0%

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 11 - RETIREMENT PLAN

The Bank has established a 401(k) retirement plan which allows eligible officers and employees to contribute up to the maximum allowable amount under the IRS Code. The Bank has the option, at the discretion of the board of directors, to make contributions to the plan. During the year ended December 31, 2009 the Bank did not contribute to the plan. For the year ended December 31, 2008 the Bank contributed \$25,286.

NOTE 12 - STOCK OPTIONS

Effective with the organization of the Bank, the Bank's board of directors approved a stock option plan, which was ratified by the Bank's stockholders 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. In December 2005, the board of directors awarded a total of 123,250 options related to these shares, by individual agreements to employees of the Bank. These options have an exercise price of \$13.50 per share, which was estimated to be greater than the fair value of the stock on the date the options were granted. The options became fully vested on the grant date and expire in five years. The Bank intends to issue new common shares when options are exercised. No options were exercised under this plan in 2009 and 2008, respectively.

A summary of the status of the Bank's stock options outstanding is presented below:

	2009		2008	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price
Outstanding at Beginning of Year	123,250	\$ 13.50	123,250	\$ 13.50
Granted by Individual Agreements	0	0	0	0
Exercised	0	0	0	0
Forfeited	0	0	0	0
Outstanding at End of Year	<u>123,250</u>	\$ 13.50	<u>123,250</u>	\$ 13.50
Options Exercisable at Year-End	<u>123,250</u>		<u>123,250</u>	
Weighted-Average Fair Value of Options Granted During the Year	\$ <u>N/A</u>		\$ <u>N/A</u>	

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

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 13.50	123,250	1.00	\$ 13.50	123,250	\$ 13.50

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 13 - LEASE COMMITMENTS

The Bank has entered into an operating lease agreement and a sublease agreement to rent space that serves as the Bank's main office. The initial term of the lease and sublease was for five years commencing in November and October 2002, respectively. The lease and sublease were renewed for an additional five years commencing on November 1, 2007 and expiring October 31, 2012. The Bank has the option at that time to renew for an additional five years. The total monthly rental payment under the lease and sublease is \$13,630.

The Bank entered into an operating lease during 2007 for the rental of office space in Dandridge, Tennessee for the purpose of establishing a loan production office. This lease has an initial term of five years with two five year renewal options. The total monthly rental under this lease is \$1,308. During 2008, the Bank ceased operations at this loan production office. The Bank currently has the space sublet for \$800 per month, increasing to \$1,000 per month in January 2010 until the existing lease expires.

The Bank entered into a twenty year ground lease in west Morristown where the Bank built a full service branch. The payments on this lease commenced in January of 2008 at \$2,500 per month.

The Bank also leases certain office equipment for \$864 per month. These leases will expire in 2011.

Rent expense for all lease commitments for the year ended December 31, 2009 was \$223,601 (\$207,336 during 2008).

Future minimum rental payments under all noncancellable operating leases as of December 31, 2009 are as follows:

2010	\$	219,624
2011		219,624
2012		167,613
2013		30,000
2014		30,000
Thereafter		390,000
	\$	<u>1,056,861</u>

NOTE 14 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

The Bank's primary business activity is with customers located within East Tennessee. As of December 31, 2009 and 2008, the Bank had a concentration in loans which are secured by real estate, as shown in Note 4. The usual risk associated with such a concentration is generally mitigated by being spread over several hundred unrelated borrowers and by adequate loan-to-collateral value ratios. Note 3 describes the types and amounts of securities the Bank has invested in as of December 31, 2009 and 2008. The Bank does not have any significant concentrations with any one industry or customer.

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with FASB ASC 820, the fair value of a financial instrument is 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. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Valuation Hierarchy:

In accordance with this guidance, the Bank groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access.

Level 2 - Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active and other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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, the Bank classifies the securities within level 1 of the valuation hierarchy. Securities are defined as both long and short positions. Level 1 securities include highly liquid government bonds and exchange-traded equities.

If quoted market prices are not available, the Bank estimates fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include government-sponsored enterprise obligations, corporate bonds, and other securities. Mortgage-backed securities are included in level 2 if observable inputs are available. In certain cases where there is limited activity or less transparency around inputs to the valuation, the Bank classifies those securities in level 3.

Impaired loans - The Bank does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with FASB ASC 310. The fair value of

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

impaired loans is estimated using several methods including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2009, substantially all of the total impaired loans were evaluated based on the fair value of collateral. In accordance with FASB ASC 310, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on the observable market price or a current, independent appraised value, the Bank records the impaired loan as nonrecurring Level 2. The Bank records the impaired loan as nonrecurring Level 3 when management has become aware of events that have significantly impacted the condition or marketability of the collateral since the most recent appraisal. In this case, management will reduce the appraisal value based on factors determined by their judgment and collective knowledge of the collateral and market conditions.

Foreclosed Assets - Foreclosed assets consisting of properties obtained through foreclosure or in satisfaction of loans is initially recorded at fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs. At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and any subsequent adjustments to the fair value are recorded as a component of foreclosed real estate expense. Other real estate is included in Level 3 of the valuation hierarchy.

Liabilities:

At December 31, 2009, the Bank had no liabilities meeting the criteria for disclosure.

The following tables present the financial instruments carried at fair value as of December 31, 2009, in the balance sheets:

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

	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities Available for Sale:				
Obligations of U.S. Government Agencies	\$ 18,070,823	\$ 18,070,823	\$ 0	\$ 0
Mortgage-Backed and Related Securities	15,486,682	0	15,486,682	0
Securities Available-for-Sale	\$ 33,557,505	\$ 18,070,823	\$ 15,486,682	\$ 0

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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

	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans	\$ 6,975,293	\$ 0	\$ 0	\$ 6,975,293
Foreclosed Assets	1,827,445	0	0	1,827,445
	<u>\$ 8,802,738</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 8,802,738</u>

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.

The following methods and assumptions were used by the Bank in estimating the fair value disclosures for financial instruments:

Cash and Cash Equivalents - Cash and cash equivalents include cash and due from banks, cash on hand, and federal funds sold. The carrying amounts reported in the balance sheets approximate fair value.

Equity Investments - The carrying value of these equity investments with regulatory and other entities in which the Bank has an ongoing business relationship approximates fair value, based on the stock redemption provisions of entities.

Interest Receivable - The carrying amounts of interest receivable approximate fair value.

Deposits - The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits and NOW, money market, and savings accounts, is equal to the amount payable on demand at the reporting date. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Securities Sold Under Agreements to Repurchase - The estimated fair value of these liabilities, which are short term, approximates their carrying value.

Advances From Federal Home Loan Bank - Rates currently available to the Bank for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt.

Interest Payable - The carrying amounts of interest payable approximate fair value.

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Commitments to Extend Credit - The fair value of loan commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. Fixed-rate commitments to extend credit are not material to the Bank as of December 31, 2009 and 2008.

The carrying amount and estimated fair value of the Bank's financial instruments at December 31, are as follows:

	2009		2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS:				
Cash and Cash Equivalents	\$ 7,186,512	\$ 7,186,512	\$ 3,079,510	\$ 3,079,510
Securities	\$ 33,557,505	\$ 33,557,505	\$ 26,371,646	\$ 26,464,581
Equity Investments	\$ 829,900	\$ 829,900	\$ 2,027,342	\$ 2,027,342
Net Loans	\$ 75,759,650	\$ 75,220,822	\$ 81,328,038	\$ 80,866,092
Interest Receivable	\$ 542,335	\$ 542,335	\$ 559,845	\$ 559,845
FINANCIAL LIABILITIES:				
Deposits	\$ 98,854,409	\$ 99,333,634	\$ 92,384,414	\$ 92,950,743
Securities Sold Under Agreements to Repurchase	\$ 2,583,891	\$ 2,583,891	\$ 3,264,788	\$ 3,264,788
Advances From Federal Home Loan Bank	\$ 10,500,000	\$ 10,834,639	\$ 7,000,000	\$ 7,655,262
Interest Payable	\$ 346,071	\$ 346,071	\$ 409,779	\$ 409,779

NOTE 16 - 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 17 - COMMITMENTS AND CONTINGENT LIABILITIES

The Bank is subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position of the Bank.

NOTE 18 - IMPAIRED EQUITY INVESTMENTS

Included in the Bank's December 31, 2009 statement of operations as loss on impaired equity investments is a \$1,128,642 impairment charge related to the Bank's investments in Silverton Financial Services, Inc., which was a leading correspondent bank with over 1,400 bank clients, and was taken into receivership on May 1, 2009. In accordance with generally accepted

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

NOTES TO FINANCIAL STATEMENTS

Years Ending December 31, 2009 and 2008

NOTE 18 - IMPAIRED EQUITY INVESTMENTS (Continued)

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.

Market for Our Common Equity and Related Matters

From August 16, 2006 to December 18, 2008, the Bank's common stock was traded on the Nasdaq National Market ("Nasdaq") under the symbol CNLA. On December 9, 2008, we voluntarily delisted the common stock from Nasdaq, effective the open of trading on December 19, 2008. Since our voluntary delisting, our shares have been quoted on the Nasdaq Over-the-Counter Bulletin Board under the symbol CNLA.OB, and on the Pink Sheets under the symbol CNLA. We took this action to reduce and more effectively manage our regulatory and administrative costs, and to enable our management to better focus on the growth and development of our business.

As of March 15, 2010, there were approximately 744 shareholders of record of the Bank's common stock and 1,891,426 shares outstanding. The development of an active secondary market requires the existence of an adequate number of willing buyers and sellers. Historically, the reported trading volume would indicate a lack of activity in the secondary market for our common stock. The lack of activity in the secondary market for our common stock may materially impact a shareholder's ability to promptly sell common stock at a price acceptable to the selling shareholder, and contributes to the volatility of our common stock's price. The high and low prices per share as reported on a quarterly basis in 2009 and 2008 are as follows:

<u>Quarter</u>	<u>High</u>	<u>Low</u>	<u>Dividend</u>
2009			
4 th Quarter	\$3.00	\$ 1.70	\$ -
3 rd Quarter	4.25	1.55	-
2 nd Quarter	4.30	2.60	-
1 st Quarter	4.25	2.10	-
2008			
4 th Quarter	\$6.55	\$ 3.71	\$ -
3 rd Quarter	8.00	6.25	-
2 nd Quarter	9.00	5.50	-
1 st Quarter	11.00	6.60	-

The Bank has not paid and does not anticipate paying dividends on its common stock in the immediate future. The Bank is required by federal law to obtain prior approval of the Office of the Comptroller of the Currency (OCC) for payments of dividends if the total of all dividends declared by our Board of Directors in any year will exceed (1) the total of the Bank's net profits for that year, plus (2) the Bank's retained net profits of the preceding two years, less any required transfers to surplus. Under applicable OCC regulations, no dividends may be paid by a national bank until it is cumulatively profitable; as a consequence, the Bank is currently prohibited from paying dividends. No assurance can be given that dividends will be declared by the Bank, or if declared, what the amount of the dividends will be or whether such dividends, once declared, would continue.

Shareholders may obtain, without charge, a copy of Community National Bank of the Lakeway Area's 2009 Annual Report to the Office of the Comptroller of the Currency on Form 10-K. Written requests should be addressed to:

Darwin K. Kilday
Chief Financial Officer and Corporate Secretary of the Bank
Community National Bank of the Lakeway Area
PO Box 1919
Morristown, TN 37816-1919

A copy of the Annual Report on Form 10-K is also available on our website www.cnbla.com.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Community National Bank of the Lakeway Area:

We consent to the incorporation by reference to the Registration Statement on Form S-8, filed August 30, 2007, and in the related prospectus of Community National Bank of the Lakeway Area of our report, dated March 29, 2010, relating to the balance sheets of Community National Bank of the Lakeway Area as of December 31, 2009 and 2008, and the related statements of operations, changes in stockholders' equity, and cash flows for the two year period ended December 31, 2009.

PERSHING YOAKLEY & ASSOCIATES, P.C.
Knoxville, Tennessee
March 30, 2010

**CERTIFICATION BY CHIEF EXECUTIVE OFFICER
PURSUANT TO RULE 13a-14(a)/15(d)-14(a)**

I, Samuel F. Grigsby, Jr., certify that:

1. I have reviewed this report on Form 10-K of Community National Bank of the Lakeway Area (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and
 - d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting.
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: March 30, 2010

/s/ Samuel F. Grigsby, Jr.
Samuel F. Grigsby, Jr.
Chairman and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION BY CHIEF FINANCIAL OFFICER
PURSUANT TO RULE 13a-14(a)/15(d)-14(a)**

I, Darwin K. Kilday, certify that:

1. I have reviewed this report on Form 10-K of Community National Bank of the Lakeway Area (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and
 - d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting.
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

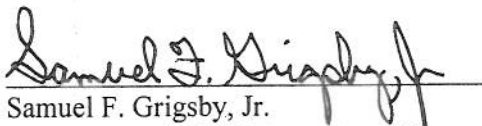
Date: March 30, 2010

/s/ Darwin K. Kilday
Darwin K. Kilday
Chief Financial Officer
(Principal Financial and Accounting Officer)


**CERTIFICATIONS PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Community National Bank of the Lakeway Area (the "Bank") on Form 10-K for the year ended December 31, 2009 as filed with the Office of the Comptroller of the Currency on the date hereof (the "Report"), Samuel F. Grigsby, Jr., Chief Executive Officer of the Bank, and Darwin K. Kilday, Chief Financial Officer of the Bank, respectively, do each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank.



Samuel F. Grigsby, Jr.
Chairman and Chief Executive Officer
March 30, 2010



Darwin K. Kilday
Executive Vice President and Chief Financial Officer
March 30, 2010