

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

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

For the Transition Period from _____ to _____

Community National Bank of the Lakeway Area

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

United States

6021

27-0031825

(State or jurisdiction of
incorporation or organization)

(Primary Standard Industrial
Classification Code Number)

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

225 West First North Street, Morristown, Tennessee 37814

(Address of principal executive offices)

(423) 587-2345

(Issuer's telephone number)

Not Applicable

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

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "accelerated filer," "large accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date 1,891,426 shares of common stock, \$1.00 par value per share, issued and outstanding as of March 14, 2010.

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

March 31, 2010

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FORWARD LOOKING STATEMENTS

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

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

PART 1

ITEM 1. FINANCIAL STATEMENTS

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

INDEX TO FINANCIAL STATEMENTS

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COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA
BALANCE SHEETS

	March 31, 2010 (Unaudited)	December 31, 2009
ASSETS	(Dollars in thousands)	
Cash and Cash Equivalents:		
Cash and Due From Banks	\$ 4,429	\$ 2,596
Federal Funds Sold	5,550	4,590
Total Cash and Cash Equivalents	9,979	7,186
Securities:		
Available for Sale, at Fair Value	33,820	33,558
Total Securities	33,820	33,558
Equity Investments, at Cost	839	830
Loans, Net of Estimated Allowance for Loan Losses of \$1,489 at March 31, 2010 and \$1,439 at December 31, 2009	72,982	75,760
Premises and Equipment, Net	2,991	3,048
Interest Receivable	504	542
Foreclosed Assets	1,874	1,827
Deferred Tax Benefit	1,307	1,330
Prepaid Banking Agency Assessments	549	586
Other Assets	244	179
TOTAL ASSETS	\$ 125,089	\$ 124,846
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 8,677	\$ 8,975
Interest-bearing	90,534	89,880
Total Deposits	99,211	98,855
Securities Sold Under Agreements to Repurchase	2,123	2,584
Advances from Federal Home Loan Bank	10,500	10,500
Interest Payable	459	346
Other Liabilities	91	125
Total Liabilities	112,384	112,410
STOCKHOLDERS' EQUITY		
Common Stock, Par Value \$1, Authorized 4,000,000 Shares; Issued and Outstanding 1,891,426 Shares at March 31, 2010 and December 31, 2009	1,891	1,891
Capital in Excess of Par Value	17,042	17,042
Retained Deficit	(6,465)	(6,502)
Accumulated Other Comprehensive Income	237	5
Total Stockholders' Equity	12,705	12,436
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 125,089	\$ 124,846

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF OPERATIONS

	(Unaudited)	
For the Three Months Ended March 31,	2010	2009
	(Dollars in thousands, except for per share data)	
INTEREST INCOME		
Loans, Including Fees	\$ 1,231	\$ 1,314
Investment Securities	261	292
Federal Funds Sold and Other	14	13
Total Interest Income	<u>1,506</u>	<u>1,619</u>
INTEREST EXPENSE		
Deposits	476	602
Advances	88	70
Other	2	2
Total Interest Expense	<u>566</u>	<u>674</u>
NET INTEREST INCOME	940	945
PROVISION FOR ESTIMATED LOAN LOSSES	<u>50</u>	<u>88</u>
NET INTEREST INCOME AFTER PROVISION FOR ESTIMATED LOAN LOSSES	<u>890</u>	<u>857</u>
NONINTEREST INCOME		
Service Charges on Deposit Accounts	68	73
Net Gain on Sale of Foreclosed Assets	67	0
Commissions on Loans Originated for Others	1	1
Other	46	27
Total Noninterest Income	<u>182</u>	<u>101</u>
NONINTEREST EXPENSE		
Salaries and Employee Benefits	432	450
Occupancy Costs	190	198
Data Processing	96	60
Office Supplies and Postage	25	24
Advertising and Promotion	23	34
Legal and Other Professional	66	74
Foreclosed Asset Valuation Expense	89	0
Net Loss on Sales of Securities Available for Sale and Impaired Equity Investments	0	1,297
Other	146	111
Total noninterest expense	<u>1,067</u>	<u>2,248</u>
NET INCOME (LOSS) BEFORE INCOME TAXES	5	(1,290)
INCOME TAX BENEFIT	<u>32</u>	<u>53</u>
NET INCOME (LOSS)	<u>\$ 37</u>	<u>\$ (1,237)</u>
INCOME (LOSS) PER SHARE		
Basic	<u>\$ 0.02</u>	<u>\$ (0.65)</u>
Diluted	<u>\$ 0.02</u>	<u>\$ (0.65)</u>

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA
STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended March 31, 2010 and 2009

	Three Months Ended March 31,	
	2010	2009
	(Unaudited – in thousands)	
Net income (loss)	\$ 37	\$ (1,237)
Other comprehensive income, net of tax effects:		
Net unrealized gains (losses) on securities available for sale arising during the period	287	(34)
Reclassification adjustment for (gains) losses included in net loss	0	34
Deferred income tax (expense) benefit related to net unrealized gains (losses) on securities available for sale, net of valuation allowance	(55)	0
Other comprehensive income, net of tax effects	232	0
Comprehensive income (loss)	\$ 269	\$ (1,237)

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA
 STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
 For the Three Months Ended March 31, 2010
 (Unaudited)

	Common Stock	Capital in Excess of Par Value	Retained Deficit	Accumulated Other Comprehensive Income	Total
(Dollars in Thousands)					
Balances, December 31, 2009	\$ 1,891	\$ 17,042	\$ (6,502)	\$ 5	\$ 12,436
Net loss	0	0	37	0	37
Other comprehensive income	0	0	0	232	232
Balances, March 31, 2010	\$ 1,891	\$ 17,042	\$ (6,465)	\$ 237	\$ 12,705

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA
STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2010 and 2009 (Unaudited)

For the three months ended March 31,	2010	2009
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income (Loss)	\$ 37	\$ (1,237)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:		
Provision for Estimated Loan Losses	50	88
Provision for Foreclosed Assets Valuation	89	0
Depreciation	67	69
Net Amortization/Accretion of Premiums and Discounts on Securities	114	19
Net Amortization of Premiums on Purchased Loans	2	3
Net Loss on Sales of Securities Available for Sale	0	169
Loss on Impairment of Equity Securities	0	1,128
Net Gain on the Sale of Foreclosed Assets	(67)	0
Decrease in Interest Receivable	38	99
Increase in Deferred Tax Benefit	(32)	(53)
Increase in Prepaid Expenses and Other Assets	(28)	(54)
Increase in Interest Payable	113	145
Decrease in Other Liabilities	(34)	(23)
Total adjustments	312	1,590
Net Cash Provided by Operating Activities	349	353
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities Available for Sale:		
Sales and Calls	3,100	9,706
Purchases	(4,000)	(12,314)
Principal Repayments Received	811	583
Securities Held to Maturity:		
Sales and Calls	0	3,644
Principal Repayments Received	0	42
Purchases of Equity Investments	(9)	(18)
Proceeds from the Sale of Foreclosed Assets	281	0
Net (Decrease) Increase in Loans	2,376	(61)
Purchases of Premises and Equipment	(10)	(13)
Net Cash Provided by Investing Activities	2,549	1,569
CASH FLOWS FROM FINANCING ACTIVITIES		
Net Decrease in Non Interest-Bearing Deposits	(298)	(1,306)
Net (Decrease) Increase in Interest-Bearing Deposits (Excluding Time Deposits)	(474)	4,712
Net Increase (Decrease) in Time Deposits	1,128	(5,564)
Net (Decrease) Increase in Repurchase Agreements	(461)	230
Net Cash Used in Financing Activities	(105)	(1,928)

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

STATEMENTS OF CASH FLOWS (Cont.)

(Unaudited)

	For the three months ended March 31,	
	<u>2010</u>	<u>2009</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	2,793	(6)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>7,186</u>	<u>3,080</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 9,979</u>	<u>\$ 3,074</u>
Supplementary Disclosures of Cash Flow Information:		
Cash Paid During the Year for:		
Interest	\$ 453	\$ 530
Income Taxes	\$ 0	\$ 0
Supplementary Disclosures for Noncash Investing Activities:		
Change in Unrealized Gains/Losses on Securities Available for Sale	\$ 287	\$ 0
Change in Deferred Income Taxes Associated with Unrealized Gains/ Losses on Investment Securities Available for Sale	\$ 55	\$ 0
Change in Net Unrealized Gains/Losses on Securities Available for Sale	\$ 232	\$ 0
Loans moved to foreclosed assets	\$ 350	\$ 926

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

Community National Bank of the Lakeway Area

Notes to Financial Statements (Unaudited)

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

Nature of Operations – Community National Bank of the Lakeway Area (the Bank) commenced banking operations on April 9, 2003. The Bank provides a variety of banking services to individuals and businesses primarily in the counties of Hamblen and Jefferson through its main office and branch in Morristown 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 March 31, 2010 and December 31, 2009.

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. The Bank had no debt securities classified as held to maturity at March 31, 2010.

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.

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

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 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 March 31, 2010 and December 31, 2009, approximately \$25 thousand 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. 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

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

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 March 31, 2010 of \$481 thousand and December 31, 2009 of \$392 thousand.

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. 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 58% (approximately) valuation allowance at March 31, 2010 compared to 56% (approximately) at December 31, 2009 to offset the net deferred tax asset resulting from timing differences. (See Note 10 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.

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

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.

	March 31, 2010	March 31, 2009
Per Share Information:		
Basic, as Reported	\$ 0.02	\$ (0.65)
Diluted, as Reported	\$ 0.02	\$ (0.65)

Income (loss) per share is based on the following for the quarters ended March 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

Newly Adopted Accounting Pronouncements-In the first quarter of 2010, the Financial Accounting Standards Board (FASB) updated Accounting Standards Update No. 2010-09, *Subsequent Events (Topic 855)-Amendments to Certain Recognition and Disclosure Requirements*. This guidance amends FASB ASC 855, *Subsequent Events*, so that SEC filers no longer are required to disclose the date through which subsequent events have been evaluated in originally issued and revised financial statements. SEC filers must evaluate subsequent events through the date the financial statements are issued.

Also during the first quarter of 2010, the FASB issued Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements*. This update requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. This guidance was effective for interim and annual reporting periods beginning after December 15, 2009.

NOTE 2. INCOME (LOSS) PER COMMON SHARE

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

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Average number of shares outstanding	1,891,426	1,891,426
Effect of dilutive options (see below)	0	0
Average number of shares outstanding used to calculate loss per share	1,891,426	1,891,426

NOTE 3. SECURITIES

In accordance with FASB ASC 260, *Earnings Per Share*, no potential additional shares should be included in the computation of any diluted per share amount when a loss is reported, therefore, basic and diluted loss per share amounts are the same for periods reporting a net loss. Additionally, for the three month periods ended March 31, 2010 and 2009, outstanding stock options totaling 123,250 with an exercise price of \$13.50 were not included in the computation of diluted earnings per share because such shares would have had an anti-dilutive effect on earnings per share.

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

	Securities Available for Sale			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
(Dollars in thousands)				
As of March 31, 2010 (Unaudited):				
Debt Securities:				
Obligations of U.S. Government Agencies	\$ 19,092	\$ 61	\$ (81)	\$ 19,072
Mortgage-Backed and Related Securities	14,435	313	0	14,748
Total Securities Available for Sale	\$ 33,527	\$ 374	\$ (81)	\$ 33,820
As of December 31, 2009:				
Debt Securities:				
Obligations of U.S. Government Agencies	\$ 18,263	\$ 38	\$ (230)	\$ 18,071
Mortgage-Backed and Related Securities	15,289	215	(17)	15,487
Total Securities Available for Sale	\$ 33,552	\$ 253	\$ (247)	\$ 33,558

The amortized cost and estimated fair value of debt securities as of March 31, 2010 (unaudited), by contractual maturity, are as follows:

	Available for Sale	
	Amortized Cost	Estimated Fair Value
(Dollars in thousands)		
Due in One Year or Less	\$ 1,000	\$ 998
Due After One Year Through Five Years	7,919	7,925
Due After Five Years Through Fifteen Years	9,136	9,116
Due After Fifteen Years	1,037	1,033
	19,092	19,072
Mortgage-Backed and Related Securities	14,435	14,748
Total Securities	\$ 33,527	\$ 33,820

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

Debt securities with a total estimated fair value (which approximates book value) of approximately \$17.6 million as of March 31, 2010 were pledged primarily to secure deposits of public funds, repurchase agreements, and federal funds lines of credit.

NOTE 4. ALLOWANCE FOR LOAN LOSSES

Activity in the estimated allowance for loan losses for the three month periods ended March 31, 2010 and 2009 is as follows:

	March 31, 2010	March 31, 2009
	(Dollars in thousands)	
Balance at Beginning of Year	\$ 1,439	\$ 2,522
Charge-offs	(1)	(1,041)
Recoveries	1	1
Provision-Charged to Expense	50	88
Balance at End of Period	<u>\$ 1,489</u>	<u>\$ 1,570</u>

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

	At March 31, 2010	At March 31, 2009
	(Dollars in thousands)	
Nonaccrual loans	\$ 2,272	\$ 3,216
Restructured loans	2,850	0
Total nonperforming loans	<u>5,122</u>	<u>3,216</u>
Foreclosed assets	1,874	1,248
Total nonperforming assets	<u>\$ 6,996</u>	<u>\$ 4,464</u>
Accruing loans past due 90 days or more	\$ 0	\$ 0
Allowance for loan losses	1,489	1,570
Nonperforming loans to period end loans	6.88%	3.92%
Allowance for loan losses to period end loans	2.00%	1.92%
Allowance for loan losses to nonperforming loans	29.07%	48.82%
Nonperforming assets to total assets	5.59%	3.88%

NOTE 6. DEPOSITS

A summary of deposits as of March 31, 2010 (unaudited) and December 31, 2009 is as follows:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Noninterest-Bearing Demand Accounts	\$ 8,677	\$ 8,975
Interest-Bearing Accounts		
Checking Accounts	22,329	22,913
Money Market Accounts	9,223	9,104
Savings Accounts	7,182	7,192
Time Deposits:		
Less Than \$100,000	26,133	25,472
\$100,000 or More	25,667	25,200
Total Interest-Bearing Deposits	90,534	89,880
Total Deposits	\$ 99,211	\$ 98,855

NOTE 7. STOCK OPTION PLANS

Effective with the organization of the Bank, the Bank's board of directors approved an incentive stock option plan, which was ratified by the Bank's shareholders on April 4, 2003. The plan reserved 141,000 shares of the Bank's common stock for issuance pursuant to the options to be granted. As of March 31, 2010, 123,250 options have been granted and have vested under this plan. The Bank intends to issue new shares when options are exercised under this plan.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. No options were awarded during the three month periods ended March 31, 2010 and 2009.

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

	Three Months Ended March 31, 2010		Three Months Ended March 31, 2009	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at Beginning of Period	123,250	\$13.50	123,250	\$13.50
Granted	0		0	
Exercised	0		0	
Surrendered	0		0	
Forfeited	0		0	
Outstanding at End of Period	123,250	\$13.50	123,250	\$13.50
Options Exercisable at Period-End	123,250		123,250	
Weighted-Average Fair Value of Options Granted During the Period	N/A		N/A	

NOTE 7. STOCK OPTION PLANS (Continued)

Information pertaining to options outstanding at March 31, 2010 is as follows:

Options Outstanding			Options Exercisable		
<u>Exercise Price</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$13.50	123,250	.75 years	\$13.50	123,250	\$13.50

NOTE 8. FEDERAL HOME LOAN BANK ADVANCES

The Bank has four advances from the FHLB of Cincinnati at March 31, 2010 (two in 2009). One advance is for \$5 million and matures in 2015. The second advance obtained in 2007 is for \$2 million and will mature in 2010. The FHLB has a one-time option to convert the \$5 million dollar 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. Two additional fixed rate advances were obtained in July 2009 for \$3 million and \$500 thousand and mature in 2012 and 2013, respectively. The weighted average interest rate on all four advances is 3.40%. 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 federal funds accommodation lines of credit through three correspondent commercial banks. The accommodation lines allow for borrowings up to a maximum amount of \$7,997,000. Advances must be repaid on the next business day with interest. No borrowings were outstanding on these lines at March 31, 2010 or 2009.

NOTE 9. EMPLOYMENT AGREEMENTS

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

NOTE 10. INCOME TAXES

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the book and tax basis of the allowance for loan losses, accumulated depreciation, net operating loss carryforwards, organizational start-up-costs and the conversion from the accrual basis of accounting for financial reporting purposes to the cash basis of accounting for tax reporting. The net deferred tax assets and liabilities, which are recorded net of a valuation allowance, represent the future tax return consequences of those differences which will either be taxable or deductible when the assets and liabilities are recovered or settled. The Bank has recorded approximately a 58% valuation allowance at March 31, 2010 to offset the net deferred tax asset resulting from the above timing differences. The 58% valuation allowance will be provided until it is more likely than not that any net deferred tax assets will be realized. A 100% valuation allowance was recorded on the capital loss carryforward related to a loss on impaired equity securities. The 100% valuation allowance was recorded because it is unlikely the Bank will have capital gains to offset the loss in the future. Realization of the potential net deferred tax asset is dependent upon whether there will be sufficient taxable income available within the carryforward period under the federal and state tax laws.

The Bank has state and federal net operating loss carryforwards totaling approximately \$6.4 million and \$6.1 million respectively at March 31, 2010. These carryforwards are available to offset tax liabilities on future income through 2028 for federal taxes and 2023 for state.

As of March 31, 2010, 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 11. IMPAIRED EQUITY INVESTMENTS

Included in the Bank's March 31, 2009 Income Statement in the section titled "Net loss on sales of securities available for sale and impaired equity securities" is a \$1.3 million impairment charge related to the Bank's equity investments in Silverton Financial Services, Inc. (Silverton Bank), 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 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.

NOTE 12. 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 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.

NOTE 12. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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 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 March 31, 2010, 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 are 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 March 31, 2010, the Bank had no liabilities meeting the criteria for disclosure.

The following tables present the financial instruments carried at fair value as of March 31, 2010, in the balance sheets:

Assets measured at fair value on a recurring basis as of March 31, 2010:

	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	\$ 19,072	\$ 0	\$ 19,072	\$ 0
Mortgage-Backed and Related Securities	14,748	0	14,748	0
Securities Available for Sale	<u>\$ 33,820</u>	<u>\$ 0</u>	<u>\$ 33,820</u>	<u>\$ 0</u>

NOTE 12. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a nonrecurring basis as of March 31, 2010:

	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans	\$ 5,122	\$ 0	\$ 0	\$ 5,122
Foreclosed Assets	1,874	0	0	1,874
	<u>\$ 6,996</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 6,996</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.

NOTE 12. 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 March 31, 2010 and December 31, 2009.

The carrying amount and estimated fair value of the Bank's financial instruments at March 31, 2010 and December 31, 2009, are as follows:

	March 31, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS:				
Cash and Cash Equivalents	\$ 9,979	\$ 9,979	\$ 7,186	\$ 7,186
Securities	\$ 33,820	\$ 33,820	\$ 33,558	\$ 33,558
Equity Investments	\$ 839	\$ 839	\$ 830	\$ 830
Net Loans	\$ 72,982	\$ 72,685	\$ 75,760	\$ 75,221
Interest Receivable	\$ 504	\$ 504	\$ 542	\$ 542
FINANCIAL LIABILITIES:				
Deposits	\$ 99,211	\$ 99,615	\$ 98,855	\$ 99,334
Securities Sold Under Agreements to Repurchase	\$ 2,123	\$ 2,123	\$ 2,584	\$ 2,584
Advances From Federal Home Loan Bank	\$ 10,500	\$ 10,868	\$ 10,500	\$ 10,835
Interest Payable	\$ 459	\$ 459	\$ 346	\$ 346

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

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

This item contains "forward-looking statements" relating to, without limitation, future economic performance, plans and objectives of management for future operations, and projections of revenue and other financial items that are based upon the beliefs of our management, as well as assumptions made based upon information currently available to our management. The words "expect," "intend," "believe," and "estimate," as well as similar expressions, are intended to identify forward-looking statements. Our actual results may differ materially from the results discussed in the forward-looking statements, and our operating performance each quarter is subject to various risks and uncertainties that are discussed in detail in our filings with the Office of the Comptroller of the Currency ("OCC"), including the "Risk Factors" section in our Annual Report on Form 10-K for the year ended December 31, 2009.

The Bank posted net income of \$37 thousand or \$0.02 per share for the first quarter of 2010 compared to a net loss of \$(1.2) million or \$(0.65) per share for the same period in 2009. Included in the net profit for the first quarter was an \$89 thousand write down of foreclosed commercial property due to a decline in value upon reappraisal. On the positive side, the Bank also recognized a net gain on the sale of foreclosed properties totaling \$67 thousand. Significant items for the quarter ended March 31, 2010 include:

- Total deposits increased slightly during the first quarter with the majority of the growth in time deposits;
- Gross loans declined during the quarter due primarily to a commercial property foreclosure and continued weak loan demand;
- The net interest margin declined from 3.40% for the first three months of 2009 to 3.24% for the first three months of 2010;
- Capital remains strong.

Deposits for the first three months of 2010 increased a meager 0.40% to \$99.2 million as compared to \$98.8 million at December 31, 2009. Unlike the past few quarters, the deposit growth came from the traditional products rather than the Rewards Checking product that has been the source of deposit growth during the past year. Time deposits under \$100,000 increased \$661 thousand or 2.60%, while time deposits over \$100,000 increased \$467 thousand or 1.85%. Money market deposits also had an increase of \$119 thousand or 1.31%. On the other hand, noninterest-bearing demand accounts were down \$298 thousand or 3.32% and interest-bearing checking accounts declined \$584 thousand or 2.55%. The decline in interest-bearing checking was due primarily to a significant rate drop during the first quarter of 2010 in the Rewards Checking product.

Gross loans year-to-date declined from \$77.2 million at December 31, 2009 to \$74.5 million at March 31, 2010. The decline is due in part to the continued weak loan demand the Bank has experienced and in part to loans being moved to foreclosed assets. The Bank had one commercial loan foreclosed during the quarter totaling \$350 thousand.

During the first three months of 2010 the net interest margin for the Bank declined 16 basis points to 3.24% compared to 3.40% for the first three months of 2009. The yield on earning assets declined 63 basis points over the same period from 5.82% at March 31, 2009 to 5.19% for the three months ended March 31, 2010. The Bank's cost of funds declined 57 basis points from 2.60% at March 31, 2009 to 2.03% for the quarter ended March 31, 2010. The decline in yield on earning assets was attributable to the decline in yield on investment securities and federal funds sold. During the past year several agency securities have been called and have been reinvested at the lower prevailing rates. In addition, the Bank completed the restructuring of the mortgage-backed portfolio from FHLMC and FNMA securities to less volatile GNMA securities during the first quarter of 2009, resulting in a lower yield going forward. The cost of funds continues to decline as time deposits reprice at lower rates. The Bank also lowered the rate paid on the popular Rewards Checking product during the quarter and plans to lower the rate again in the second quarter of 2010 which will further reduce the cost of deposits. The Bank continues to maintain a fairly significant amount of liquidity, giving up short-term yield to better position the Bank to take advantage of rising rates in the future. Due to the current economic environment, the Bank has \$2.3 million in nonaccrual loans and \$1.9 million in foreclosed properties. Management continues to market the foreclosed properties in an effort to increase interest earning assets and the resulting net interest margin.

Management continues to focus on reducing noninterest expense and look for more efficient ways to do business. Noninterest expense for the first three months of 2010 was reported at \$1.1 million as compared to \$2.2 million for the same period in 2009. The most significant difference in the two years reported is the \$1.1 million write off of the impaired Silverton Bank stock during the first quarter of 2009. Asset quality continues to be a concern and a fairly unpredictable source of noninterest expense. For instance, the Bank had a net increase of \$89 thousand in the foreclosed assets valuation allowance for the first quarter of 2010 compared to the same period of 2009. This was the result of a write down of one of the Bank owned properties due to a reappraisal of a commercial property that resulted in a significantly lower carrying value for the property. Total data processing expense also increased from \$60 thousand for the quarter ended March 31, 2009 to \$96 thousand for the quarter ended March 31, 2010. This increase was in two line items, ATM expense and internet banking expense. Both of these items increased significantly with internet banking expense doubling from year to year. The increase in online banking is primarily the result of the increase in the Rewards Checking product. Salary and benefits were down for the quarter from \$450 thousand at March 31, 2009 to \$432 thousand for the quarter ended March 31, 2010. This savings has been accomplished primarily through attrition even though benefit costs have risen over the past twelve months. Legal and professional expense, occupancy and advertising were also down slightly from 2009.

In spite of the poor operating performance for the year ended December 31, 2009, the Bank remains well capitalized based on the current published regulatory standards. Management believes these minimum standards will increase in the future, but the Bank anticipates being able to meet the revised minimum standards as well. Tier 1 capital at March 31, 2010 was 9.20% and total risk-based capital was 16.79%, both well in excess of the 5.00% and 10.00%, respectively, currently required by the regulatory authorities for a bank to be considered well capitalized. The Bank's strong capital position will help the Bank weather the tough economic conditions that currently prevail.

Samuel F. Grigsby, Jr., CEO of Community National Bank of the Lakeway Area, commented, "Community National Bank and our customers continue to be affected by the economic crisis facing our community, state, nation and world. We are seeing some signs of recovery, but the recovery continues to be very slow. The employment picture for the area is still grim, and until we get people back to work, recovery for the local economy will take time. The Bank will continue our focus on improving the net interest margin and the efficiency of our operations while delivering competitive products to our customer base. While the first quarter operating results are certainly not at the level management wants, it is hopefully a start to a much better year. Again, asset quality and a rebounding economy will most likely determine the outcome for 2010. The Bank continues to be considered "well capitalized" under the current regulatory standards with tier 1 capital in excess of 9% and total risk based capital in excess of 16%."

Comparison of Financial Condition at March 31, 2010 and December 31, 2009

Community National Bank of the Lakeway Area's total assets at March 31, 2010 were \$125.1 million, a slight increase of \$0.3 million from the \$124.8 million recorded at December 31, 2009. The increase in assets was primarily due to a \$1.8 million increase in cash and due from banks, and a \$960 thousand increase in federal funds sold. In addition to the increase in cash equivalents, investments also increased from \$33.6 million at December 31, 2009 to \$33.8 million at March 31, 2010.

Net loans for the period declined from \$75.8 million at December 31, 2009 to \$73.0 million at March 31, 2010. This represents a decline during the three-month period of approximately 3.7%. Loan demand continues to be weak, and the Bank continues to have a few foreclosures. Both of these factors have resulted in a decline in the loan portfolio. Net loans to deposits at March 31, 2010 were 73.6% compared to 76.6% at December 31, 2009.

The estimated allowance for loan losses at March 31, 2010 was \$1.49 million or 2.0% of gross loans. This compares to \$1.44 million or 1.9% of gross loans at December 31, 2009. The change during the period consisted of a provision to the allowance account of \$50 thousand. There were no net charge offs of loans during the period. Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses. Provisions are made to the allowance to maintain a level adequate to absorb anticipated loan losses.

There were \$7.0 million of nonperforming assets at March 31, 2010. This amount was comprised of \$2.3 million of nonaccrual loans, \$2.9 million of restructured loans, and \$1.9 million of foreclosed assets. At December 31, 2009, the Bank had \$2.0 million in nonaccrual loans, \$1.1 million in restructured loans and \$1.8 million in foreclosed assets. The Bank was carrying seven properties in other real estate owned at March 31, 2010. Three of the properties, with a current carrying value of \$925 thousand, are purchased participation loans while the other properties are a mix of commercial and 1-4 family local credits. Based on the current information analyzed by the Bank's management, we believe there should be sufficient collateral to avoid significant additional losses. Management continues to monitor the loans and will review updated appraisals as they become available. Subsequent to March 31, 2010, one of the 1-4 family properties was sold at a slight gain, and it appears one of the commercial participations will be under contract soon.

Total investments at March 31, 2010 were \$33.8 million as compared to \$33.6 million at December 31, 2009. During the first three months of 2010, the Bank purchased \$4.0 million in new securities, had \$3.1 million called or sold, and received principal repayments on mortgage-backed securities of \$811 thousand. The entire investment portfolio is classified as available-for-sale. The \$33.8 million in the available-for-sale portfolio is reported at fair value and consists of approximately 56.4% U.S. government agencies and 43.67% mortgage-backed securities. Many of the U.S. agency securities are callable and the Bank has experienced, and will likely continue to experience, calls of the higher yielding securities during 2010. The reinvestment of these funds in comparable securities could have a negative impact on future earnings. Management is hopeful that loan demand will improve which would potentially allow the Bank to invest in higher yielding assets.

Total equity investments, which are carried at cost, increased from \$830 thousand at December 31, 2009 to \$839 thousand at March 31, 2010. The increase was due to a required purchase of \$9 thousand of Federal Home Loan Bank stock during the period as part of the membership requirement. As of March 31, 2010, the equity investments consisted solely of Federal Home Loan Bank stock with a carrying value of \$443 thousand and Federal Reserve Bank stock with a carrying value of \$396 thousand.

Interest receivable, foreclosed assets and other assets were basically level for the quarter with a slight increase of \$37 thousand from \$3.13 million at December 31, 2009 to \$3.17 million at March 31, 2010. The increase was primarily attributable to the \$47 thousand increase in foreclosed properties during the quarter. The deferred tax benefit declined during the period by \$23 thousand.

Net fixed assets decreased during the three months ended March 31, 2010. The Bank had depreciation expense for the period totaling \$67 thousand and new equipment purchases and leasehold improvements of \$10 thousand, for a net decline of \$57 thousand.

Deposits at March 31, 2010 increased by \$356 thousand to \$99.2 million as compared to the \$98.8 million reported at December 31, 2009. Noninterest-bearing demand deposits declined slightly during the three month period ended March 31, 2010 by \$298 thousand or 3.3%. Money market accounts increased \$119 thousand or 1.3% during the period. Time deposits increased \$1.1 million during the first three months of 2010. Time deposits under \$100,000 increased \$661 thousand while time deposits over \$100,000 increased \$467 thousand. NOW accounts declined during the first three months of 2009 as a result of lowering the offering rate on the Rewards Checking account. NOW accounts declined slightly from \$22.9 million at December 31, 2009 to \$22.3 million at March 31, 2010. Our rewards checking program is a high yield checking account designed to reward customers for electronic banking, which results in a cost savings for the Bank in the form of processing fees, postage, etc.

Stockholders' equity increased during the first three months of 2010 due to the recording of a net profit of \$37 thousand and an increase in other comprehensive income. Accumulated comprehensive income was \$237 thousand at March 31, 2010 compared to \$5 thousand at December 31, 2009. Total equity was \$12.7 million at March 31, 2010 compared to \$12.4 million at December 31, 2009.

Net interest income before loan loss provision was down slightly at \$940 thousand for the three months ended March 31, 2010 compared to \$945 thousand for the same period in 2009. The interest spread and net interest margin for the quarter ended March 31, 2010 were 3.16% and 3.24% respectively, compared to 3.22% and 3.40% respectively, for the same period in 2009. The average yield on earning assets for the quarter ended March 31, 2010 declined 63 basis points to 5.19% while the average volume of earning assets increased to \$116.0 million from \$111.2 million for the three months ended March 31, 2010 compared to the same period in 2009. The average rate paid on interest-bearing liabilities declined 57 basis points to 2.03%, while the average volume of interest-bearing liabilities increased \$8.0 million, to \$111.5 million for the three months ended March 31, 2010, compared to the same period in 2009.

The decline in net interest margin for the first quarter of 2010 was primarily a result of the lower yields and increased balances in the Bank's investment and liquidity portfolios. Hopefully an improved economy will result in increased loan demand, allowing the Bank to convert some of the short-term lower yielding investments in to loans. Management continues to monitor deposit rates paid in the local and other markets and will adjust the Bank's rates as needed to improve the net interest margin.

The following chart summarizes the average balances and yields on interest earning assets and interest costing liabilities for the three months ended March 31, 2010 and 2009 respectively:

	Three Months Ended March 31,			
	2010 Average Balance	Yield / Cost	2009 Average Balance	Yield / Cost
	(Dollars in thousands)			
Loans, Gross	75,617	6.51%	80,939	6.49%
Investment Securities	34,351	3.04%	24,083	4.85%
Federal Funds Sold and Other	6,087	0.92%	3,397	1.41%
Deposits	98,216	1.94%	92,935	2.59%
Borrowings	13,331	2.70%	10,600	2.72%

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

	Three Months Ended March 31, 2010 Compared to 2009		
	Increase (Decrease)		
	Due To		
	Volume	Rate	Net
	(Dollars in thousands)		
Interest Income:			
Loans	\$ (129)	\$ 46	\$ (83)
Securities	(249)	218	(31)
Other	2	(1)	1
Total interest-earning assets	<u>(376)</u>	<u>263</u>	<u>(113)</u>

Interest Expense:			
Deposits	37	(163)	(126)
Borrowings	18	0	18
Total interest-bearing liabilities	<u>55</u>	<u>(163)</u>	<u>(108)</u>
Net change in interest income	\$ <u>(431)</u>	\$ <u>426</u>	\$ <u>(5)</u>

For the three months ended March 31, 2010, the Bank increased the provision for loan losses by \$50 thousand, compared to \$88 thousand for the quarter ended March 31, 2009. Management reviews the loan portfolio each month to determine the appropriate level of reserves. Provisions are made to maintain a level adequate to absorb anticipated loan losses. Currently, the allowance for loan losses is 2.00% of gross loans, compared to 1.9% reported for the same period in 2009.

Noninterest income for the three months ended March 31, 2010 was \$182 thousand compared to \$101 thousand for the same period in 2009. The increase was primarily due to the \$67 thousand gain recognized on the sale of foreclosed assets by the Bank.

Noninterest expense for the three months ended March 31, 2010 was \$1.1 million compared to \$2.2 million for the same period in 2009. The decline from March 31, 2009 to March 31, 2010 was due to the absence of the \$1.1 million dollar write-off of the impaired equity investment (Silverton Bank stock) the Bank incurred in 2009. Management continues to review noninterest expense and has seen a decline in several line items. Salaries and benefits have declined despite an increase in insurance costs. Occupancy, office supplies and postage, advertising and legal and other professional expenses have also declined. The largest increase during the first quarter of 2010 was the write down of one of the foreclosed properties the Bank owns totaling \$89 thousand due to a reappraisal of the property. The Bank also continues to see higher than normal collection costs. During the past two years, the collection expense was mostly associated with the purchased participations the Bank owned. Currently, the local economy continues to suffer, resulting in a few foreclosed properties and increased collection expenses.

For the three months ended March 31, 2010, noninterest expense was \$1.1 million compared to 2.2 million for the same period in 2009. The large discrepancy between the two periods was the write off of the \$1.1 million impaired equity investment in Silverton Bank during 2009. In comparing March 31, 2010 to March 31, 2009 a couple of line items have increased while the remainder were level or declined. One of the increased items was data processing expense which increased from \$60 thousand in 2009 to \$96 thousand for 2010. The majority of the increase was in internet banking expense which increased from \$16 thousand for the quarter ended March 31, 2009 to \$32 thousand for the same period in 2010. ATM expense for the period also increased from \$27 thousand for the first quarter of 2009 to \$43 thousand for the first quarter of 2010. These increases are transaction driven and are directly attributable to increased volume. Foreclosed asset valuation allowance also increased from \$0 in 2009 to \$89 thousand for the first quarter of 2010. This was attributable to a decline in the value of foreclosed properties upon reappraisal. Salaries and employee benefits expense declined during the period from \$450 thousand to \$432 thousand. This decline is mostly due to attrition and was accomplished despite increased benefit costs. Other declining expenses include occupancy costs, advertising, and legal and professional expenses.

Off-Balance Sheet Arrangements

In the normal course of business, to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance-sheet risks. These financial instruments consist of commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. Most letters of credit are extended for one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The Bank's exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument.

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

The following table summarizes our off-balance-sheet financial instruments with contract amounts that represent credit risk as of March 31, 2010:

Commitments to extend credit	\$ 8,708,609
Stand-by letters of credit	\$ 46,000

Capital Requirements

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

The following table lists the criteria for a well-capitalized bank as compared to Community National Bank at March 31, 2010:

	Total Risk-Based Capital Ratio	Tier I Risk-Based Capital Ratio	Leverage Ratio
Well-capitalized	10.00% or above	6.00% or above	5.00% or above
Community National Bank	16.79%	15.53%	9.20%

The Bank was a well-capitalized institution under the above criteria as of March 31, 2010.

Liquidity and Interest Rate Sensitivity

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

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

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

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

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

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

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

Liquidity represents the ability to provide steady sources of funds for loan commitments and investment activities, as well as to maintain sufficient funds to cover deposit withdrawals and payment of debt and operating obligations. We can obtain these funds by converting assets to cash or by attracting new deposits. Our Bank's ability to maintain and increase deposits serves as its primary source of liquidity. Secondary sources of liquidity for the Bank are Federal Funds accommodation lines with three correspondent banks. At March 31, 2010, Community National Bank of the Lakeway Area had approximately \$8.00 million dollars available in Federal Funds accommodation lines from the three correspondent banks. The Bank has also pledged collateral to the Federal Reserve Bank in Atlanta in order to use the Discount Window for overnight borrowings.

The Bank has four advances from the FHLB of Cincinnati at March 31, 2010 (two in 2009). One advance is for \$5 million and matures in 2015. The second advance obtained in 2007 is for \$2 million and will mature in 2010. The 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. Two additional fixed rate advances were obtained in July 2009 for \$3 million and \$500 thousand and mature in 2012 and 2013, respectively. The weighted average interest rate on all four advances is 3.40%. Pursuant to a collateral agreement with the FHLB, advances are secured by the Bank's FHLB stock and qualifying first mortgage loans.

The Bank had unused lines of credit and loan commitments at March 31, 2010 totaling \$8.71 million. We know of no other trends, demands, commitments, events, or uncertainties that should result in or are reasonably likely to result in our Bank's liquidity increasing or decreasing in any material way in the foreseeable future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4T. CONTROLS AND PROCEDURES

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

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

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

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in "Part I, Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibits

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

SIGNATURES

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

COMMUNITY NATIONAL BANK OF THE LAKEWAY AREA

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

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