UNITED TENNESSEE BANKSHARES, INC.

2012 ANNUAL REPORT

United Tennessee Bankshares, Inc.

P O Box 249
Newport, Tennessee 37822-0249
Phone: (423)623-6088 **Fax (423)623-6020**

To our Stockholders,

We are delighted to present this Annual Report to our shareholders. This past year has been another challenging year for the financial industry as well as United Tennessee Bankshares. We met the challenge and are continuing to deal with the instability in the economy. United Tennessee Bankshares looks forward to the upcoming year and we are in a good position for the future.

United Tennessee Bankshares, Inc. decreased slightly from $188 million in total assets at December 31, 2011, to $187 million at December 31, 2012. The investment portfolio grew from $65 million to $68 million while deposits fell from $170 million to $167 million.

We are very pleased with our results of operations in 2012. Our income increased $29,000 to $1,482,000, which is the fifth consecutive year of increases. We congratulate the staff for their hard work that made these results possible.

The Board of Directors is pleased to maintain our dividend at the same level as last year during a time when many banks have had to reduce or eliminate dividends. The investors who purchased UNTN stock in 1998, with the upcoming dividend, will have received cumulative cash dividends in excess of their initial investment.

Please review this Annual Report, which more fully describes our performance. We look forward to 2013 being a very good year. We continue to grow and increase dividends and earnings while many financial institutions struggle. We continue to be a well-capitalized institution poised to take advantage of any and all opportunities afforded to us in our competitive market place. We strive to provide good value in all major decisions. We appreciate your investment in United Tennessee Bankshares, Inc. and invite your continued support of Newport Federal Bank, Newport's truly home owned community bank.

Sincerely,

Chris Triplett
President

UNITED TENNESSEE BANKSHARES, INC.

United Tennessee Bankshares, Inc. (the "Company") became the holding company for Newport Federal Bank (the "Bank") upon its conversion from mutual to stock form (the "Conversion"), which was completed on January 1, 1998. Prior to January 1, 1998, the Company had no assets or liabilities and engaged in no business activities. The Company's assets primarily consist of its investment in the Bank.

The Company's executive offices are located at 170 W. Broadway, Newport, Tennessee 37821-2325, and its telephone number is (423) 623-6088. Our web site is www.newportfederalbank.com.

The Bank was organized as a federally chartered mutual savings institution in 1934 under the name Newport Federal Savings and Loan Association. Effective January 1, 1998, the Bank became a stock savings bank and changed its name to Newport Federal Bank. The Bank currently operates through three full-service banking offices located in Newport, Tennessee. The Bank's deposits are insured to applicable limits by the Federal Deposit Insurance Corporation ("FDIC").

MARKET FOR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock trades on the NASDAQ OTC Bulletin Board (OTCBB) under the symbol "UNTN." There are approximately 828,015 shares of the Company's Common Stock outstanding, and approximately 100 record holders.

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

The Company's principal business activities are conducted through its wholly owned subsidiary, the Bank. The Bank's principal business consists of accepting deposits from the general public through its main office and branch offices and investing those funds in loans secured by one-to-four-family residential properties located in its primary market area. The Bank also maintains a portfolio of investment securities and originates a limited amount of commercial real estate loans and consumer loans. The Bank's investment securities portfolio consists of U.S. government corporations and agency securities, municipal bonds of governmental entities in Tennessee, corporate debt and mortgage-backed securities, which are guaranteed as to principal and interest by the FHLMC, GNMA, FNMA or other governmental agencies. The Bank also maintains an investment in FHLB of Cincinnati common stock.

The Bank's net income primarily depends on its net interest income, which is the difference between interest income earned on loans and investment securities and interest paid on customers' deposits, and other borrowings. The Bank's net income is also affected by noninterest income, such as service charges on customers' deposit accounts, loan service charges and other fees, and noninterest expense, primarily consisting of compensation expense, deposit insurance and other expenses incidental to its operations.

The Bank's operations and those of the banking industry as a whole are significantly affected by prevailing economic conditions, competition and the monetary and fiscal policies of governmental agencies. The Bank's lending activities are influenced by demand for and supply of housing and competition among lenders and the level of interest rates in its market area. The Bank's deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily on competing investments, account maturities and the levels of personal income and savings in its market area.

Net interest income, the primary component of the Company's net income, is determined by the difference or "spread" between the yield earned on its interest-earning assets and the rates paid on its interest-bearing liabilities, and the relative amounts of such assets and liabilities. Key components of an asset/liability strategy are the monitoring and managing of interest rate sensitivity on both the interest-earning assets and interest-bearing liabilities.

An asset or liability is interest rate sensitive within a specific time period if it will mature or reprice within that time period. If the Company's assets mature or reprice more quickly or to a greater extent than its liabilities, its net interest income would tend to increase during periods of rising interest rates but decrease during periods of falling interest rates. If its assets mature or reprice more slowly or to a lesser extent than its liabilities, its net interest income would tend to decrease during periods of rising interest rates, but increase during periods of falling interest rates. The Company's policy has been to mitigate the interest rate risk inherent in the traditional savings institution business of originating long term loans funded by short-term deposits by pursuing the following strategies: (i) it has historically maintained liquidity and capital levels to compensate for unfavorable movements in market interest rates; and (ii) in order to mitigate the adverse effect of interest rate risk on future operations, it emphasizes the origination of variable rate mortgage loans, and it makes limited amounts of shorter term consumer loans.

Comparison of Financial Condition at December 31, 2012 and December 31, 2011

Total assets decreased $1.6 million, or 0.9%, from $188.4 million at December 31, 2011 to $186.8 million at December 31, 2012. The Company’s asset decrease was attributable principally to an increase in Interest Earning Deposits and Investment Securities overly offset by a decrease in Net Loans Receivable and Cash & Amounts Due.

Investment securities available for sale increased approximately $3.0 million, or 4.5%, from $65.7 million at December 31, 2011 to $68.7 million at December 31, 2012. The Bank used the proceeds from excess cash on hand to fund the growth in the Investment Securities Available for Sale.

Loans receivable decreased $7.3 million, or 6.9% from $105.3 million at December 31, 2011 to $98.0 million at December 31, 2012 as repayments exceeded originations for the period. Loan demand for 1-4 family mortgages has decreased in the current economic environment for the Company.

Total deposits decreased $2.8 million, or 1.7% from $169.9 million at December 31, 2011 to $167.1 million at December 31, 2012. The decrease was primarily due to a low interest rate environment and individuals using personal funds in order to pay off their loans early. The Bank strives to offer competitive interest rates in an ever-increasing low interest environment.

The Company’s shareholders’ equity increased $1.3 million, or 8.1% from $16.3 million at December 31, 2011 to $17.6 million at December 31, 2012. The increase was primarily due to net income of $1,482,000 and an increase in accumulated other comprehensive income of $195,000, partially offset by dividends paid to shareholders of $417,654. The Company has also sold shares of stock owned in the net amount of $53,500.

Comparison of Results of Operations for the Years Ended December 31, 2012 and December 31, 2011

Net income was $1,482,000 for the year ended December 31, 2012 compared to net income of $1,453,000 for the year ended December 31, 2011. The increase in net income during 2012 was primarily due to increases in fee income, non-interest income, in addition to a reduction in income tax expense. Net income for 2012 represented a return on average assets of 0.79% compared to 0.82% for 2011, and a return on average equity of 8.76% for 2012 as compared to 9.51% for 2011.

Interest income totaled $8.0 million for 2012 and $8.7 million for 2011. Interest income on loans for the year ended December 31, 2012, was $6.7 million compared to $7.1 million for year ended December 31, 2011. Interest income on investment securities for year ended December 31, 2012, was $1.3 million compared to $1.6 million compared to year ended December 31, 2011. The average yield on interest-earning assets was 4.4% in 2012 and 5.1% in 2011.

The Company’s primary source of interest income is from loans receivable. Interest income from loans receivable was $6.7 million for the year ended December 31, 2012 and the average yield earned on loans receivable was 6.4%.

Interest expense totaled $1.6 million and $2.3 million for the years ended December 31, 2012 and 2011, respectively. The decrease in interest expense of $700,000 during 2012 was due to a 52 basis point reduction in our average cost of funds.

Net interest income was $6.4 million for the years ended December 31, 2012 and 2011. The net interest spread for 2012 was 3.48% compared to 3.64% in 2011. The ratio of average interest-earning assets to average interest-bearing liabilities decreased to 107.18% in 2012 from 108.68% in 2011. The Company's net interest margin decreased in 2012 to 3.54% from 3.76% in 2011.

The provision for loan losses was $1,000,000 in 2012 and in 2011. The amount of provision for any period is determined as of the end of the period based on a comparison of the amount of existing loan loss reserves with management's analysis of various risk factors that affect the loan portfolio. At December 31, 2012, the ratio of the allowance to impaired loans was 52.22%.

Noninterest income for the years ended December 31, 2012 and 2011 was $537,000 and $458,000, respectively. Noninterest income consists primarily of customer service fees related to customers' deposit accounts, loan service charges, and increases in the cash surrender value of life insurance.

Noninterest expense for the years ended December 31, 2012 and 2011 was $3.87 million and $3.73 million, respectively. Noninterest expense consists primarily of compensation and benefits, occupancy and equipment, federal deposit insurance premiums and data processing fees. The primary increase in Noninterest Expense was due to increased expenses related to foreclosed properties,

The Company's operating efficiency, measured by its efficiency ratios (noninterest expense divided by the total of net interest income and noninterest income), for the years ended December 31, 2012 and 2011 was 55.83% and 54.08%. The increase in the ratio during 2012 was due to an increase in Non-Interest Expense.

The Company's effective tax rate was 28.17% and 32.92% for the years ended December 31, 2012 and 2011, respectively.

Sources of Capital and Liquidity

The Bank has historically maintained substantial levels of capital. The assessment of capital adequacy depends on several factors, including asset quality, earnings trends, liquidity and economic conditions. The Company seeks to maintain high levels of regulatory capital to give the Company maximum flexibility in the changing regulatory environment and to respond to changes in market and economic conditions. These levels of capital have been achieved through consistent earnings enhanced by low levels of noninterest expense and have been maintained at those high levels as a result of its policy of moderate growth generally confined to its market area. Average equity to average total assets at December 31, 2012 and 2011 was 9.01% and 8.58%, respectively. At December 31, 2012, the Bank exceeded all current regulatory capital requirements and met the definition of a "well capitalized" institution, the highest regulatory category.

The Bank seeks to maintain a relatively high level of liquidity in order to retain flexibility in terms of lending and investment opportunities and deposit pricing, and in order to meet funding needs of deposit outflows and loan commitments. Historically, the Bank has been able to meet its liquidity demands through internal sources of funding.

The Company's most liquid assets are cash and amounts due from depository institutions, which are short-term highly liquid investments with original maturities of less than three months that are readily convertible to known amounts of cash. The levels of these assets are dependent on its operating, financing and investing activities during any given period. At December 31, 2012 and 2011, cash and amounts due from depository institutions totaled $5.6 million and $7.6 million, respectively.

The Company's primary sources of funds are deposits, proceeds from principal and interest payments on loans and investment securities and earnings. While scheduled principal repayments on loans and investment securities are a relatively predictable source of funds, deposit flows and loan and investment securities prepayments are greatly influenced by general interest rates, economic conditions, competition and other factors. The Company does not solicit deposits outside of its market area through brokers or other financial institutions.

The Company has also designated all of its investment securities as available for sale in order to meet liquidity demands. At December 31, 2012, it had designated securities with a fair value of $68.7 million as available for sale. In addition to internal sources of funding, the Company as a member of the FHLB of Cincinnati has substantial borrowing authority with the FHLB. The Company's use of a particular source of funds is based on need, comparative total costs and availability.

At December 31, 2012, the Company had commitments of approximately $3.45 million in undisbursed portions of construction loans, unused lines of credit and outstanding letters of credit. At the same date, the total amount of certificates of deposit, which were scheduled to mature in one year or less, was $89.8 million. The Company anticipates that it will have resources to meet its current commitments through internal funding sources described above. Historically, it has been able to retain a significant amount of its certificates of deposit as they mature.

Selected Ratios

	At or for the Year Ended December 31,				
	2012	2011	2010	2009	2008
Performance Ratios:					
Return on average assets (net income divided by average total assets)	0.79%	0.82%	0.90%	0.74%	0.76%
Return on average equity (net income divided by average equity)	8.76%	9.51%	10.09%	7.89%	7.68%
Dividend payout ratio (dividends per share divided by earnings per share)	27.93%	27.84%	27.75%	35.88%	37.40%
Interest rate spread (combined weighted average interest rate earned less combined weighted average interest rate cost)	3.48%	3.64%	3.95%	3.66%	3.13%
Net interest margin (net interest income divided by average interest earning assets)	3.54%	3.76%	4.06%	3.67%	3.37%
Ratio of average interest-earning assets to average interest-bearing liabilities	107.18%	108.68%	106.87%	105.94%	105.55%
Ratio of noninterest expense to average total assets	2.06%	2.09%	2.45%	2.63%	2.43%
Efficiency ratio (noninterest expense divided by total of net interest income and noninterest income)	55.83%	54.08%	55.64%	66.61%	68.62%
Asset Quality Ratios:					
Impaired assets to total assets at end of period	3.40%	3.72%	2.77%	3.44%	1.92%
Impaired loans to total loans at end of period	4.49%	5.48%	3.80%	3.66%	1.79%
Allowance for loan losses to total loans at end of period	2.34%	1.75%	1.53%	0.94%	0.84%
Allowance for loan losses to impaired loans at end of period	52.22%	31.94%	40.34%	25.62%	46.58%
Provision for loan losses to total loans	0.99%	0.93%	0.82%	0.37%	0.11%
Net charge-offs to average loans outstanding	0.51%	0.73%	0.24%	0.27%	0.13%

Selected Ratios (Continued)

Capital Ratios:					
Equity to total assets at end of period	9.41%	8.64%	8.53%	9.39%	9.46%
Average equity to average assets	9.02%	8.58%	8.93%	9.43%	9.83%
Stock Price (last trade prior to December 31):	$ 12.00	$ 10.50	$ 11.35	$ 13.00	$ 13.00

UNITED TENNESSEE BANKSHARES, INC.
AND SUBSIDIARY

Newport, Tennessee

CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER INFORMATION

December 31, 2012, 2011, and 2010

PUGH
CPAs

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PUGH & COMPANY, P.C.
www.pughcpas.com

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Senior Management
United Tennessee Bankshares, Inc.
Newport, Tennessee

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of United Tennessee Bankshares, Inc. and subsidiary which comprise the consolidated statements of financial condition as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in shareholder's equity and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of United Tennessee Bankshares, Inc. and subsidiary as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Pugh & Company, P.C.

Certified Public Accountants
Knoxville, Tennessee
March 11, 2013

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

As of December 31,	2012	2011
ASSETS		
Cash and Amounts Due from Depository Institutions	$ 5,571,165	$ 7,554,850
Interest-Bearing Deposits in Other Banks	4,233,000	0
Investment Securities Available for Sale, at Fair Value	68,707,250	65,726,045
Loans Receivable, Net	97,978,916	105,263,920
Equity Securities, at Cost	1,160,700	1,160,700
Premises and Equipment, Net	2,975,414	3,104,616
Accrued Interest Receivable	894,540	1,003,683
Foreclosed Real Estate	1,845,187	1,120,696
Intangible Assets, Net	73,323	153,316
Cash Surrender Value of Life Insurance	2,278,002	2,172,874
Prepaid FDIC Assessment	165,000	316,882
Prepaid Expenses and Other Assets	912,087	827,120
TOTAL ASSETS	$ 186,794,584	$ 188,404,702
LIABILITIES AND EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 54,675,485	$ 52,391,258
Term	112,495,561	117,507,008
Total Deposits	167,171,046	169,898,266
Accrued Interest Payable	35,434	116,483
Accrued Income Taxes	99,848	16,592
Accrued Benefit Plan Liabilities	1,724,434	1,878,935
Other Liabilities	181,621	225,031
Total Liabilities	169,212,383	172,135,307
SHAREHOLDERS' EQUITY		
Common Stock - No Par Value, Authorized 20,000,000 Shares; Issued 835,309 Shares in 2012 (835,309 Shares in 2011); Outstanding 828,015 Shares in 2012 (825,638 Shares in 2011)	4,283,854	4,283,854
Retained Earnings	12,913,278	11,849,053
Treasury Stock, at Cost; 7,294 Shares in 2012 (9,671 Shares in 2011)	(92,372)	(145,923)
Accumulated Other Comprehensive Income (Loss)	477,441	282,411
Total Shareholders' Equity	17,582,201	16,269,395
TOTAL LIABILITIES AND EQUITY	$ 186,794,584	$ 188,404,702

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

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31,	2012	2011	2010
INTEREST INCOME			
Loans	$ 6,658,052	$ 7,142,589	$ 7,400,392
Investment Securities	1,303,399	1,585,828	1,345,266
Total Interest Income	7,961,451	8,728,417	8,745,658
INTEREST EXPENSE			
Deposits	1,564,381	2,291,018	2,561,761
Advances from Federal Home Loan Bank	0	0	39,616
Total Interest Expense	1,564,381	2,291,018	2,601,377
NET INTEREST INCOME	6,397,070	6,437,399	6,144,281
PROVISION FOR LOAN LOSSES	(1,000,000)	(1,000,000)	(900,000)
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,397,070	5,437,399	5,244,281
NONINTEREST INCOME			
Deposit Account Service Charges	245,142	244,590	270,378
Loan Service Charges and Fees	57,919	72,476	64,856
Net Gain (Loss) on Sales of Investment Securities Available for Sale	45,079	(9,859)	(28,711)
Gain (Loss) on Sales of Premises and Equipment	0	0	1,500
Increase in Cash Surrender Value of Life Insurance	105,128	67,473	142,298
Other	83,769	82,968	73,254
Total Noninterest Income	537,037	457,648	523,575
NONINTEREST EXPENSE			
Compensation and Benefits	1,862,250	1,803,460	1,752,067
Occupancy and Equipment	419,738	447,924	456,847
Federal Deposit Insurance Assessments	197,357	266,238	285,002
Data Processing Fees	317,025	291,592	287,866
Advertising and Promotion	83,662	100,476	100,377
Amortization	79,992	79,992	79,992
Loss on Foreclosed Real Estate	329,962	172,548	179,258
Other	581,043	566,994	568,801
Total Noninterest Expense	3,871,029	3,729,224	3,710,210
INCOME BEFORE INCOME TAXES	2,063,078	2,165,823	2,057,646
INCOME TAXES	(581,199)	(713,124)	(631,176)
NET INCOME	$ 1,481,879	$ 1,452,699	$ 1,426,470
EARNINGS PER SHARE	$ 1.79	$ 1.76	$ 1.73

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

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31,	2012	2011	2010
NET INCOME	$ 1,481,879	$ 1,452,699	$ 1,426,470
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:			
Unrealized Gains (Losses) on Investment Securities Available for Sale	269,485	1,514,290	(1,167,683)
Reclassification Adjustment for (Gains) Losses Included in Net Income	45,079	(9,859)	(28,711)
Income Taxes Related to Unrealized Gains/Losses on Investment Securities Available for Sale	(119,534)	(571,684)	454,630
Other Comprehensive Income (Loss), Net of Tax	195,030	932,747	(741,764)
COMPREHENSIVE INCOME	$ 1,676,909	$ 2,385,446	$ 684,706

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

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Three Years Ended December 31, 2012

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, December 31, 2009	$ 4,184,123	$ 9,777,876	$ (67,463)	$ 91,428	$ 13,985,964
Purchase of Common Stock	0	0	(65,391)	0	(65,391)
Net Income	0	1,426,470	0	0	1,426,470
Dividends Paid	0	(398,788)	2,545	0	(396,243)
Proceeds from Sale of Treasury Stock	0	0	11,830	0	11,830
Proceeds from Issuance of Common Stock	68,791	0	0	0	68,791
Other Comprehensive Income (Loss)	0	0	0	(741,764)	(741,764)
Balances, December 31, 2010	4,252,914	10,805,558	(118,479)	(650,336)	14,289,657
Purchase of Common Stock	0	0	(37,710)	0	(37,710)
Net Income	0	1,452,699	0	0	1,452,699
Dividends Paid	0	(409,204)	4,282	0	(404,922)
Proceeds from Sale of Treasury Stock	0	0	5,984	0	5,984
Proceeds from Issuance of Common Stock	30,940	0	0	0	30,940
Other Comprehensive Income (Loss)	0	0	0	932,747	932,747
Balances, December 31, 2011	4,283,854	11,849,053	(145,923)	282,411	16,269,395
Purchase of Common Stock	0	0	(14,959)	0	(14,959)
Net Income	0	1,481,879	0	0	1,481,879
Dividends Paid	0	(417,654)	3,647	0	(414,007)
Proceeds from Sale of Treasury Stock	0	0	64,863	0	64,863
Proceeds from Issuance of Common Stock	0	0	0	0	0
Other Comprehensive Income (Loss)	0	0	0	195,030	195,030
Balances, December 31, 2012	$ 4,283,854	$ 12,913,278	$ (92,372)	$ 477,441	$ 17,582,201

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

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31,	2012	2011	2010
OPERATING ACTIVITIES			
Net Income	$ 1,481,879	$ 1,452,699	$ 1,426,470
Adjustments to Reconcile Net Income to Net			
Cash Provided by Operating Activities:			
Provision for Loan Losses	1,000,000	1,000,000	900,000
Depreciation	174,114	198,690	211,783
Amortization	79,993	79,992	79,992
Amortization of Investment Securities Premiums and			
Discounts, Net	621,189	(5,222)	31,058
Increase (Decrease) in Unearned Loan Fees	(17,913)	(14,715)	(15,419)
Net Loss (Gain) on Sales of Foreclosed Real Estate	264,061	94,989	163,493
Net Loss (Gain) on Sales of Premises and Equipment	0	0	(1,500)
Increase in Cash Surrender Value of Life Insurance	(105,128)	(67,473)	(142,298)
Net (Gain) Loss on Sales of Investment Securities			
Available for Sale	(45,079)	9,859	28,711
Deferred Income Tax (Benefit)	(230,920)	128,222	(267,831)
(Increase) Decrease in:			
Accrued Interest Receivable	109,143	12,470	(91,725)
Prepaid Expenses and Other Assets	26,419	(81,109)	(47,552)
Prepaid FDIC Assessment	151,882	189,238	215,002
Increase (Decrease) in:			
Accrued Interest Payable	(81,049)	(6,941)	11,474
Accrued Income Taxes	83,256	(122,116)	13,299
Accrued Benefit Plan Liabilities	(154,501)	(452,096)	164,750
Other Liabilities	(43,410)	83,861	32,208
Total Adjustments	1,832,057	1,047,649	1,285,445
Net Cash Provided by (Used in) Operating Activities	3,313,936	2,500,348	2,711,915
INVESTING ACTIVITIES			
Purchase of Investment Securities Available for Sale	(58,589,676)	(61,054,801)	(46,724,563)
Proceeds from Sales of Investment Securities			
Available for Sale	4,819,533	12,537,845	950,000
Proceeds from Maturities and Calls of Investment Securities			
Available for Sale	47,185,000	27,100,000	22,000,000
Principal Payments Received on Investment Securities			
Available for Sale	3,342,392	570,955	858,832
Net (Increase) Decrease in Interest-Bearing			
Deposits in Other Banks	(4,233,000)	0	0
Net (Increase) Decrease in Loans	4,705,623	2,178,662	1,329,111
Purchases of Premises and Equipment	(44,912)	(31,359)	(29,445)
Proceeds from Sales of Premises and Equipment	0	6,714	1,500
Proceeds from Sales of Foreclosed Real Estate	608,742	640,711	445,487
Net Cash Provided by (Used in) Investing Activities	(2,206,298)	(18,051,273)	(21,169,078)

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

For the Years Ended December 31,	2012	2011	2010
FINANCING ACTIVITIES			
Dividends Paid, Net	(414,007)	(404,922)	(396,243)
Proceeds from Sale of Treasury Stock	64,863	5,984	11,830
Proceeds from Issuance of Common Stock	0	30,940	68,791
Purchase of Common Stock for Treasury Stock	(14,959)	(37,710)	(65,391)
Net Increase in Deposits	(2,727,220)	19,298,804	20,227,843
Repayment of Advances from Federal Home Loan Bank	0	0	(2,000,000)
Net Cash Provided by (Used in) Financing Activities	(3,091,323)	18,893,096	17,846,830
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,983,685)	3,342,171	(610,333)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	7,554,850	4,212,679	4,823,012
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 5,571,165	$ 7,554,850	$ 4,212,679
Supplementary Disclosures of Cash Flow Information:			
Cash Paid During the Year for:			
Interest	$ 1,645,430	$ 2,297,959	$ 2,589,903
Income Taxes	$ 773,200	$ 764,337	$ 940,946
Supplementary Disclosures of Noncash Investing Activities:			
Acquisition of Foreclosed Real Estate	$ 1,990,123	$ 1,617,256	$ 571,486
Sale of Foreclosed Real Estate by Origination of Mortgage Loans	$ 392,829	$ 234,608	$ 514,170
Change in Unrealized Gain/Loss on Investment Securities Available for Sale	$ 314,564	$ 1,504,431	$ (1,196,394)
Change in Deferred Income Taxes Associated with Unrealized Gain/Loss on Investment Securities Available for Sale	$ 119,534	$ 571,684	$ (454,630)
Change in Net Unrealized Gain/Loss on Investment Securities Available for Sale	$ 195,030	$ 932,747	$ (741,764)

UNITED TENNESSEE BANKSHARES, INC.
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012, 2011, and 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles - The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Financial Accounting Standards Board (FASB).

Basis of Consolidation - On January 1, 1998, Newport Federal Savings and Loan Association converted from a mutual savings association to a capital stock savings bank, changed its name to Newport Federal Bank, and was simultaneously acquired by its holding company, United Tennessee Bankshares, Inc. (Company). See Note 16 for additional information concerning the Association's stock conversion. The consolidated financial statements include the accounts of United Tennessee Bankshares, Inc. and its wholly-owned subsidiary, Newport Federal Bank (Bank). All intercompany accounts have been eliminated.

Nature of Operations - The Bank provides a variety of financial services to individuals and corporate customers through its three offices in Newport, Tennessee. The Bank's primary deposit products are interest-bearing checking and savings accounts and certificates of deposit. Its primary lending products are one-to-four family first mortgage loans.

Consolidated Statement of Comprehensive Income - The objective of this statement is to report a measure of all changes in equity of an enterprise that results from transactions and other economic events of the period other than transactions with owners. Items included in comprehensive income include revenues, gains, and losses that under accounting principles generally accepted in the United States of America are directly charged to equity. Examples include foreign currency translations, pension liability adjustments, and net unrealized gains and losses on investment securities available for sale.

Use of Estimates - The preparation of consolidated 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 and disclosures. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and the valuation of foreclosed real estate (see below).

Cash and Cash Equivalents - Cash and cash equivalents include "Cash and Amounts Due from Depository Institutions."

Cash and Amounts Due from Depository Institutions - Cash and amounts due from depository institutions include the following approximate amounts on deposit with the Federal Home Loan Bank of Cincinnati (FHLB) as of December 31:

	2012	2011
Unrestricted Deposits at FHLB	$ 3,938,120	$ 6,251,912

Interest-Bearing Deposits in Other Banks - These deposits mature within one year or less, are covered by FDIC insurance, and are carried at cost which approximates estimated fair value.

Investment Securities - The Bank has classified all its investment securities in the available for sale category. These securities are carried at estimated fair value (see Note 17). Securities may be sold in response to changes in interest rates, liquidity needs, or for other purposes. Any unrealized gain or loss is reported in the consolidated statements of comprehensive income, net of any deferred tax effect. Realized gains or losses on the sales of securities are based on the net proceeds and amortized cost of the securities sold, using the specific identification method. See Note 2 for additional information on investment securities.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Equity Securities Carried at Cost - The Bank maintains a required investment in the Federal Home Loan Bank (“FHLB”) of Cincinnati. The investment in FHLB stock is in part based on the amount of borrowings from the FHLB (see Note 8). During 2009, the Bank purchased stock in its data processing provider at a cost of $35,000. These investments are carried at cost because they are not readily marketable and there is no established market price.

Allowance for Loan and Lease Losses - The allowance for loan and lease losses (ALLL) 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 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. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated future cash flows. The ALLL is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Because of uncertainties associated with regional 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 ALLL may change materially in the near term. In addition, regulatory agencies, as an integral part of their examination process, periodically review the ALLL. 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 ALLL may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated. See Note 4 for more information.

Loan Fees - Loan fees, net of estimated initial direct costs related to initiating and closing long-term mortgage loans have been deferred and are being amortized into interest income over the contractual lives of the loans as an adjustment of yield, using the level yield method.

Recognition of Interest on Loans - Interest on loans is calculated using the simple interest method on the principal outstanding. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of interest is doubtful. Management reviews all loans that are contractually past-due 90 days to determine if accrual of interest should be discontinued. Loans are returned to accrual status when all amounts contractually due are brought current and future payments are reasonably assured. Interest payments received on impaired loans are recorded as interest income unless collection of the loan is doubtful, in which case payments are recorded as a reduction of principal.

Premises and Equipment, Net - Premises and equipment are stated at cost less accumulated depreciation. Depreciation, computed principally using the straight-line method for financial accounting purposes and accelerated methods for income tax reporting purposes, is based on estimated useful lives of three to thirty-nine years.

Foreclosed Real Estate - Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less costs to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expenses. Expenditures for improvements are added to the carrying amount of the property if they increase the fair value of the property. The Bank's historical average holding period for such properties is approximately nine months.

Amortization of Intangible Assets - The depositor-relationship intangible asset is being amortized using the straight-line method over fifteen years (see Note 6).

Income Taxes - Income taxes are provided for the tax effects of the transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of investment securities, allowance for loan losses, deferred loan fees and other deferred items, and accumulated depreciation for financial accounting and income tax reporting. The deferred tax assets and liabilities 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. An appropriate provision is made in the consolidated financial statements for deferred income taxes in recognition of these differences.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

GAAP describes a two-step approach to recognizing and measuring certain tax positions. The first step is to determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step is to measure and recognize in the consolidated financial statements the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Earnings Per Share - Earnings per share is based on the weighted average number of shares outstanding of 827,625, 825,437 and 824,420 for 2012, 2011, and 2010, respectively.

Evaluation of Subsequent Events - Management has evaluated subsequent events through March 11, 2013, which is the date the financial statements were available to be issued.

NOTE 2 - INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities are as follows:

	Investment Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2012				
Debt Securities:				
Obligations of U.S. Government Corporations and Agencies	$ 18,744,452	$ 118,477	$ (22,239)	$ 18,840,690
Residential Mortgage-Backed Securities	17,474,157	103,215	(44,738)	17,532,634
Corporate Debt Securities	8,558,883	135,809	(18,890)	8,675,802
Obligations of States and Political Subdivisions	23,159,693	639,295	(140,864)	23,658,124
Total Debt Securities	$ 67,937,185	$ 996,796	$ (226,731)	$ 68,707,250
December 31, 2011				
Debt Securities:				
Obligations of U.S. Government Corporations and Agencies	$ 35,335,547	$ 164,340	$ (3,752)	$ 35,496,135
Residential Mortgage-Backed Securities	11,646,778	7,041	(32,460)	11,621,359
Corporate Debt Securities	5,641,164	58,517	(185,164)	5,514,517
Obligations of States and Political Subdivisions	12,647,054	449,985	(3,005)	13,094,034
Total Debt Securities	$ 65,270,543	$ 679,883	$ (224,381)	$ 65,726,045

Gross realized gains and losses from sales of investment securities classified as available for sale are as follows:

	For the Years Ended December 31,		
	2012	2011	2010
Gross Realized Gains	$ 45,079	$ 95,526	$ 20,768
Gross Realized Losses	0	(105,385)	(49,479)
	$ 45,079	$ (9,859)	$ (28,711)

NOTE 2 - INVESTMENT SECURITIES (Continued)

The amortized cost and estimated fair value of debt securities available for sale as of December 31, 2012 by contractual maturity, are as follows:

	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in One Year or Less	$ 749,837	$ 755,128
Due After One Year To Five Years	19,444,075	19,658,182
Due After Five Years To Ten Years	17,783,009	18,029,168
Due After Ten Years	12,486,107	12,732,138
	50,463,028	51,174,616
Mortgage-Backed Securities	17,474,157	17,532,634
	$ 67,937,185	$ 68,707,250

Expected maturities can differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Investments with book values of approximately $33,166,000 and $29,664,000 (which approximates market values) as of December 31, 2012 and 2011, respectively, were pledged to secure deposits of public funds.

Investment securities with gross unrealized losses at December 31, 2012 and 2011, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows:

	Less than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
As of December 31, 2012:						
Debt Securities:						
Obligations of U.S. Government Corporations and Agencies	$ 5,737,974	$ (22,239)	$ 0	$ 0	$ 5,737,974	$ (22,239)
Residential Mortgage-Backed Securities	6,285,538	(44,738)	0	0	6,285,538	(44,738)
Corporate Debt Securities	3,872,650	(18,890)	0	0	3,872,650	(18,890)
Obligations of States and Political Subdivisions	7,616,082	(140,864)	0	0	7,616,082	(140,864)
Total Debt Securities	$ 23,512,244	$ (226,731)	$ 0	$ 0	$ 23,512,244	$ (226,731)
As of December 31, 2011:						
Debt Securities:						
Obligations of U.S. Government Corporations and Agencies	$ 4,996,248	$ (3,752)	$ 0	$ 0	$ 4,996,248	$ (3,752)
Residential Mortgage-Backed Securities	8,436,202	(32,460)	0	0	8,436,202	(32,460)
Corporate Debt Securities	3,751,533	(113,752)	703,275	(71,412)	4,454,808	(185,164)
Obligations of States and Political Subdivisions	1,427,046	(3,005)	0	0	1,427,046	(3,005)
Total Debt Securities	$ 18,611,029	$ (152,969)	$ 703,275	$ (71,412)	$ 19,314,304	$ (224,381)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (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.

NOTE 2 - INVESTMENT SECURITIES (Continued)

At December 31, 2012, the 41 investment securities with unrealized losses have depreciated less than 1% from the Bank's amortized cost basis. Except for the corporate debt securities, these securities are guaranteed by U.S. government agencies or corporations, or issued by state and local governments. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

Since management has the ability to hold all of its investment securities until maturity, or for the foreseeable future if classified as available for sale, no declines in fair value are deemed to be other-than-temporary. Accordingly, management has not recorded any permanent write downs in the carrying value of its investments securities.

NOTE 3 - LOANS RECEIVABLE

The Bank provides mortgage and consumer lending services to individuals primarily in the East Tennessee area. Loans receivable are summarized as follows:

	As of December 31, 2012	As of December 31, 2011
Construction Loans, Net of Undisbursed Portion	$ 50,892	$ 740,072
Residential Real Estate:		
1-4 Family First Liens	80,021,491	83,432,646
Junior Liens and Open End	2,117,229	3,430,880
MultiFamily	1,825,748	2,623,035
Total	83,964,468	89,486,561
Other Real Estate Loans:		
Nonresidential	5,092,092	5,651,529
Land	8,565,495	7,606,654
Total	13,657,587	13,258,183
Commercial and Industrial:		
Secured	12,630	281,126
Unsecured	0	37,300
Total	12,630	318,426
Consumer Loans:		
Automobiles	1,326,247	1,435,480
Other	1,614,055	2,214,366
Total	2,940,302	3,649,846
Total Loans	100,625,879	107,453,088
Less:		
Net Deferred Loan Origination Fees	(290,089)	(308,002)
Allowance for Loan and Lease Losses (see Note 4)	(2,356,874)	(1,881,166)
Net Loans	$ 97,978,916	$ 105,263,920

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, lines of credit and commercial letters of credit. These financial instruments are recorded in the consolidated financial statements when they become payable. The Bank had no outstanding loan commitments at December 31, 2012 and 2011 (in addition to undisbursed portion of construction loans). Unused lines of credit were $3,346,000 and $3,362,000 at December 31, 2012 and 2011. Outstanding letters of credit were $111,000 and $128,000 at December 31, 2012 and 2011.

NOTE 4 - LOAN QUALITY

Management performs a quarterly evaluation of the adequacy of the allowance for loan and lease losses (ALLL). Consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' actual or perceived financial and managerial strengths, the adequacy of the underlying collateral (if collateral dependent) and other relevant factors. It is management's general practice to obtain a new appraisal or asset valuation for any loan that it has rated as substandard or lower, including loans on nonaccrual of interest. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on other factors including, but not limited to, the economy, maintenance and general condition of the collateral, industry, type of property/equipment/vehicle, and the knowledge management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated when determining the realizable value to the Bank.

Certain factors involved in the evaluation are inherently subjective, as they require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

For the purposes of calculating the ALLL, the Bank segregates its loan portfolio into the following segments based primarily on the type of supporting collateral: construction loans, residential real estate, commercial real estate, commercial and industrial loans, and loans to individuals for consumer purposes. The construction segment contains loans to individuals to construct their own homes as well as loans to contractors and developers to construct homes or buildings for resale or develop residential or commercial real estate. The construction segment has its own unique risk characteristics including the need to periodically inspect the property during construction to ensure the funds disbursed are used properly and the real estate held for collateral maintains its value in relation to the amount owed on it. The construction segment also has risk characteristics related to the probability of eventual sale of the finished project or the ability to generate sufficient rental income to service the debt. The residential real estate segment is segregated from the commercial real estate segment due to the obvious differences in inherent risks in each of these types of properties and borrower types. Commercial and industrial loans can be secured by all types of collateral owned by local small and medium-sized businesses, or they can be unsecured. These loans have inherent risks associated with each particular business and its ability to service its debt through the company’s regular operations. The collateral associated with this loan type is usually unique to the industry in which the entity operates and is not necessarily marketable to a wide range of other businesses. Loans to individuals can be secured by vehicles, other consumer goods, or they could be unsecured. They have risk characteristics including the volatility of the collateral’s value and the inherent risk of loaning on collateral that is mobile and subject to damage without proper insurance coverage. Unsecured loans have the risk characteristics of not being collateralized and relying on the integrity and ability of the borrower to repay them from discretionary funds. The loan portfolio is also evaluated by the risk ranking assigned to the loan by the lending officer and re-assessed periodically by the loan review function.

The analysis for determining the ALLL is consistent with guidance set forth in generally accepted accounting principles (GAAP) and the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The analysis has two components: specific and general allocations. The specific component addresses specific reserves established for impaired loans. A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Expected cash flow or collateral values discounted for market conditions and selling costs are used to establish specific allocations. Loans measured for the ALLL under the specific allocation method normally tend to be impaired loans secured by real estate and consumer loans.

The general component addresses the reserves established for pools of homogenous loans, including primarily non-classified loans. The general component includes a quantitative and qualitative analysis. The quantitative analysis includes the Bank's historical loan loss experience (weighted towards most recent periods) and other factors derived from economic and market conditions that have been determined to have an effect on the probability and magnitude of a loss. The qualitative analysis utilizes factors such as: loan volume, management characteristics, levels of nonperforming loans, results of the loan review process, specific credit concentrations, and legal and regulatory issues. Input for these factors is determined on the basis of management's observation, judgment and experience. As a result of this input, additional loss percentages can be assigned to each pool of loans.

NOTE 4 - LOAN QUALITY (Continued)

The total allowance reflects the Bank's estimate of loan losses inherent in the loan portfolio and management considers the ALLL to be adequate to cover losses inherent in the portfolio as of December 31, 2011 and 2012.

The following tables present, by loan segment, the ALLL and changes to the ALLL for the years ended December 31, 2011 and 2012.

(Dollars in thousands)	Construct	1-4 Family First Liens	1-4 Family Revolv. & Open- & Jr	Multifamily Dwelling Units	Nonres. Propert	Land	Comm. & Indust	Consumer	Unalloc.	Total
Allowance at December 31, 2010	$ 18	$ 842	$ 39	$ 30	$ 87	$ 83	$ 10	$ 79	$ 496	$ 1,684
Charge-offs	0	(582)	0	0	(106)	(14)	0	(122)	0	(824)
Recoveries	0	0	0	0	0	0	0	21	0	21
Provision	(14)	1,023	(32)	(21)	118	(37)	(7)	192	(222)	1,000
Allowance at December 31, 2011	4	1,283	7	9	99	32	3	170	274	1,881
Charge-offs	0	(421)	(5)	0	(62)	(33)	0	(35)	0	(556)
Recoveries	0	9	0	0	0	0	0	23	0	32
Provision	(3)	919	29	37	82	173	(3)	(79)	(155)	1,000
Allowance at December 31, 2012	$ 1	$ 1,790	$ 31	$ 46	$ 119	$ 172	$ 0	$ 79	$ 119	$ 2,357

The following tables present, by loan segment, loans that were evaluated for the ALLL under the specific reserve (individually) and those that were evaluated under the general reserve (collectively) as of December 31, 2011 and 2012.

(Dollars in thousands)	Construct	1-4 Family First Liens	1-4 Family Revolv. & Open- & Jr	Multifamily Dwelling Units	Nonres. Propert	Land	Comm. & Indust	Consumer	Unalloc.	Total
December 31, 2011										
Loans Evaluated for Allowance:										
Individually	$ 0	$ 4,660	$ 659	$ 846	$ 1,867	$ 1,345	$ 60	$ 43	$ 0	$ 9,480
Collectively	740	78,773	2,772	1,777	3,784	6,262	258	3,607	0	97,973
Total	$ 740	$ 83,433	$ 3,431	$ 2,623	$ 5,651	$ 7,607	$ 318	$ 3,650	$ 0	$ 107,453
Allowance Established for Loans Evaluated:										
Individually	$ 0	$ 61	$ 0	$ 0	$ 80	$ 0	$ 0	$ 34	$ 0	$ 175
Collectively	4	1,222	7	9	19	32	3	136	274	1,706
Allowance at December 31, 2011	$ 4	$ 1,283	$ 7	$ 9	$ 99	$ 32	$ 3	$ 170	$ 274	$ 1,881
December 31, 2012										
Loans Evaluated for Allowance:										
Individually	$ 0	$ 1,440	$ 0	$ 826	$ 325	$ 200	$ 0	$ 0	$ 0	$ 2,791
Collectively	51	78,582	2,117	1,000	4,767	8,365	13	2,940	0	97,835
Total	$ 51	$ 80,022	$ 2,117	$ 1,826	$ 5,092	$ 8,565	$ 13	$ 2,940	$ 0	$ 100,626
Allowance Established for Loans Evaluated:										
Individually	$ 0	$ 156	$ 0	$ 38	$ 80	$ 8	$ 0	$ 0	$ 0	$ 282
Collectively	1	1,634	31	8	39	164	0	79	119	2,075
Allowance at December 31, 2012	$ 1	$ 1,790	$ 31	$ 46	$ 119	$ 172	$ 0	$ 79	$ 119	$ 2,357

NOTE 4 - LOAN QUALITY (Continued)

The following tables show additional information about those loans considered to be impaired at December 31, 2011 and 2012.

(Dollars in thousands)	December 31, Recorded Investment	December 31, Unpaid Principal Balance	December 31, Related Allowance	For the Year Ended December 31, Average Recorded Investment	For the Year Ended December 31, Interest Income Recognized
2011					
Impaired Loans with No Specific Allowance:					
Residential Real Estate:					
1-4 Family First Liens	$ 2,024	$ 2,024	$ 0	$ 2,019	$ 128
Junior Liens and Open End	109	109	0	109	5
MultiFamily	846	846	0	860	38
Total	2,979	2,979	0	2,988	171
Other Real Estate Loans:					
Nonresidential	586	586	0	586	24
Land	600	600	0	620	38
Total	1,186	1,186	0	1,206	62
Total	$ 4,165	$ 4,165	$ 0	$ 4,194	$ 233
Impaired Loans with Specific Allowance:					
Residential Real Estate:					
1-4 Family First Liens	$ 825	$ 825	$ 51	$ 794	$ 40
Other Real Estate Loans:					
Nonresidential	866	866	71	595	56
Consumer Loans:					
Other	34	34	34	36	1
Total	$ 1,725	$ 1,725	$ 156	$ 1,425	$ 97
2012					
Impaired Loans with No Specific Allowance:					
Residential Real Estate:					
1-4 Family First Liens	$ 970	$ 970	$ 0	$ 970	$ 24
Junior Liens and Open End	5	5	0	2	1
Total	975	975	0	972	25
Other Real Estate Loans:					
Nonresidential	340	340	0	337	0
Land	410	410	0	411	0
Total	750	750	0	748	0
Total	$ 1,725	$ 1,725	$ 0	$ 1,720	$ 25
Impaired Loans with Specific Allowance:					
Residential Real Estate:					
1-4 Family First Liens	$ 1,440	$ 1,440	$ 156	$ 1,403	$ 80
MultiFamily	825	825	38	836	0
Total	2,265	2,265	194	2,239	80
Other Real Estate Loans:					
Nonresidential	325	325	80	327	22
Land	200	200	8	200	10
Total	525	525	88	527	32
Total	$ 2,790	$ 2,790	$ 282	$ 2,766	$ 112

NOTE 4 - LOAN QUALITY (Continued)

As part of the process to calculate the ALLL, the Bank reviews several credit quality factors including payment status (performing, nonperforming and aging) and internal risk rating. The following tables present a summary of nonperforming assets as of December 31:

	2011		2012	
	Balance	% of Loan Segment	Balance	% of Loan Segment
(Dollars in thousands)				
Nonaccrual Loans:				
Residential Real Estate:				
1-4 Family First Liens	$ 225	0%	$ 626	1%
Junior Liens and Open End	0	0%	0	0%
MultiFamily	846	33%	826	31%
Total	1,071	1%	1,452	2%
Other Real Estate Loans:				
Nonresidential	260	4%	340	6%
Land	0	0%	410	5%
Total	260	2%	750	6%
Consumer Loans:				
Other	0	0%	0	0%
Total	$ 1,331	1%	$ 2,202	2%
Loans Past Due 90 Days or More and Not Included Above:				
Residential Real Estate:				
1-4 Family First Liens	$ 607	1%	$ 42	0%
Junior Liens and Open End	0	0%	2	0%
Total	607	1%	44	0%
Other Real Estate Loans:				
Land	16	0%	0	0%
Total	16	0%	0	0%
Consumer Loans:				
Other	26	2%	3	0%
Total	$ 649	1%	$ 47	0%
Total Nonaccrual and Past Due 90 Days or More	$ 1,980	2%	$ 2,249	2%
Repossessed Assets	0		0	
Foreclosed Real Estate	1,121		1,845	
Total Nonperforming Assets	$ 3,101		$ 4,094	
Restructured Loans (TDRs):				
Performing	$ 260		$ 305	
Nonperforming	910		606	
Total TDRs	$ 1,170		$ 911	
Nonperforming Loans to Total Gross Loans	1.8%		2.1%	
Nonperforming Assets to Total Assets	1.6%		2.2%	

NOTE 4 - LOAN QUALITY (Continued)

The following tables present the aging of the loan portfolio at December 31:

(Dollars in thousands)	Current	Past Due Loans 30-89 Days	Past Due Loans 90 + Days	Past Due Loans Total	Non-Accrual	Total Loans
December 31, 2011						
Construction	$ 511	$ 229	$ 0	$ 229	$ 0	$ 740
1-4 Family	81,142	4,890	607	5,497	225	86,864
Multifamily	1,613	164	0	164	846	2,623
Nonresidential	5,167	224	0	224	260	5,651
Land	7,278	313	16	329	0	7,607
Commercial & Industrial	307	11	0	11	0	318
Consumer	3,388	236	26	262	0	3,650
Total	$ 99,406	$ 6,067	$ 649	$ 6,716	$ 1,331	$ 107,453
December 31, 2012						
Construction	$ 51	$ 0	$ 0	$ 0	$ 0	$ 51
1-4 Family	77,834	3,635	44	3,679	626	82,139
Multifamily	1,000	0	0	0	826	1,826
Nonresidential	4,625	127	0	127	340	5,092
Land	7,907	248	0	248	410	8,565
Commercial & Industrial	13	0	0	0	0	13
Consumer	2,848	89	3	92	0	2,940
Total	$ 94,278	$ 4,099	$ 47	$ 4,146	$ 2,202	$ 100,626

In addition to monitoring the performance status of the loan portfolio, the Bank also utilizes a risk rating scale (1 - 8) to evaluate loan asset quality. Loans that are rated 1 - 4 are classified as Pass credits. Loans rated a 5 (Special Mention) are pass credits but have been identified as credits that warrant additional attention and monitoring. Loans that are risk rated 6 or higher (Substandard, Doubtful, or Loss) are placed on the Bank's internal watch list. Loans on the watch list are adversely criticized/classified because the borrowers are experiencing weakening cash flow and there is concern that the Bank may not receive all of the remaining payments when due. If these trends continue, the Bank has an increasing likelihood that it will need to liquidate collateral or use other means for repayment. The Bank's watch list includes loans that may or may not be delinquent or on nonaccrual of interest, loans that may or may not be considered impaired, and potential problem loans. Potential problem loans are loans on the watch list that represent borrowers that may or may not be able to comply with current loan terms, but exclude loans that are 90 days or more past due and nonaccrual loans. Management emphasizes early identification and monitoring of these loans to proactively minimize any risk of loss.

In the normal course of loan portfolio management, the account officer assigned to a particular relationship is responsible for reviewing the relationship monthly and assigning the appropriate risk rating based on the Bank's 8 point risk rating scale. The loan review function also assesses the risk ratings quarterly and makes recommendations for changes as needed. In the event a credit relationship is downgraded to a risk rating of 6 or higher, the relationship is reviewed no less than quarterly at the Bank's loan committee meeting.

Loans excluded from the scope of the annual review process are generally classified as pass credit until: (a) they become past due; (b) management becomes aware of deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Bank for a modification. In these circumstances, the customer relationship is specifically evaluated for potential classification as to special mention, substandard or doubtful, or could even be considered for charge-off. The Bank uses the following definitions for risk ratings:

<u>Pass</u> – Strong credit with no existing or known potential weaknesses deserving management's close attention.

NOTE 4 - LOAN QUALITY (Continued)

Special Mention – Loans included in this category are currently protected but are potentially weak. These loans constitute an undue and unwarranted credit risk but do not presently expose the Bank to a sufficient degree of risk to warrant adverse classification. As a general rule, for the purpose of calculating a loan loss reserve, loans in this category will have the historical loss reserve percentage applied and will remain in a pool with loans that are considered acceptable or better when determining the general valuation reserves. Loans classified as special mention have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard – Substandard loans are inadequately protected by the current net worth and financial capacity of the borrower or of the collateral pledged, if any. The borrower or guarantor is unwilling or unable to meet loan terms or loan covenants for the foreseeable future.

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full highly questionable or improbable, based on currently existing facts, condition, and values.

Loss – Loans classified as losses are uncollectible or no longer a bankable asset. This classification does not mean that the asset has absolutely no recoverable value. Certain salvage value is inherent in these loans. Nevertheless, it is not practical or desirable to defer writing off a portion or whole of a perceived asset even though partial recovery may be collected in the future.

The following tables report the internal credit rating for loans at December 31:

(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2011					
Construction	$ 740	$ 0	$ 0	$ 0	$ 740
1-4 Family	81,545	2,361	2,958	0	86,864
Multifamily	1,777	0	846	0	2,623
Nonresidential	3,783	416	1,452	0	5,651
Land	6,263	744	600	0	7,607
Commercial & Industrial	258	60	0	0	318
Consumer	3,607	9	34	0	3,650
Total	$ 97,973	$ 3,590	$ 5,890	$ 0	$ 107,453
December 31, 2012					
Construction	$ 51	$ 0	$ 0	$ 0	$ 51
1-4 Family	78,838	891	2,410	0	82,139
Multifamily	1,001	0	825	0	1,826
Nonresidential	3,913	514	665	0	5,092
Land	7,089	866	610	0	8,565
Commercial & Industrial	13	0	0	0	13
Consumer	2,926	9	5	0	2,940
Total	$ 93,831	$ 2,280	$ 4,515	$ 0	$ 100,626

NOTE 4 - LOAN QUALITY (Continued)

Certain loan modifications are considered troubled debt restructurings (TDRs) when the Bank, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The bank uses various restructuring techniques, including, but not limited to, deferral of past due interest or principal, reduction of interest rates (but not below the current market rate for loans with similar risk characteristics), extending maturities and modification of amortization schedules. The Bank typically does not forgive principal balances or past due interest prior to pay off or surrender of the collateral. Loans considered to be TDRs are classified as impaired loans for purposes of determination of the allowance for loans losses, until the Bank determines the loans are performing based on terms specified by the restructuring agreements. The allowance for these loans is calculated in the same manner as other impaired loans, as described above. As of December 31, 2011 and 2012, the Bank did not have any commitments to lend additional funds to borrowers whose loan terms have been modified as TDRs. Additionally, for the years ended December 31, 2011 and 2012, the Bank did restructure a few loans as TDRs which subsequently defaulted on their modified terms. The dollar amount and number of TDR's and their activity for the years ended December 31, 2011 and 2012 are not material in relation to the Bank's loan portfolio, and management has chosen not to provide any additional disclosures concerning them.

NOTE 5 - PREMISES AND EQUIPMENT, NET

Premises and equipment, net are summarized as follows:

	As of December 31, 2012	2011
Land	$ 513,262	$ 513,262
Buildings	3,414,962	3,414,962
Furniture and Equipment	742,673	697,761
	4,670,897	4,625,985
Less Accumulated Depreciation	(1,695,483)	(1,521,369)
	$ 2,975,414	$ 3,104,616

NOTE 6 - INTANGIBLE ASSETS

During 1998, the Bank purchased a branch from Union Planters Bank of the Lakeway Area. The Bank evaluates its intangible assets each year. The Bank's intangible assets as of December 31 are as follows:

Amortized Intangible Assets:	2012	2011
Branch Depositor Relationships (Core Deposits) with Definite		
Useful Lives of 15 Years Gross Carrying Amount	$ 1,199,876	$ 1,199,876
Accumulated Amortization	(1,126,553)	(1,046,560)
	$ 73,323	$ 153,316

Estimated future amortization expense is $73,323 for the final year in 2013.

NOTE 7 - DEPOSITS

A summary of deposits is as follows:

	As of December 31, 2012	As of December 31, 2011
Demand Deposits:		
Noninterest-Bearing Accounts	$ 3,288,868	$ 2,802,266
NOW Accounts	11,654,204	11,676,323
Money Market Deposit Accounts	23,282,035	23,817,437
Passbook Savings	16,450,378	14,095,232
Total Demand Deposits	54,675,485	52,391,258
Term Deposits:		
Less Than $100,000	50,844,280	54,129,488
$100,000 or More	61,651,281	63,377,520
Total Term Deposits	112,495,561	117,507,008
Total Deposits	$ 167,171,046	$ 169,898,266

Deposits in excess of $250,000 may not be federally insured, depending upon ownership.

The scheduled maturities of certificates of deposit as of December 31, 2012 are as follows:

2013	$ 89,762,046
2014	21,966,531
2015	363,666
2016	403,318
	$ 112,495,561

NOTE 8 - ADVANCES FROM FEDERAL HOME LOAN BANK

The Bank obtains short-term advances periodically for operating liquidity. Pursuant to the Bank's collateral agreement with the FHLB, advances are secured by the Bank's FHLB stock and qualifying first mortgage loans. There were no advances outstanding as of December 31, 2012 and 2011.

NOTE 9 - INCOME TAXES

The Company files income tax returns in the U.S. federal jurisdiction and Tennessee state jurisdiction. With few exceptions, the Company is no longer subject to examinations by tax authorities for years before 2009. The Company has not accrued or expensed any amounts for interest or penalties associated with income taxes for the years for the years ended December 31, 2012 and 2011.

Income taxes as shown in the consolidated statements of income differ from the amount computed using the statutory federal income tax rate due to tax exempt interest, dividends, and other nontaxable income, and state income tax expense.

Income taxes consist of:

	For the Years Ended December 31, 2012	2011	2010
Current	$ 812,119	$ 584,902	$ 899,007
Deferred Taxes (Benefit)	(230,920)	128,222	(267,831)
	$ 581,199	$ 713,124	$ 631,176

NOTE 9 - INCOME TAXES (Continued)

Deferred tax liabilities have been provided for taxable temporary differences related to the allowance for loan losses, accumulated depreciation, unrealized gains on investment securities, and loan fees. Deferred tax assets have been provided for deductible temporary differences related to deferred loan fees, unrealized losses on investment securities, nonqualified retirement plans and deferred compensation plans. The net deferred tax assets in the accompanying consolidated statements of financial condition include the following components:

	As of December 31,	
	2012	2011
Deferred Tax Assets	$ 1,693,684	$ 1,461,029
Deferred Tax Liabilities	(982,117)	(863,404)
Net Deferred Tax Assets	$ 711,567	$ 597,625

The deferred tax effect included above on the unrealized gains and losses on investment securities available for sale resulted in a deferred tax liability for 2012 of $292,625 ($173,091 in 2011).

NOTE 10 - REGULATORY MATTERS

In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Office of the Comptroller of the Currency (OCC) assumed responsibility from the Office of Thrift Supervision (OTS) on July 21, 2011 for the ongoing examination, supervision, and regulation of federal savings banks and associations. The Bank is subject to various regulatory capital requirements administered by its primary federal regulator. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that if undertaken could have a direct material effect on the Bank and the consolidated financial statements. Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines involving 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 under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors. Management believes that the Bank meets all capital adequacy requirements to which it is subject.

Reconciliation of capital under accounting principles generally accepted in the United States of America to the capital amounts per the regulations is as follows (amounts in thousands):

	2012	2011
Bank Capital (total equity) per accounting principles generally accepted in the United States of America	$ 17,457	$ 16,164
Less Intangible Assets, Net of Amortization	(73)	(153)
Less Net Unrealized (Gain) Loss on Investment Securities Available for Sale	(477)	(282)
Tier 1 Capital per the Regulations	16,907	15,729
Add Allowable Portion of Unrealized Gain on Equity Securities Available for Sale	0	0
Add Allowable Portion of Allowance for Loan Losses	1,059	1,140
Total and Risk-Based Capital per the Regulations	$ 17,966	$ 16,869

NOTE 10 - REGULATORY MATTERS (Continued)

Quantitative measures established by bank regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Tier 1 Capital and Total or Risk-based Capital to Risk-Weighted Assets and Tier 1 Capital to Adjusted Total Assets (as defined in the regulations). As of December 31, 2012, 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 below. There are no conditions or events since that date that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios are also presented in the following table. All amounts are in thousands of dollars.

	Actual		To Comply With Absolute Minimum Capital Requirements		To Be Considered Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012						
Total Capital (to Risk-Weighted Assets)	$ 17,966	21.5%	$ 6,672	8.0%	$ 8,341	10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 16,907	20.3%	$ 3,336	4.0%	$ 5,004	6.0%
Tier I Capital (to Adjusted Total Assets)	$ 16,907	9.1%	$ 7,447	4.0%	$ 9,309	5.0%
As of December 31, 2011						
Total Capital (to Risk-Weighted Assets)	$ 16,869	18.6%	$ 7,253	8.0%	$ 9,067	10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 15,729	17.3%	$ 3,627	4.0%	$ 5,440	6.0%
Tier I Capital (to Adjusted Total Assets)	$ 15,729	8.4%	$ 7,516	4.0%	$ 9,395	5.0%

NOTE 11 - RETIREMENT PLANS

401(k) Retirement Plan - The Bank has established a 401(k) retirement plan, which allows eligible officers and employees to contribute up to the maximum allowed by law and the Plan on a tax-deferred basis. The Bank has the option, at the discretion of the board of directors, to make contributions to the plan. Total 401(k) retirement plan expense was $106,390, $110,746, and $111,532, for the years ended December 31, 2012, 2011, and 2010, respectively.

Directors Long-Term Incentive Plan - In June 1997, the Bank established a long-term incentive plan for the board of directors to provide target retirement benefits of 75% of board fees for ten years for directors who retire with twenty or more years of service. In 2012, the board of directors voted to terminate this plan and participant balances will be paid out over the next two years. The balances are credited with a rate equivalent to the Bank's IRA deposit account rate. Activity in the directors' retirement plan for the years ended December 31 is as follows:

	2012	2011	2010
Liability Balance at Beginning of Year	$ 376,880	$ 387,979	$ 418,886
Accrued and Expensed	1,207	4,648	3,098
Interest Credited to Balances	1,283	6,901	10,153
Withdrawals	(305,458)	(22,648)	(44,158)
Liability Balance at End of Year	$ 73,912	$ 376,880	$ 387,979

Executive Bonus/Retention Plan – In 2012 the Bank established an executive bonus/retention plan for certain executive officers which utilizes safety and soundness factors to compute an annual bonus based on how well the Bank performs. Prior to age 65, ½ of the calculated bonus is paid in cash immediately and ½ is deferred and paid when the officer retires at age 65. After age 65, all annual bonus amounts are paid immediately if the officer is still employed by the Bank. Reduced deferred benefits are available for officers who retire or leave the Bank after attaining age 55 and prior to age 65, and no deferred amounts are paid if the officer retires or leaves the Bank prior to age 55.The plan also includes certain death and disability benefits before retirement age is attained. For 2012, the Bank accrued and expensed approximately $19,000 for benefits under this plan.

NOTE 12 - STOCK PURCHASE PLANS

In 2009 the Company's board of directors adopted and its shareholders approved a Director Stock Purchase Plan and an Employee Stock Purchase Plan. The plans are more fully described below.

Directors Stock Purchase Plan - The maximum number of shares of common stock that can be sold under this plan is 20,000 shares. Each participant cannot be sold more than 1,200 shares of common stock and the purchase price is 85% of the fair value of the common stock, as determined by the board of directors. Options to purchase shares are required to be exercised in March of each year and in the same year that they are granted.

	2012	2011	2010
Directors Plan Activity:			
Number of Shares Purchased	0	2,400	3,295
Total Cost of Shares Purchased	$ 0	$ 28,560	$ 39,211

Employees Stock Purchase Plan - The maximum number of shares of common stock that can be sold under this plan is 40,000 shares. All full-time employees and certain part-time employees are eligible to purchase shares and the purchase price is 85% of the fair value of the common stock, as determined by the board of directors. Options to purchase shares are required to be exercised in the same year that they are granted and expire if not exercised by year-end.

Employees Plan Activity:	2012	2011	2010
Number of Shares Purchased	0	200	2,500
Total Cost of Shares Purchased	$ 0	$ 2,380	$ 29,580

NOTE 13 - DIRECTORS DEFERRED COMPENSATION

In 1998, the Company established a deferred compensation plan whereby directors, at their option, can defer all or portions of the fees they earn each year. Fees not paid are accrued for the benefit of the directors and their accounts are adjusted quarterly for the return equivalent to the change in the fair value of the Company's common stock or alternatively each director can elect to receive a rate equivalent to the Bank's IRA deposit account rate. Activity in the plan for the years ended December 31 is as follows:

	2012	2011	2010
Balances, Beginning of Year	$ 1,271,814	$ 1,728,006	$ 1,570,524
Directors Fees Deferred During Year	88,000	57,200	113,800
Income During Year	23,491	24,892	43,682
Withdrawals	0	(538,284)	0
Balances, End of Year	$ 1,383,305	$ 1,271,814	$ 1,728,006

NOTE 14 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Most of the Bank's business activity is with customers located within East Tennessee. Note 2 discusses the types of securities the Bank invests in. Investments in obligations of U.S. Government corporations and agencies are guaranteed by the FHLB, FHLMC and FNMA. Investments in residential mortgage-backed securities are guaranteed by GNMA, FNMA and FHLMC. Investments in state and municipal securities involve governmental entities within the State of Tennessee. Note 3 discusses the types of loans the Bank invests in. As of December 31, 2012, the Bank had concentrations of loans in real estate lending. Generally these loans are secured by the underlying real estate. The usual risks associated with such concentrations are generally mitigated by being spread over several hundred unrelated borrowers and by adequate loan-to-collateral value ratios.

NOTE 15 - 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 16 - STOCK CONVERSION

In May 1997, the board of directors approved a plan of reorganization from a mutual savings association to a capital stock savings bank and the concurrent formation of a holding company. In November 1997, the Office of Thrift Supervision approved the plan of conversion subject to the approval of the members, and in December 1997 the members of the Association also approved the plan of conversion. The conversion was accomplished effective January 1, 1998 through amendment of the Association's charter and the sale of the Holding Company's common stock in an amount equal to the appraised pro forma consolidated market value of the Holding Company and the Association after giving effect to the conversion. A subscription offering of the shares of common stock was offered to depositors, borrowers, directors, officers, employees, and employee benefit plans of the Bank, and to certain other eligible subscribers. On January 1, 1998, in accordance with its approved plan of conversion, the Holding Company issued 1,454,750 of its $10 par value stock providing gross receipts of $14,547,500. On January 1, 1998, the Bank changed its name to Newport Federal Bank and issued 100,000 shares of its $1 par value stock to the Holding Company in exchange for $7,100,000. Total conversion costs of $571,822 were deducted from the proceeds of the shares sold in the conversion.

At the time of the conversion, the Bank was required to establish a liquidation account in an amount equal to its capital as of June 30, 1997. The liquidation account will be maintained for the benefit of eligible accountholders who continue to maintain their accounts at the Bank after the conversion. The liquidation account will be reduced annually to the extent that eligible accountholders have reduced their qualifying deposits as of each anniversary date. Subsequent increases will not restore an eligible accountholder's interest in the liquidation account. In the event of a complete liquidation, each eligible accountholder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the current adjusted qualifying balances for accounts then held. The Bank and the Holding Company are subject to several restrictions concerning the repurchase of stock and dividend payment restrictions pursuant to the applicable rules and policies of the OCC.

NOTE 17 - FAIR VALUE DISCLOSURES

GAAP generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. The Bank has not elected to adopt the fair value option for any financial instruments. However, other accounting pronouncements require the Bank to measure certain assets at fair value as described below.

GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. GAAP describes three levels of inputs that may be used to measure fair value:

Level 1: Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset and liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or the liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability

NOTE 17 - FAIR VALUE DISCLOSURES (Continued)

A description of valuation methodologies used for assets and liabilities recorded at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is shown below. The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Investment Securities Available-for-Sale - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement for these securities is based upon quoted prices of like or similar securities, utilizing Level 2 inputs. These measurements are obtained from a service provider who considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the securities' terms and conditions, among other things.

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 in accordance with GAAP 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. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses. The fair value of individually identified impaired loans is measured based on the present value of expected payments or the collateral value if the loan is collateral dependent. Impaired loans are classified within Level 3 of the valuation hierarchy.

Foreclosed Real Estate - Foreclosed real estate is recorded at fair value on a nonrecurring basis. Fair value measurement is based on management's estimate of the amount that will be realized when the property is sold and is classified within Level 3 of the valuation hierarchy.

Assets Recorded at Fair Value on a Recurring Basis

The tables below present information about certain assets measured at fair value:

		Fair Value Measurements Using		
	Carrying Amount in the Balance Sheet	Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
As of December 31, 2012:				
Obligations of U.S. Government Corporations and Agencies	$ 18,840,690	$ 0	$ 18,840,690	$ 0
Residential Mortgage-Backed Securities	17,532,634	0	17,532,634	0
Corporate Debt Securities	8,675,802	0	8,675,802	0
Obligations of States and Political Subdivisions	23,658,124	0	23,658,124	0
Investment Securities Available for Sale	$ 68,707,250	$ 0	$ 68,707,250	$ 0
As of December 31, 2011:				
Obligations of U.S. Government Corporations and Agencies	$ 35,496,135	$ 0	$ 35,496,135	$ 0
Residential Mortgage-Backed Securities	11,621,359	0	11,621,359	0
Corporate Debt Securities	5,514,517	0	5,514,517	0
Obligations of States and Political Subdivisions	13,094,034	0	13,094,034	0
Investment Securities Available for Sale	$ 65,726,045	$ 0	$ 65,726,045	$ 0

NOTE 17 - FAIR VALUE DISCLOSURES (Continued)

Assets Recorded at Fair Value on a Nonrecurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

	Carrying Amount in the Balance Sheet	Fair Value Measurements Using: Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
As of December 31, 2012:				
Impaired Loans, Net of Allowance	$ 4,232,689	$ 0	$ 0	$ 4,232,689
Foreclosed Real Estate	1,845,187	0	0	1,845,187
	$ 6,077,876	$ 0	$ 0	$ 6,077,876
As of December 31, 2011:				
Impaired Loans, Net of Allowance	$ 5,733,632	$ 0	$ 0	$ 5,733,632
Foreclosed Real Estate	1,120,696	0	0	1,120,696
	$ 6,854,328	$ 0	$ 0	$ 6,854,328

GAAP also requires the Company to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the balance sheets, for which it is practicable to estimate fair value, and which are not already recorded at fair value.

A financial instrument is defined as cash, evidence of an ownership interest in an entity, or a contract that both: (1) imposes on one entity a contractual obligation to deliver cash or another financial instrument to a second entity, or to exchange other financial instruments on potentially unfavorable terms with the second entity, and (2) conveys to that second entity a contractual right to receive cash or another financial instrument from the first entity, or to exchange other financial instruments on potentially favorable terms with the first entity.

For the Bank, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments as defined above. However, a large majority of those assets and liabilities do not have an active trading market nor are their characteristics similar to other financial instruments for which an active trading market exists. In addition, it is the Bank's practice and intent to hold the majority of its financial instruments to maturity and not to engage in trading or sales activities. Therefore, much of the information as well as the amounts disclosed below are highly subjective and judgmental in nature. The subjective factors include estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Because the fair value is estimated as of December 31, 2012 and 2011, the amounts which will actually be realized or paid upon settlement or maturity of the various financial instruments could be significantly different.

The estimates of fair value are based on existing financial instruments without attempting to estimate the value of anticipated future business or activity nor the value of assets and liabilities that are not considered financial instruments. For example, the value of mortgage loan servicing rights and the value of the Bank's long-term relationships with depositors, commonly known as core deposit intangibles, have not been considered in the estimates of fair values presented below. In addition, the tax implications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been included in the estimated fair values below.

The following methods and assumptions were used to estimate the fair value of the following classes of financial instruments:

Cash and Amounts Due from Depository Institutions - For these short-term instruments, the recorded book value is a reasonable estimate of fair value.

Interest-Bearing Deposits in Other Banks - For these short-term instruments, the recorded book value is a reasonable estimate of fair value.

NOTE 17 - FAIR VALUE DISCLOSURES (Continued)

Investment Securities Available for Sale - See disclosure above.

Loans Receivable, Net - The estimated fair value of fixed rate mortgage loans is calculated by discounting future cash flows to their present value. Future cash flows, consisting of both principal and interest payments, are discounted using current local market rates for similar loans with similar maturities. The estimated fair value of variable rate loans is considered equal to recorded book value. The estimated fair value of the allowance for loan losses is considered to be its recorded book value. Additionally, the credit exposure known to exist in the loan portfolio is embodied in the allowance for loan losses. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable and are disclosed above.

Cash Surrender Value of Life Insurance - The recorded book value is a reasonable estimate of fair value.

Equity Securities, at Cost - Management does not consider it practicable to estimate the fair value of equity securities carried at cost and also considers their carrying values to be immaterial in relation to the Company's other financial instruments. Therefore, no estimate of fair value for these investments is disclosed.

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

Advances from Federal Home Loan Bank - Interest rates on these advances are similar to rates currently being offered for similar borrowings. Therefore, the recorded book value is a reasonable estimate of fair value.

Off-Balance-Sheet Loan Commitments - The fair value of loan commitments is based on 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. The fair value of these items is not material to the Bank as of the dates indicated below.

The recorded book value and estimated fair value of the Company's financial instruments which are not carried at fair value as of December 31, 2012 and 2011 are as follows:

	As of December 31, 2012		As of December 31, 2011	
	Recorded Book Value	Estimated Fair Value	Recorded Book Value	Estimated Fair Value
FINANCIAL ASSETS:	(amounts in thousands)			
Cash and Amounts Due from Depository Institutions	$ 5,571	$ 5,571	$ 7,555	$ 7,555
Net Loans, Excluding Net Impaired Loans	$ 93,746	$ 93,623	$ 99,530	$ 99,395
Cash Surrender Value of Life Insurance	$ 2,278	$ 2,278	$ 2,173	$ 2,173
FINANCIAL LIABILITIES:				
Deposits	$ 167,171	$ 167,626	$ 169,898	$ 170,550

NOTE 18 - SPLIT DOLLAR LIFE INSURANCE BENEFITS

GAAP requires the Bank to recognize a liability for the estimated cost of providing life insurance benefits to employees during the postretirement period. The Bank accrued and expensed $1,500, $3,081 and $4,873 for the cost attributable to the years ended December 31, 2012, 2011, and 2010, respectively.

CONSOLIDATING INFORMATION

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INDEPENDENT AUDITOR'S REPORT ON CONSOLIDATING INFORMATION

Board of Directors and Senior Management
United Tennessee Bankshares, Inc.
Newport, Tennessee

We have audited the consolidated financial statements of United Tennessee Bankshares, Inc. and subsidiary as of and for the years ended December 31, 2012 and 2011, and have issued our report thereon, dated March 11, 2013, which contained an unmodified opinion on those consolidated financial statements. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole.

The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Pugh & Company, P.C.

Certified Public Accountants
Knoxville, Tennessee
March 11, 2013

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATING SCHEDULE – STATEMENT OF FINANCIAL CONDITION

As of December 31, 2012

	United Tennessee Bankshares, Inc.	Newport Federal Bank	Intercompany Eliminations	Consolidated
ASSETS				
Cash and Amounts Due from Depository Institutions	$ 115,832	$ 5,455,333	$ 0	$ 5,571,165
Interest-Bearing Deposits in Other Banks	0	4,233,000	0	4,233,000
Investment Securities Available for Sale, at Fair Value	0	68,707,250	0	68,707,250
Loans Receivable, Net	0	97,978,916	0	97,978,916
Equity Securities, at Cost	0	1,160,700	0	1,160,700
Premises and Equipment, Net	0	2,975,414	0	2,975,414
Accrued Interest Receivable	0	894,540	0	894,540
Foreclosed Real Estate	0	1,845,187	0	1,845,187
Intangible Assets, Net	0	73,323	0	73,323
Cash Surrender Value of Life Insurance	0	2,278,002	0	2,278,002
Investment in Subsidiary	16,979,917	0	(16,979,917)	0
Prepaid FDIC Assessment	0	165,000	0	165,000
Prepaid Expenses and Other Assets	9,012	903,075	0	912,087
TOTAL ASSETS	$ 17,104,761	$ 186,669,740	$ (16,979,917)	$ 186,794,584
LIABILITIES AND EQUITY				
LIABILITIES				
Deposits:				
Demand	$ 0	$ 54,675,485	$ 0	$ 54,675,485
Term	0	112,495,561	0	112,495,561
Total Deposits	0	167,171,046	0	167,171,046
Accrued Interest Payable	0	35,434	0	35,434
Accrued Income Taxes	0	99,848	0	99,848
Accrued Benefit Plan Liabilities	0	1,724,434	0	1,724,434
Other Liabilities	0	181,621	0	181,621
Total Liabilities	0	169,212,383	0	169,212,383
SHAREHOLDERS' EQUITY				
Common Stock	4,283,854	7,100,000	(7,100,000)	4,283,854
Retained Earnings	12,913,279	9,879,916	(9,879,917)	12,913,278
Treasury Stock, at Cost	(92,372)	0	0	(92,372)
Accumulated Other Comprehensive Income (Loss)	0	477,441	0	477,441
Total Shareholders' Equity	17,104,761	17,457,357	(16,979,917)	17,582,201
TOTAL LIABILITIES AND EQUITY	$ 17,104,761	$ 186,669,740	$ (16,979,917)	$ 186,794,584

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATING SCHEDULE – STATEMENT OF INCOME

As of December 31, 2012

	United Tennessee Bankshares, Inc.	Newport Federal Bank	Intercompany Eliminations	Consolidated
INTEREST INCOME				
Loans	$ 0	$ 6,658,052	$ 0	$ 6,658,052
Investment Securities	0	1,303,399	0	1,303,399
Total Interest Income	0	7,961,451	0	7,961,451
INTEREST EXPENSE				
Deposits	0	1,564,381	0	1,564,381
Total Interest Expense	0	1,564,381	0	1,564,381
NET INTEREST INCOME	0	6,397,070	0	6,397,070
PROVISION FOR LOAN LOSSES	0	(1,000,000)	0	(1,000,000)
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	0	5,397,070	0	5,397,070
NONINTEREST INCOME				
Deposit Account Service Charges	0	245,142	0	245,142
Loan Service Charges and Fees	0	57,919	0	57,919
Net Gain (Loss) on Sales of Investment Securities Available for Sale	0	45,079	0	45,079
Income of Subsidiary	1,497,692	0	(1,497,692)	0
Increase in Cash Surrender Value of Life Insurance	0	105,128	0	105,128
Other	0	83,769	0	83,769
Total Noninterest Income	1,497,692	537,037	(1,497,692)	537,037
NONINTEREST EXPENSE				
Compensation and Benefits	0	1,862,250	0	1,862,250
Occupancy and Equipment	0	419,738	0	419,738
Federal Deposit Insurance Assessments	0	197,357	0	197,357
Data Processing Fees	0	317,025	0	317,025
Advertising and Promotion	0	83,662	0	83,662
Amortization	0	79,992	0	79,992
Loss on Foreclosed Real Estate	0	329,962	0	329,962
Other	25,624	555,419	0	581,043
Total Noninterest Expense	25,624	3,845,405	0	3,871,029
INCOME BEFORE INCOME TAXES	1,472,068	2,088,702	(1,497,692)	2,063,078
INCOME TAXES (BENEFIT)	(9,812)	591,011	0	581,199
NET INCOME	$ 1,481,880	$ 1,497,691	$ (1,497,692)	$ 1,481,879

OTHER INFORMATION

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To the Board of Directors and Senior Management
United Tennessee Bankshares, Inc. and Subsidiary
Newport, Tennessee

In planning and performing our audit of the consolidated financial statements of United Tennessee Bankshares, Inc. and its subsidiary Newport Federal Bank as of and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the Company's internal control over financial reporting (internal control) as a basis for designing our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

The Company's internal controls consist of policies and procedures established by management to provide reasonable, but not absolute, assurance that the financial data are recorded, authorized, processed, summarized, and reported consistent with the assertions embodied in the consolidated financial statements. In establishing those policies and procedures, management assesses their expected benefits and related costs. Because of the inherent limitations in internal control, including the possibility of management override of controls, errors or fraud may occur and not be detected by such controls. Also, projection of any assessment of internal control to future periods is subject to the risk that policies or procedures may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses.

However, material weaknesses may exist that have not been identified.

This communication is intended solely for the information and use of senior management, the board of directors and appropriate federal banking regulatory agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Pugh & Company, P.C.

Certified Public Accountants
Knoxville, Tennessee
March 11, 2013