MACKINAC FINANCIAL CORP /MI/
Form 10-Q
November 16, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____ to ____

Commission file number: 0-20167

MACKINAC FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

MICHIGAN	38-2062816
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
130 SOUTH CEDAR STREET, MANISTIQUE, MI	49854
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (888) 343-8147

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

Yes þ No o

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

Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Small reporting company þ

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

Yes o No þ

As of October 31, 2009, there were outstanding 3,419,736 shares of the registrant s common stock, no par value.

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MACKINAC FINANCIAL CORPORATION
PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)

(Dollars in thousands)	**September 30, 2009 (unaudited)**	**December 31, 2008**	**September 30, 2008** (unaudited)
ASSETS			
Cash and due from banks	**$ 23,249**	$ 10,112	$ 8,217
Federal funds sold			4,422
Cash and cash equivalents	**23,249**	10,112	12,639
Interest-bearing deposits in other financial institutions	**662**	582	382
Securities available for sale	**80,203**	47,490	42,781
Federal Home Loan Bank stock	**3,794**	3,794	3,794
Loans:			
Commercial	**306,590**	296,088	290,406
Mortgage	**73,116**	70,447	67,576
Installment	**4,394**	3,745	3,539
Total Loans	**384,100**	370,280	361,521
Allowance for loan losses	**(4,081)**	(4,277)	(3,385)
Net loans	**380,019**	366,003	358,136
Premises and equipment	**10,281**	11,189	11,360
Other real estate held for sale	**5,821**	2,189	1,751
Other assets	**9,151**	10,072	10,110
TOTAL ASSETS	**$ 513,180**	$ 451,431	$ 440,953
LIABILITIES AND SHAREHOLDERS EQUITY			
LIABILITIES:			
Noninterest bearing deposits	**$ 33,254**	$ 30,099	$ 34,858
NOW, money market, checking	**88,843**	70,584	80,185
Savings	**18,807**	20,730	18,957
CDs<$100,000	**59,637**	73,752	74,940
CDs>$100,000	**25,409**	25,044	30,220
Brokered	**192,631**	150,888	121,534
Total deposits	**418,581**	371,097	360,694

Borrowings:			
Federal funds purchased			
Short-term			
Long-term	**36,140**	36,210	36,210
Total borrowings	**36,140**	36,210	36,210
Other liabilities	**2,693**	2,572	2,622
Total liabilities	**457,414**	409,879	399,526
SHAREHOLDERS EQUITY:			
Preferred stock outstanding	**10,466**		
Common stock and additional paid in capital No par value			
Authorized - 18,000,000 shares			
Issued and outstanding - 3,419,736 shares	**43,485**	42,815	42,794
Retained earnings (accumulated deficit)	**378**	(1,708)	(1,456)
Accumulated other comprehensive income	**1,437**	445	89
Total shareholders equity	**55,766**	41,552	41,427
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 513,180**	$ 451,431	$ 440,953

See accompanying notes to condensed consolidated financial statements.

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MACKINAC FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in Thousands, Except per Share Data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands except per share data)	**2009**	2008	**2009**	2008
INTEREST INCOME:				
Interest and fees on loans:				
Taxable	**$ 5,106**	$ 5,537	**$ 15,212**	$ 17,241
Tax-exempt	**63**	100	**237**	310
Interest on securities:				
Taxable	**888**	303	**2,020**	840
Tax-exempt	**7**	1	**11**	4
Other interest income	**28**	87	**44**	257
Total interest income	**6,092**	6,028	**17,524**	18,652
INTEREST EXPENSE:				
Deposits	**1,550**	2,308	**4,894**	7,924
Borrowings	**232**	349	**774**	1,194
Total interest expense	**1,782**	2,657	**5,668**	9,118
Net interest income	**4,310**	3,371	**11,856**	9,534
Provision for loan losses	**700**	450	**1,400**	1,200
Net interest income after provision for loan losses	**3,610**	2,921	**10,456**	8,334
OTHER INCOME:				
Service fees	**236**	229	**750**	597
Net security gains	**644**	(1)	**644**	64
Net gains on sale of secondary market loans	**247**	16	**472**	113
Proceeds from lawsuit settlement				3,475
Other	**1,291**	44	**1,382**	96
Total other income	**2,418**	288	**3,248**	4,345
OTHER EXPENSES:				
Salaries and employee benefits	**1,603**	1,534	**4,761**	5,416
Occupancy	**336**	336	**1,069**	1,039
Furniture and equipment	**193**	202	**604**	570
Data processing	**221**	212	**665**	649

Professional service fees	**161**	120	**458**	352
Loan and deposit	**402**	176	**1,175**	430
Telephone	**50**	41	**139**	125
Advertising	**80**	93	**238**	213
Other	**397**	221	**1,043**	803
Total other expenses	**3,443**	2,935	**10,152**	9,597
Income before provision for income taxes	**2,585**	274	**3,552**	3,082
Provision for income taxes	**864**	58	**1,142**	958
NET INCOME	**1,721**	216	**2,410**	2,124
Preferred dividend expense	**185**		**323**	
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	**$ 1,536**	$ 216	**$ 2,087**	$ 2,124
INCOME PER COMMON SHARE:				
Basic	**$ .45**	$ .06	**$ .61**	$ .62
Diluted	**$ .45**	$ .06	**$ .61**	$ .62

See accompanying notes to condensed consolidated financial statements.

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MACKINAC FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(Dollars in Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	**2009**	2008
Balance, beginning of period	**$ 53,939**	$ 40,975	**$ 41,551**	$ 39,321
Net income for period	**1,721**	216	**2,410**	2,124
Net unrealized gain on securities available for sale	**226**	215	**992**	29
Total comprehensive income	**1,947**	431	**3,402**	2,153
Dividend on preferred stock	**(185)**		**(323)**	
Stock option compensation	**17**	21	**52**	63
Repurchase of common stock oddlot shares				(110)
Issuance of preferred stock			**10,382**	
Issuance of common stock warrants			**618**	
Accretion of preferred stock discount	**48**		**84**	
Balance, end of period	**$ 55,766**	$ 41,427	**$ 55,766**	$ 41,427

See accompanying notes to condensed consolidated financial statements.

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MACKINAC FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30, 2009	2008
Cash Flows From Operating Activities:		
Net income	**$ 2,410**	$ 2,124
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	**1,494**	917
Provision for deferred taxes	**1,052**	914
Provision for loan losses	**1,400**	1,200
(Gain) on sales/calls of securities available for sale	**(644)**	(64)
(Gain) on sales of premises, equipment, and other real estate	**17**	(35)
Writedown of other real estate	**36**	936
Stock option compensation	**52**	63
Change in other assets	**(686)**	(518)
Change in other liabilities	**121**	797
Net cash provided by operating activities	**5,252**	6,334
Cash Flows From Investing Activities:		
Net (increase) in loans	**(19,212)**	(11,144)
Net (increase) decrease in interest-bearing deposits in other financial institutions	**(80)**	1,428
Purchase of securities available for sale	**(50,113)**	(45,699)
Proceeds from sales, maturities or calls of securities available for sale	**18,976**	24,542
Capital expenditures	**(540)**	(519)
Proceeds from sale of premises, equipment, and other real estate	**81**	1,317
Net cash paid in connection with branch sales	**(28,578)**	
Net cash (used in) investing activities	**(79,466)**	(30,075)
Cash Flows From Financing Activities:		
Net increase in deposits	**76,744**	39,867
Issuance of Preferred Stock Series A Capital	**11,000**	
Dividend on preferred stock	**(323)**	
Net increase (decrease) in federal funds purchased		(7,710)
Net increase (decrease) in line of credit		(1,959)
Principal payments on borrowings	**(70)**	(70)
Net (decrease) repurchase of common stock oddlot shares		(110)
Net cash provided by financing activities	**87,351**	30,018

Net increase (decrease) in cash and cash equivalents	**13,137**	6,277
Cash and cash equivalents at beginning of period	**10,112**	6,362
Cash and cash equivalents at end of period	**$ 23,249**	$ 12,639
Supplemental Cash Flow Information:		
Cash paid during the year for:		
Interest	**$ 5,836**	$ 7,872
Income taxes	**90**	44
Noncash Investing and Financing Activities:		
Transfers of foreclosures from loans to other real estate held for sale (net of adjustments made through the allowance for loan losses)	**4,169**	1,804

See accompanying notes to condensed consolidated financial statements.

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MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited condensed consolidated financial statements of Mackinac Financial Corporation (the Corporation) have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine month period ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. The unaudited consolidated financial statements and footnotes thereto should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2008.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

In order to properly reflect some categories of other income and other expenses, reclassifications of expense and income items have been made to prior period numbers. The net other income and other expenses were not changed due to these classifications.

Allowance for Loan Losses

The allowance for loan losses includes specific allowances related to commercial loans, which have been judged to be impaired. A loan is impaired when, based on current information, it is probable that the Corporation will not collect all amounts due in accordance with the contractual terms of the loan agreement. These specific allowances are based on discounted cash flows of expected future payments using the loan s initial effective interest rate or the fair value of the collateral if the loan is collateral dependent.

The Corporation also has a general allowance for loan losses for loans not considered impaired. The allowance for loan losses is maintained at a level which management believes is adequate to provide for possible loan losses. Management periodically evaluates the adequacy of the allowance using the Corporation s past loan loss experience, known and inherent risks in the portfolio, composition of the portfolio, current economic conditions, and other factors. The allowance does not include the effects of expected losses related to future events or future changes in economic conditions. This evaluation is inherently subjective since it requires material estimates that may be susceptible to significant change. Loans are charged against the allowance for loan losses when management believes the collectability of the principal is unlikely. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require additions to the allowance for loan losses based on their judgments of collectability.

In management s opinion, the allowance for loan losses is adequate to cover probable losses relating to specifically identified loans, as well as probable losses inherent in the balance of the loan portfolio as of the balance sheet date.

Stock Option Plans

The Corporation sponsors three stock option plans. One plan was approved in 2000 and applies to officers, employees, and nonemployee directors. This plan was amended as a part of the December 2004 stock offering and recapitalization. The amendment, approved by shareholders, increased the shares available under this plan by 428,587 shares from the original 25,000 (adjusted for the 1:20 reverse stock split), to a total authorized share balance of 453,587. The other two plans, one for officers and employees and the other for nonemployee directors, were approved in 1997. A total of 30,000 shares (adjusted for the 1:20 reverse stock split), were

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

made available for grant under these plans. Options under all of the plans are granted at the discretion of a committee of the Corporation s Board of Directors. Options to purchase shares of the Corporation s stock are granted at a price equal to the market price of the stock at the date of grant. The committee determines the vesting of the options when they are granted as established under the plan.

2. RECENT ACCOUNTING DEVELOPMENTS

Accounting Standards Codification

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162 (The Codification). The Codification reorganized existing U.S. accounting and reporting standards issued by the FASB and other related private sector standard setters into a single source of authoritative accounting principles arranged by topic. The Codification supersedes all existing U.S. accounting standards; all other accounting literature not included in the Codification (other than Securities and Exchange Commission guidance for publicly-traded companies) is considered non-authoritative. The Codification was effective on a prospective basis for interim and annual reporting periods ending after September 15, 2009. The adoption of the Codification changed the Company s references to U.S. GAAP accounting standards but did not impact the Company s financial statements.

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MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. RECENT ACCOUNTING DEVELOPMENTS (continued)

Subsequent Events

In May 2009, the FASB issued new guidance for the recognition and disclosure of subsequent events not addressed in other applicable generally accepted accounting principles. The new guidance, which is now part of Accounting Standards Codification (ASC) 855, Subsequent Events , requires entities to disclose the date through which subsequent events have been evaluated and the nature and estimated financial effects of certain subsequent events. This new guidance is effective for interim or annual financial periods ending after June 15, 2009, and will be applied prospectively. The adoption of this new guidance did not have a material impact on the Company s financial statements.

Disclosures about Fair Value of Financial Instruments

In April 2009, the FASB issued new guidance for the accounting for other-than temporary impairments. The new guidance, which is now part of ASC 320 Investments Debt and Equity Securities (ASC 320), amends the other-than temporary impairment (OTTI) guidance in GAAP for debt securities and the presentation and disclosure requirements of OTTI on debt and equity securities in the financial statements. This new guidance does not amend existing recognition and measurement guidance related to OTTI of equity securities. The new guidance requires separate display of losses related to credit deterioration and losses related to other market factors. When an entity does not intend to sell the security and it is more likely than not that an entity will not have to sell the security before recovery of its cost basis, it must recognize the credit component of OTTI in earnings and the remaining portion in other comprehensive income. The new guidance was effective for interim reporting periods ending after June 15, 2009. See Note 4 Investment Securities.

Other-Than-Temporary Impairments

In April 2009, the FASB issued new guidance for the accounting for other-than temporary impairments. The new guidance, which is now part of ASC 320 Investments Debt and Equity Securities (ASC 320), amends the other-than temporary impairment (OTTI) guidance in GAAP for debt securities and the presentation and disclosure requirements of OTTI on debt and equity securities in the financial statements. This new guidance does not amend existing recognition and measurement guidance related to OTTI of equity securities. The new guidance requires separate display of losses related to credit deterioration and losses related to other market factors. When an entity does not intend to sell the security and it is more likely than not that an entity will not have to sell the security before recovery of its cost basis, it must recognize the credit component of OTTI in earnings and the remaining portion in adoption permitted. The Company adopted the new guidance in the second quarter of 2009, which did not have a material impact on the Company financial statements.

Additional Fair Value Measurement Guidance

In April 2009, the FASB issued new guidance for determining when a transaction is not orderly and for estimating fair value when there has been a significant decrease in the volume and level of activity for an asset or liability. The new guidance, which is now part of ASC 820, Fair Value Measurements and Disclosures (ASC 820), requires disclosure of the inputs and valuation techniques used, as well as any changes in valuation techniques and inputs used during the period, to measure fair value in interim and annual periods. In addition, the presentation of the fair value hierarchy is required to be presented by major security type as described in ASC 320. The provisions of the new guidance were effective for interim periods ending after June 15, 2009. The adoption of the new guidance in the second quarter of 2009 did not have a material impact on the Company s financial statements.

MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. EARNINGS PER SHARE

Earnings per share are based upon the weighted average number of shares outstanding. Additional shares issued as a result of option exercises would not be dilutive in either period.

The following shows the computation of basic and diluted earnings per share for the three and six months ended September 30, 2009 and 2008 (dollars in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	**2009**	2008
Net income	**$ 1,721**	$ 216	**$ 2,410**	$ 2,124
Preferred stock dividends	**185**		**323**	
Net income available to common shareholders	**$ 1,536**	$ 216	**$ 2,087**	$ 2,124
Weighted average shares outstanding	**3,419,736**	3,419,736	**3,419,736**	3,422,777
Effect of dilutive stock options outstanding				
Diluted weighted average shares outstanding	**3,419,736**	3,419,736	**3,419,736**	3,422,777
Earnings per common share:				
Basic	**$ .45**	$ .06	**$ .61**	$ .62
Diluted	**$ .45**	$ .06	**$ .61**	$ .62

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2009, December 31, 2008 and September 30, 2008 are as follows (dollars in thousands):

	September 30, 2009		December 31, 2008		September 30, 2008	
	Amortized Cost	**Estimated Fair Value**	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
US Agencies MBS	**$ 72,623**	**$ 74,563**	$ 46,316	$ 46,941	$ 42,147	$ 42,234
Obligations of states and political subdivisions	**1,207**	**1,281**	498	549	499	547
Corporate Bonds	**4,198**	**4,359**				
Total securities available for sale	**$ 78,028**	**$ 80,203**	$ 46,814	$ 47,490	$ 42,646	$ 42,781

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were $17.050 million and $17.081 million, respectively, at September 30, 2009.

5. LOANS

The composition of loans at September 30, 2009, December 31, 2008 and September 30, 2008 is as follows (dollars in thousands):

	September 30,	December 31,	September 30,

	2009	2008	2008
Commercial real estate	**$ 211,994**	$ 185,241	$ 184,423
Commercial, financial, and agricultural	**70,520**	79,734	75,610
One to four family residential real estate	**66,700**	65,595	62,895
Construction:			
Commercial	**24,076**	31,113	30,373
Consumer	**6,416**	4,852	4,681
Consumer	**4,394**	3,745	3,539
Total loans	**$ 384,100**	$ 370,280	$ 361,521

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MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

5. LOANS (Continued)

LOANS Allowance for loan losses

An analysis of the allowance for loan losses for the nine months ended September 30, 2009, the year ended December 31, 2008, and the nine months ended September 30, 2008 is as follows: (dollars in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Balance at beginning of period	**$ 4,277**	$ 4,146	$ 4,146
Recoveries on loans	**50**	121	117
Loans charged off	**(1,646)**	(2,290)	(2,078)
Provision for loan losses	**1,400**	2,300	1,200
Balance at end of period	**$ 4,081**	$ 4,277	$ 3,385

In the first nine months of 2009, net charge off activity of $1.596 million equated to .43% of average loans outstanding compared to net charge-offs of $1.961 million, or .55% of average loans, in the first nine months of 2008. The allowance for loan losses and current year provision is discussed in more detail under Management s Discussion and Analysis.

LOANS Impaired loans

Nonperforming loans are those which are contractually past due 90 days or more as to interest or principal payments, on nonaccrual status, or loans, the terms of which have been renegotiated to provide a reduction or deferral on interest or principal.

Information regarding impaired loans as of September 30, 2009, December 31, 2008 and September 30, 2008 is as follows (dollars in thousands):

				Valuation Reserve		
	September 30, 2009 (Unaudited)	December 31, 2008	September 30, 2008 (Unaudited)	**September 30, 2009**	December 31, 2008	September 30, 2008
Balances, at period end						
Impaired loans with specific valuation reserve	**$ 6,561**	$ 3,730	$ 3,913	**$ 1,341**	$ 994	$ 951
Impaired loans with no specific valuation reserve	**4,967**	1,157	736			
Total impaired loans	**$ 11,528**	$ 4,887	$ 4,649	**$ 1,341**	$ 994	$ 951
	$ 10,655	$ 4,887	$ 4,649	**$ 1,341**	$ 994	$ 951

Impaired loans on nonaccrual basis												
Impaired loans on accrual basis		**3**										
Total impaired loans	**$**	**10,658**	$	4,887	$	4,649	**$**	**1,341**	$	994	$	951
Average investment in impaired loans	**$**	**9,809**	$	4,834	$	4,732						
Interest income recognized during impairment		**32**		60		50						
Interest income that would have been recognized on an accrual basis		**508**		377		263						
Cash-basis interest income recognized				60		50						

The average investment in impaired loans was approximately $9.809 million for the nine months ended September 30, 2009, $4.834 million for the year ended December 31, 2008, and $4.732 million for the nine months ended September 30, 2008, respectively. Additional discussion on impaired loans is presented in the Management s Discussion and Analysis section of this report.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

5. LOANS (Continued)

LOANS Related parties

The Bank, in the ordinary course of business, grants loans to the Corporation s executive officers and directors, including their families and firms in which they are principal owners.

Activity in such loans is summarized below (dollars in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Loans outstanding beginning of period	**$ 6,516**	$ 1,720	$ 1,720
New loans	**2,160**	372	115
Net activity on revolving lines of credit	**812**	2,378	2,109
Repayment	**(1,205)**	(687)	(647)
Change in related party interest	**297**	2,733	3,758
Loans outstanding end of period	**$ 8,580**	$ 6,516	$ 7,055

There were no loans to related-parties classified substandard at September 30, 2009, December 31, 2008 or September 30, 2008, respectively. In addition to the outstanding balances above, there were unused commitments of $.114 million to related parties at September 30, 2009.

6. LONG-TERM BORROWINGS

Long-term borrowings consist of the following at September 30, 2009, December 31, 2008 and September 30, 2008 (dollars in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Federal Home Loan Bank fixed rate advances at rates ranging from 4.98% to 5.16% maturing in December 2010	**$ 15,000**	$ 15,000	$ 15,000
Federal Home Loan Bank variable rate advances at rates ranging from .492% to ..545% maturing in January and February 2011	**20,000**	20,000	20,000
Farmers Home Administration, fixed-rate note payable, maturing August 24, 2024 interest payable at 1%	**1,140**	1,210	1,210
	$ 36,140	$ 36,210	$ 36,210

The Federal Home Loan Bank borrowings are collateralized at September 30, 2009 by the following: a collateral agreement on the Corporation s one to four family residential real estate loans with a book value of approximately $27.752 million; mortgage related and municipal securities with an amortized cost and estimated fair value of $16.263 million and $17.021 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling $3.794 million. Prepayment of the remaining advances is subject to the provisions and conditions of the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of September 30, 2009.

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling $.280 million originated and held by the Corporation s wholly owned subsidiary, First Rural Relending, and an assignment of a demand deposit account in the amount of $.947 million, and guaranteed by the Corporation.

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MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

7. STOCK OPTION PLANS

A summary of stock option transactions for the nine months ended September 30, 2009 and 2008, and the year ended December 31, 2008, is as follows:

	September 30, 2009	December 31, 2008	September 30, 2008
Outstanding shares at beginning of year	**446,237**	446,417	446,417
Granted during the period			
Expired during the period	**35,180**	180	180
Outstanding shares at end of period	**411,057**	446,237	446,237
Weighted average exercise price per share at end of period	**$ 12.03**	$ 12.14	$ 12.14
Shares available for grant at end of period	**24,780**	18,488	18,488

There were no options granted in the first nine months of 2009 and 2008.

Following is a summary of the options outstanding and exercisable at September 30, 2009:

Exercise Price Range	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life-Years	Weighted Average Exercise Price
$9.16	12,500	5,000	9.20	$ 9.16
$9.75	257,152	120,861	5.20	9.75
$10.65	57,500	11,500	7.20	10.65
$11.50	40,000	8,000	6.00	11.50
$12.00	40,000	8,000	5.70	12.00
$156.00 - $240.00	3,545	3,545	1.50	186.75
$300.00	360	360	.50	300.00
	411,057	157,266	5.60	$ 12.03

8. INCOME TAXES

A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. At September 30, 2009, the Corporation evaluated the valuation allowance against the net deferred tax asset which would require future taxable income in order to be utilized. The Corporation, as of September 30, 2009 had a net operating loss and tax credit carryforwards for tax purposes of approximately $32.1 million, and $2.1 million, respectively.

The Corporation utilized NOL carryforwards to offset taxable income for the first nine months of 2007. In the third quarter of 2007, the Corporation reversed a portion of the valuation allowance, $7.500 million that pertained to the deferred tax benefit of NOL and tax credit carryforwards. This valuation adjustment was recorded as a current period income tax benefit. In 2006, the Corporation recorded a $.500 million tax benefit and utilized additional NOL carryforwards to offset current taxable income. The recognition of the deferred tax benefit in 2007 and 2006 was in accordance with generally accepted accounting principles, and considered among other things, the probability of utilizing the NOL and credit carryforwards.

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

8. INCOME TAXES (Continued)

The Corporation recorded the future benefits from these carryforwards at such time as it became more likely than not that they would be utilized prior to expiration. Please refer to further discussion on income taxes contained in Management s Discussion and Analysis. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL, approximately $32.1 million, and all of the credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is $1.4 million for the NOL and the equivalent value of tax credits, which is approximately $.477 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December, 2004.

9. FAIR VALUE MEASUREMENTS

Fair value estimates, methods, and assumptions are set forth below for the Corporation s financial instruments:

Cash, cash equivalents, and interest-bearing deposits - The carrying values approximate the fair values for these assets.

Securities Fair values are based on quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Federal Home Loan Bank stock Federal Home Loan Bank stock is carried at cost, which is its redeemable value and approximates its fair value, since the market for this stock is limited.

Loans Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, residential mortgage, and other consumer. The fair value of loans is calculated by discounting scheduled cash flows using discount rates reflecting the credit and interest rate risk inherent in the loan.

The methodology in determining fair value of nonaccrual loans is to average them into the blended interest rate at 0% interest. This has the effect of decreasing the carrying amount below the risk-free rate amount and, therefore, discounts the estimated fair value.

Impaired loans are measured at the estimated fair value of the expected future cash flows at the loan s effective interest rate or the fair value of the collateral for loans which are collateral dependent. Therefore, the carrying values of impaired loans approximate the estimated fair values for these assets.

Deposits The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits and savings, is equal to the amount payable on demand at the reporting date. The fair value of time deposits is based on the discounted value of contractual cash flows applying interest rates currently being offered on similar time deposits.

Borrowings Rates currently available for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt. The fair value of borrowed funds due on demand is the amount payable at the reporting date.

Accrued interest The carrying amount of accrued interest approximates fair value.

Off-balance-sheet instruments The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the current interest rates, and the present creditworthiness of the counterparties. Since the differences in the current fees and those reflected to the off-balance-sheet instruments at year-end are immaterial, no amounts for fair value are presented.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

9. FAIR VALUE MEASUREMENTS (Continued)

The following table presents information for financial instruments at September 30, 2009 and December 31, 2008 (dollars in thousands):

	September 30, 2009		**December 31, 2008**	
	Carrying Amount	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial assets:				
Cash and cash equivalents	**$ 23,249**	**$ 23,249**	$ 10,112	$ 10,112
Interest bearing deposits	**662**	**662**	582	582
Securities available for sale	**80,203**	**80,203**	47,490	47,490
Federal Home Loan Bank stock	**3,794**	**3,794**	3,794	3,794
Net loans	**380,019**	**383,241**	366,003	372,080
Cash surrender value life insurance	**1,444**	**1,444**	1,397	1,397
Other Real Estate	**5,821**	**5,821**	2,189	2,189
Accrued interest receivable	**1,504**	**1,504**	1,457	1,457
Total financial assets	**$ 496,696**	**$ 499,918**	$ 433,024	$ 439,101
Financial liabilities:				
Deposits	**$ 418,581**	**$ 418,313**	$ 371,097	$ 371,434
Borrowings	**36,140**	**36,523**	36,210	36,846
Directors deferred compensation	**840**	**840**	912	912
Accrued interest payable	**320**	**320**	488	488
Total financial liabilties	**$ 455,881**	**$ 455,996**	$ 408,707	$ 409,680

Limitations Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Corporation s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Corporation s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing on-and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial assets or liabilities include premises and equipment, other assets, and other liabilities. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

The following tables present information about the Corporation s assets and liabilities measured at fair value on a recurring basis at September 30, 2009, and the valuation techniques used by the Corporation to determine those fair values.

Level 1: In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access.

Level 2: Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Level 3 inputs are unobservable inputs, including inputs available in situations where there is little, if any, market activity for the related asset or liability.

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MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

9. FAIR VALUE MEASUREMENTS (Continued)

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Corporation s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

Disclosures concerning assets and liabilities measured at fair value are as follows (dollars in thousands):

Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2009

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at September 30, 2009
Assets				
Investment securities available for sale	$	$ 80,203	$	$ 80,203
Liabilities				
None				

The Corporation had no Level 3 assets or liabilities on a recurring basis as of December 31, 2008 or September 30, 2009.

The Corporation also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include held to maturity investments and loans. The Corporation has estimated the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

Assets Measured at Fair Value on a Nonrecurring Basis

(dollars in thousands)	Balance at September 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Three Months Ended September 30, 2009	Total Losses for Nine Months Ended September 30, 2009
Assets						
Impaired loans accounted for under FAS 114	$ 1,240	$	$	$ 1,240	$ 510	$ 590
Other real estate owned	5,821			5,821	90	248
					$ 600	$ 838

The Corporation had no investments subject to fair value measurement on a nonrecurring basis.

Impaired loans accounted for under FAS 114 categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. The Corporation estimates the fair value of the loans based on the present value of expected future cash flows using management s best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals).

10. SHAREHOLDERS EQUITY

Participation in the TARP Capital Purchase Program

On April 24, 2009, the Corporation entered into and closed a Letter Agreement, including the Securities Purchase Agreement-Standard Terms (collectively, the Securities Purchase Agreement), related to the CPP. Pursuant to the Securities Purchase Agreement, the Corporation issued and sold to the Treasury (i) 11,000 shares of the Corporation s Series A Preferred Shares, and (ii) the Warrant to purchase 379,310 shares of the

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

10. SHAREHOLDERS EQUITY (Continued)

Corporation s Common Shares, at an exercise price of $4.35 per share (subject to certain anti-dilution and other adjustments), for an aggregate purchase price of $11.000 million in cash. The Warrant has a ten-year term.

As a result of the CPP transaction, the Corporation is required to take certain actions, for so long as the Treasury holds any securities acquired from the Corporation pursuant to the CPP (excluding any period in which the Treasury holds only the Warrant to purchase Common Shares of the Corporation) (the CPP Period), to ensure that its executive compensation and benefit plans with respect to Senior Executive Officers (as defined in the relevant agreements) comply with Section 111(b) of Emergency Economic Stabilization Act of 2008 (EESA), as implemented by any guidance or regulations issued under Section 111(b) of EESA, and not adopt any benefit plans with respect to, or which cover, the Corporation s Senior Executive Officers that do not comply with EESA, as amended by the American Recovery and Reinvestment Act of 2009 (the ARRA), which was passed by Congress and signed by the President on February 17, 2009. The applicable executive compensation standards generally remain in effect during the CPP Period and apply to the Corporation s Senior Executive Officers (which for purposes of the ARRA and the CPP agreements, includes the Corporation s Chief Executive Officer, its Chief Financial Officer, and the next three most highly-compensated executive officers, even though the Corporation s senior executive officers consist of a smaller group of executives for purposes of the other compensation disclosures in this proxy statement).

Amounts recorded for Preferred Stock and Warrant Common Stock were estimated based on an allocation of the total proceeds from the issuance on the relative fair values of both instruments. Fair value of the Preferred Stock was determined based on assumptions regarding the discount rate (market rate) on the Preferred Stock (estimated 12%). Fair value of the Warrant Common Stock is based on the value of the underlying Preferred Stock based on an estimate for a three year term. The allocation of the proceeds received resulted in the recording of a discount on the Preferred Stock and a premium on the Warrant Common Stock. The discount on the preferred will be accreted on an effective yield basis over a three-year term. The allocated carrying value of the Preferred Stock and Warrant Common Stock on the date of issuance (based on their relative fair values) was $10.382 million and $.618 million, respectively. Cumulative dividends on the Preferred Stock are payable at 5% annum for the first five years and at a rate of 9% per annum thereafter on the liquidation preference of $1,000 per share. The Company is prohibited from paying any dividend with respect to shares of common stock unless all accrued and unpaid dividends are paid in full on the Preferred Stock for all past dividend periods. The Preferred Stock is non-voting, other than class voting rights on matters that could adversely affect the Preferred Stock. The Preferred Stock may be redeemed at any time with regulatory approval. The Treasury may also transfer the Preferred Stock to a third party at any time. The preferred stock qualifies as Tier 1 Capital for regulatory purposes at the holding company.

The Corporation has the right to redeem the Series A Preferred Shares at any time after consulting with its primary regulator, in which case the executive compensation standards would no longer apply to the Corporation. This capital will be used to increase the strong capital position of the Bank. The Bank will use the capital to grow loans. In addition, the capital will allow the Corporation to consider acquisitions of deposit franchisees that would enhance our funding mix.

11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK

Financial Instruments With Off-Balance-Sheet Risk

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

The Corporation s exposure to credit loss, in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit, is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

These commitments are as follows (dollars in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Commitments to extend credit:			
Variable rate	**$ 37,533**	$ 40,036	$ 40,133
Fixed rate	**8,653**	4,487	2,752
Standby letters of credit Variable rate	**1,231**	1,838	6,308
Credit card commitments Fixed rate	**2,638**	2,438	2,457
	$ 50,055	$ 48,799	$ 51,650

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management s credit evaluation of the party. Collateral held varies but may include accounts receivable; inventory; property, plant, and equipment; and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The commitments are structured to allow for 100% collateralization on all standby letters of credit.

Credit card commitments are commitments on credit cards issued by the Corporation s subsidiary and serviced by other companies. These commitments are unsecured.

Contingencies

In the normal course of business, the Corporation is involved in various legal proceedings. For expanded discussion on the Corporation s legal proceedings, see Part II, Item 1, Legal Proceedings in this report.

Concentration of Credit Risk

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan. The Bank s most prominent concentration in the loan portfolio relates to commercial real estate loans to operators of nonresidential buildings. This concentration at September 30, 2009 represents $47.0 million, or 15.33%, compared to $41.5 million, or 14.29%, of the commercial loan portfolio on September 30, 2008. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gaming, petroleum, forestry, agriculture and construction. Due to the diversity of the Bank s locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic sector.

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MACKINAC FINANCIAL CORPORATION
ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Corporation intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement for purposes of these safe harbor provisions. Forward-looking statements which are based on certain assumptions and describe future plans, strategies, or expectations of the Corporation, are generally identifiable by use of the words believe , expect , intend , anticipate , estimate , project , or similar expressions. The Corporation s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could cause actual results to differ from the results in forward-looking statements include, but are not limited to:

The highly regulated environment in which the Corporation operates could adversely affect its ability to carry out its strategic plan due to restrictions on new products, funding opportunities, or new market entrances;

General economic conditions, either nationally or in the state(s) in which the Corporation does business;

Legislation or regulatory changes which affect the business in which the Corporation is engaged;

Changes in the interest rate environment which increase or decrease interest rate margins;

Changes in securities markets with respect to the market value of financial assets and the level of volatility in certain markets such as foreign exchange;

Significant increases in competition in the banking and financial services industry resulting from industry consolidation, regulatory changes, and other factors, as well as action taken by particular competitors;

The ability of borrowers to repay loans;

The effects on liquidity of unusual decreases in deposits;

Changes in consumer spending, borrowing, and saving habits;

Technological changes;

Acquisitions and unanticipated occurrences which delay or reduce the expected benefits of acquisitions;

Difficulties in hiring and retaining qualified management and banking personnel;

The Corporation s ability to increase market share and control expenses;

The effect of compliance with legislation or regulatory changes;

The effect of changes in accounting policies and practices;

The costs and effects of existing and future litigation and of adverse outcomes in such litigation.

These risks and uncertainties should be considered in evaluating forward-looking statements. Further information concerning the Corporation and its business, including additional factors that could materially affect the Corporation s financial results, is included in the Corporation s filings with the Securities and Exchange Commission. All forward-looking statements contained in this report are based upon information presently available and the Corporation assumes no obligation to update any forward-looking statements.

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MACKINAC FINANCIAL CORPORATION
ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The following discussion will cover results of operations, asset quality, financial position, liquidity, interest rate sensitivity, and capital resources for the periods indicated. The information included in this discussion is intended to assist readers in their analysis of, and should be read in conjunction with, the consolidated financial statements and related notes and other supplemental information presented elsewhere in this report. This discussion should be read in conjunction with the consolidated financial statements and footnotes contained in the Corporation s Annual Report and Form 10-K for the year-ended December 31, 2008. Throughout this discussion, the term Bank refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

The Corporation recorded third quarter 2009 income of $1.536 million or $.45 per share compared to net income of $.216 million, or $.06 per share for the third quarter of 2008. Net income for the first nine months of 2009 totaled $2.087 million, or $.61 per share, compared to $2.124 million, or $.62 per share, for the same period in 2008. Weighted average shares totaled 3,419,736 year to date and for the third quarter in 2009 compared to 3,422,777 for the nine month period and 3,419,736 for the third quarter in 2008.

Total assets of the Corporation at September 30, 2009 were $513.180 million, up $72.227 million, or 16.38% from the 440.953 million in total assets reported at September 30, 2008 and up $61.749 million, or 13.68%, from total assets of $451.431 million at year-end 2008. Asset totals at September 30, 2009 reflect increased balances of investment securities of approximately $33 million, which the Corporation added to leverage the $11 million in proceeds from TARP funding. The loan portfolio increased $13.820 million in the first nine months of 2009, from December 31, 2008 balances of $370.280 million. Deposits totaled $418.581 million at September 30, 2009, an increase of 12.80% from the $371.097 million at December 31, 2008.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents increased $13.137 million in 2009. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Securities available-for-sale increased $32.713 million, or 68.9%, from December 31, 2008 to September 30, 2009, with the balance on September 30, 2009, totaling $80.203 million. Investment securities are utilized in an effort to manage interest rate risk and liquidity. In the second quarter of 2009, the Corporation increased its investment portfolio in combination with the funding received, $11.000 million, from the issuance of preferred stock. As of September 30, 2009, investment securities with an estimated fair value of $17.081 million were pledged.

Loans

Through the third quarter of 2009, loan balances increased by $13.820 million, or 3.73%, from December 31, 2008 balances of $370.280 million. During the first nine months of 2009, the Bank had total loan production of $72.8 million. This loan production, however, was significantly offset by normal principal runoff and amortization, $30.6 million, and large paydowns and refinancing, which totaled $11.4 million. Management continues to actively manage the loan portfolio, seeking to identify and resolve problem assets at an early stage. Management believes a properly positioned loan portfolio provides the most attractive earning asset yield available to the Corporation and, with changes to the loan approval process and exception reporting, management can effectively manage the risk in the loan portfolio. Management intends to continue loan growth within its markets for mortgage, consumer, and commercial loan products while concentrating on loan quality, industry concentration issues, and competitive pricing.

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MACKINAC FINANCIAL CORPORATION
ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Following is a summary of the loan portfolio at September 30, 2009, December 31, 2008 and September 30, 2008 (dollars in thousands):

	September 30, 2009	**Percent of Total**	December 31, 2008	Percent of Total	September 30, 2008	Percent of Total
Commercial real estate	**$ 211,994**	**55.19%**	$ 185,241	50.03%	$ 184,423	51.01%
Commercial, financial, and agricultural	**70,520**	**18.36**	79,734	21.53	75,610	20.91
One to four family residential real estate	**66,700**	**17.37**	65,595	17.72	62,895	17.40
Consumer	**4,394**	**1.14**	3,745	1.01	3,539	0.98
Construction:						
Commercial	**24,076**	**6.27**	31,113	8.40	30,373	8.40
Consumer	**6,416**	**1.67**	4,852	1.31	4,681	1.30
Total loans	**$ 384,100**	**100.00%**	$ 370,280	100.01%	$ 361,521	100.00%

Following is a table showing the significant industry types in the commercial loan portfolio as of September 30, 2009, December 31, 2008 and September 30, 2008 (dollars in thousands):

	September 30, 2009			December 31, 2008			September 30, 2008		
	Outstanding Balance	**Percent of Commercial Loans**	**Percent of Shareholders Equity**	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders Equity	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders Equity
R/E oper of nonresidential bldgs.	**$ 47,007**	**15.33%**	**84.29%**	$ 41,299	13.95%	99.39%	$ 41,486	14.29%	100.14%
Hospitality and tourism	**45,867**	**14.96**	**82.25**	35,086	11.85	84.44	35,287	12.15	85.18
Real estate agents & managers	**23,996**	**7.83**	**43.03**	29,292	9.89	70.49	29,277	10.08	70.67
Commercial construction	**24,076**	**7.85**	**43.17**	31,113	10.51	74.88	30,373	10.46	73.32
Other	**165,644**	**54.03**	**297.03**	159,298	53.80	383.37	153,983	53.02	371.70
Total Commercial Loans	**$ 306,590**	**100.00%**		$ 296,088	100.00%		$ 290,406	100.00%	

Management recognizes the additional risk presented by the concentration in certain segments of the portfolio. On a historical basis, the Corporation s highest concentration of credit risk was the hospitality and tourism industry. Management does not consider the current loan concentrations in hospitality and gaming to be problematic, and has no intention of further reducing loans to this industry segment. Management does not believe that its current portfolio composition has increased exposure related to any specific industry concentration as of September 30, 2009. The current concentration of real estate related loans represents a broad customer base composed of a high percentage of owner occupied developments.

Credit Quality

Management analyzes the allowance for loan losses in detail on a monthly basis to determine whether the losses inherent in the portfolio are properly reserved for. Net charge-offs for the nine months ended September 30, 2009 amounted to $1.596 million, or .43% of average loans outstanding, compared to $1.961 million, .55% of average loans outstanding, for the same period in 2008. The current reserve balance is representative of the relevant risk inherent within the Corporation s loan portfolio. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity. The $10.273 million increase in nonperforming assets from 2008 year end balances of $7.076 million includes two large credit relationships in Southeast Michigan that account for approximately 50% of the increase.

MACKINAC FINANCIAL CORPORATION
ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The table below shows period end balances of non-performing assets (dollars in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Nonperforming Assets :			
Nonaccrual loans	**$ 10,655**	$ 4,887	$ 4,649
Loans past due 90 days or more			
Restructured loans	**873**		
Total nonperforming loans	**11,528**	4,887	4,649
Other real estate owned	**5,821**	2,189	1,751
Total nonperforming assets	**$ 17,349**	$ 7,076	$ 6,400
Nonperforming loans as a % of loans	**3.00**%	1.32%	1.29%
Nonperforming assets as a % of assets	**3.38**%	1.57%	1.45%
Reserve for Loan Losses:			
At period end	**$ 4,081**	$ 4,277	$ 3,385
As a % of loans	**1.06**%	1.16%	.94%
As a % of nonperforming loans	**35.40**%	87.52%	72.81%
As a % of nonaccrual loans	**38.30**%	87.52%	72.81%

The following ratios assist management in the determination of the Corporation s credit quality:

	September 30, 2009	December 31, 2008	September 30, 2008
Total loans, at period end	**$ 384,100**	$ 370,280	$ 361,521
Average loans for the year	**370,952**	361,324	359,729
Allowance for loan losses	**4,081**	4,277	3,385
Allowance to total loans at period end	**1.06**%	1.16%	.94%
Net charge-offs during the period	**$ 1,596**	$ 2,169	$ 1,961
Net charge-offs to average loans	**.43**%	.60%	.55%
Net charge-offs to beginning allowance balance	**37.32**%	52.32%	47.30%

Management continues to address market issues impacting its loan customer base. In conjunction with the Corporation s senior lending staff and the bank regulatory examinations, management reviews the Corporation s loans, related collateral evaluations, and the overall lending process. The Corporation also utilizes a loan review consultant to perform a review of the loan portfolio. The opinion of this consultant upon completion of the independent review in 2009 provided findings similar to management on the overall adequacy of the reserve.

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MACKINAC FINANCIAL CORPORATION
ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The following table will provide additional information with respect to our nonperforming assets as of September 30, 2009 (dollars in thousands):

Collateral Type	Balance	Most Recent Appraisal	Reserve Allocation
Nonaccrual Loans			
Non-farm/non-residential (SEM)	$ 4,677	$ 5,200	$ 520
Non-farm/non-residential (NLP)	1,937	2,688	47
Construction/development (SEM)	1,000	460	400
Commercial general (SEM)	606	25	99
Non-farm/non-residential (UP)	585	901	
Cabins/land (NLP)	449	449	
Non-farm/non-residential and commercial unsecured (SEM)	371	450	15
1-4 family (UP)	222	284	13
1-4 family (NLP)	214	221	
Commercial general & automobile (SEM)	201		201
Conv 5+ residential properties (UP)	151	100	
Land development (NLP)	93	100	
Commercial general (UP)	88		50
Land (NLP)	38	130	
Commercial general (NLP)	20		
Recreational (UP)	3		
Total nonaccrual loans	10,655	11,008	1,345
Restructured loans			
Non-farm/non-residential (UP)	873	1,279	
Other Real Estate			
Land development (SEM)	2,133	2,370	
Non-farm/non-residential (NLP)	1,018	1,285	
Land development/condo (NLP)	630	700	
Land development (NLP)	511	645	
Non-farm/non-residential (SEM)	508	620	
Construction/development (NLP)	424	485	7
1-4 family (UP)	276	330	
Non-farm/non-residential (UP)	216	240	
Downtown store frontage/2/1-4 family (UP)	77	85	
1-4 family (NLP)	28	35	

Total other real estate	5,821	6,795	7
Total nonperforming assets	$ 17,349	$ 19,082	$ 1,352
REGIONAL BREAKOUT OF NONPERFORMING ASSETS			
NLP NORTHERN LOWER PENINSULA	$ 5,362	$ 6,738	$ 54
UP UPPER PENINSULA	2,491	3,219	63
SEM SOUTHEAST MICHIGAN	9,496	9,125	1,235
TOTAL	$ 17,349	$ 19,082	$ 1,352

The schedule above shows the detail of nonperforming assets categorized by type of loan/collateral. In determining estimated liquidation value, management considered existing appraisals, the date of the appraisals, and current market conditions, along with related selling costs. Personal guarantees are also in place for various nonperforming assets, which will also help mitigate losses.

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Following is the allocation of the allowance for loan losses as of September 30, 2009, December 31, 2008 and September 30, 2008 (dollars in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Commercial, financial and agricultural loans	**$ 3,564**	$ 3,819	$ 2,974
One to four family residential real estate loans	**47**	27	53
Consumer loans	**9**	40	9
Unallocated and general reserves	**461**	391	349
Totals	**$ 4,081**	$ 4,277	$ 3,385

As of September 30, 2009, the allowance for loan losses represented 1.06% of total loans. In management s opinion, the allowance for loan losses is adequate to cover probable losses related to specifically identified loans, as well as probable losses inherent in the balance of the loan portfolio.

As part of the process of resolving problem credits, the Corporation may acquire ownership of collateral which secured such credits. The Corporation carries this collateral in other real estate on the balance sheet.

The following table represents the activity in other real estate for the periods indicated (dollars in thousands):

	Nine Months Ended September 30, 2009	Year Ended December 31, 2008	Nine Months Ended September 30, 2008
Balance at beginning of period	**$ 2,189**	$ 1,226	$ 1,226
Other real estate transferred from loans due to foreclosure	**4,205**	2,849	2,745
Reclassification of redemption OREO	**(475)**		
Other real estate sold/written down	**(82)**	(1,886)	(2,220)
Loss on sale of other real estate	**(16)**		
Balance at end of period	**$ 5,821**	$ 2,189	$ 1,751

During the first nine months of 2009, the Corporation received real estate in lieu of loan payments of $4.205 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balance. Any additional reduction in the fair value results in a write-down of other real estate.

Deposits

The Corporation had an increase in deposits in the first nine months of 2009. Total deposits increased by $47.484 million, or 12.80%, in the first nine months of 2009. The increase in deposits for the first nine months of 2009 is composed of an increase in noncore deposits of $42.108 million and an increase in core deposits of $5.376 million, along with growth of $30 million to replace deposits of two branch offices sold during the third quarter of 2009. The core deposit balance increases are primarily in transactional account deposits, our lowest cost of funds. Management continues to monitor existing deposit products in order to stay competitive as to both terms and pricing. It is the intent of management to be aggressive in its markets to grow core deposits with an emphasis placed on transactional deposits.

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The following table represents detail of deposits at the end of the periods indicated (dollars in thousands):

	September 30, 2009	**% of Total**	December 31, 2008	% of Total	September 30, 2008	% of Total
Non-interest-bearing	**$ 33,254**	**7.94%**	$ 30,099	8.11%	$ 34,858	9.66%
NOW, money market, checking	**88,843**	**21.23**	70,584	19.02	80,185	22.23
Savings	**18,807**	**4.49**	20,730	5.59	18,957	5.26
Certificates of Deposit <$100,000	**59,637**	**14.25**	73,752	19.87	74,940	20.78
Total core deposits	**200,541**	**47.91**	195,165	52.59	208,940	57.93
Certificates of Deposit >$100,000	**25,409**	**6.07**	25,044	6.75	30,220	8.38
Brokered CDs	**192,631**	**46.02**	150,888	40.66	121,534	33.69
Total non-core deposits	**218,040**	**52.09**	175,932	47.41	151,754	42.07
Total deposits	**$ 418,581**	**100.00%**	$ 371,097	100.00%	$ 360,694	100.00%

Borrowings

The Corporation historically used alternative funding sources to provide long-term, stable sources of funds. Current FHLB borrowings total $35.000 million with stated maturities ranging through February 2011. Borrowings at quarter end include $20.000 million with adjustable rates that reprice quarterly based upon the three month LIBOR. The FHLB has the option to convert the remaining $15.000 million fixed-rate advances to adjustable rate advances on the original call date and quarterly thereafter. The Corporation also has a USDA Rural Development loan held by its wholly owned subsidiary, First Rural Relending that has a fixed interest rate of 1% and matures in August 2024.

Shareholders Equity

Total shareholders equity increased $14.214 million from December 31, 2008 to September 30, 2009. This increase includes the increase from the Preferred Stock issue, $10.382 million, along with the issuance of common stock warrants, $.618 million. Also contributing to the increase in shareholders equity was net income of $2.087 million, contributed capital of $52,000, in recognition of stock option expense, an increase in the market value of securities of $.992 million and the accretion of the discount on preferred stock of $84,000.

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS

Summary

The Corporation reported income of $2.087 million for the first nine months of 2009, $.61 per share, compared to net income of $2.124 million, $.62 per share, in the first nine months of 2008. In the third quarter of 2009, net income was $1.536 million, $.45 per share, compared to $.216 million, $.06 per share, in the third quarter of 2008.

Net Interest Income

Net interest income is the Corporation s primary source of core earnings. Net interest income represents the difference between the average yield earned on interest earning assets and the average rate paid on interest bearing obligations. The net interest income is impacted by economic and competitive factors that influence rates, loan demand, and the availability of funding.

Net interest margin on a fully taxable equivalent basis increased to $4.346 million, 3.69% of average earning assets, in the third quarter of 2009, compared to $3.423 million, 3.44% of average earning assets, in the third quarter of 2008. For the nine month period in 2009, net interest margin increased to $11.983 million, 3.57% of average earning assets, compared to $9.696 million, 3.30% of average earning assets, for the same period in 2008. Margin improvement in 2009 was primarily due to a reduction in funding costs between periods as average interest rates on brokered deposits declined more than rates on earning assets.

While a majority of the Corporation s loan portfolio is repriced with each prime rate change due to floating rate loans, interest paid on similar rate changes does not impact the pricing of interest bearing liabilities to nearly the same degree. The mix of time deposits reflects the Corporation s need to utilize the brokered certificate of deposit markets for loan funding when core deposits did not provide adequate sources.

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The following tables present the amount of interest income from average interest-earning assets and the yields earned on those assets, as well as the interest expense on average interest-bearing obligations and the rates paid on those obligations. The amount of interest income on nontaxable securities and loans has been adjusted to a tax equivalent basis, using a 34% tax rate. All average balances are daily average balances.

	Three Months Ended										
								2009-2008			
	Average Balances			Average Rates		Interest		Income/			Rate/
	September 30,		Increase/	September 30,		September 30,		Expense	Volume	Rate	Volume
(dollars in thousands)	**2009**	2008	(Decrease)	**2009**	2008	**2009**	2008	Variance	Variance	Variance	Variance
Loans (1,2,3)	**$ 370,310**	$ 358,844	$ 11,466	**5.57%**	6.31%	**$ 5,201**	$ 5,689	$ (488)	$ 180	$ (657)	(11)
Taxable securities	**91,837**	24,647	67,190	**3.84**	4.89	**888**	303	585	819	(65)	(169)
Nontaxable securities	**1,226**	68	1,158	**3.56**	11.70	**11**	2	9	34	(1)	(24)
Federal funds sold		7,944	(7,944)		2.00		40	(40)	(40)	(40)	40
Other interest-earning assets	**4,434**	4,178	256	**2.51**	4.48	**28**	47	(19)	3	(21)	(1)
Total earning assets	**467,807**	395,681	72,126	**5.20**	6.11	**6,128**	6,081	47	996	(784)	(165)
Reserve for loan losses	**(4,231)**	(3,500)	(731)								
Cash and due from banks	**24,233**	7,443	16,790								
Intangible assets	**1**	74	(73)								
Other assets	**25,877**	24,004	1,873								
Total assets	**$ 513,687**	$ 423,702	$ 89,985								
NOW and money market deposits	**$ 73,236**	$ 78,645	$ (5,409)	**0.96**	1.55	**177**	307	(130)	(21)	(116)	7
Interest checking	**8,853**	2,087	6,766	**1.88**	3.05	**42**	16	26	51	(6)	(19)
Savings deposits	**21,273**	17,453	3,820	**0.73**	1.41	**39**	62	(23)	13	(30)	(6)
CDs <$100,000	**66,291**	76,621	(10,330)	**2.61**	3.75	**436**	723	(287)	(97)	(219)	29
CDs >$100,000	**25,777**	29,905	(4,128)	**2.31**	3.61	**150**	271	(121)	(37)	(97)	13
Brokered deposits	**191,471**	103,012	88,459	**1.46**	3.59	**706**	930	(224)	792	(547)	(469)
Borrowings	**36,194**	37,245	(1,051)	**2.54**	3.73	**232**	349	(117)	(10)	(110)	3
Total interest-bearing liabilities	**423,095**	344,968	78,127	**1.67**	3.07	**1,782**	2,658	(876)	691	(1,125)	(442)
Demand deposits	**32,201**	33,654	(1,453)								
Other liabilities	**3,797**	3,983	(186)								
Shareholders equity	**54,594**	41,097	13,497								

Total liabilities and shareholders equity	**$ 513,687**	$ 423,702	$ 89,985								
Rate spread				**3.53%**	3.04%						
Net interest margin/revenue				**3.69%**	3.44%	**$ 4,346**	$ 3,423	$ 923	$ 305	$ 341	$ 277

(1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.

(2) The amount of interest income on nontaxable securities and loans has been adjusted to a tax equivalent basis, using a 34% tax rate.

(3) Interest income on loans includes loan fees.

	Nine Months Ended										
								2009-2008			
	Average Balances			**Average Rates**		**Interest**		Income/			Rate/
	September 30,		Increase/	September 30,		September 30,		Expense	Volume	Rate	Volume
(dollars in thousands)	**2009**	2008	(Decrease)	**2009**	2008	**2009**	2008	Variance	Variance	Variance	Variance
Loans (1,2)	**$ 370,952**	$ 359,729	$ 11,223	**5.61**	6.58%	**$ 15,570**	$ 17,712	$ (2,142)	$ 552	$ (2,597)	(97)
Taxable securities	**72,214**	24,171	48,043	**3.74**	4.63	**2,020**	838	1,182	1,664	(161)	(321)
Nontaxable securities	**838**	69	769	**2.70**	11.62	**17**	6	11	67	(5)	(51)
Federal funds sold		5,086	(5,086)		2.44		93	(93)	(93)	(93)	93
Other interest-earning assets	**4,400**	4,349	51	**1.34**	5.07	**44**	165	(121)	2	(121)	(2)
Total earning assets	**448,404**	393,404	55,000	**5.26**	6.39	**17,651**	18,814	(1,163)	2,192	(2,977)	(378)
	(4,494)	(3,820)	(674)								

Reserve for loan losses												
Cash and due from banks	**18,469**	6,569	11,900									
Intangible assets	**17**	94	(77)									
Other assets	**24,364**	23,644	720									
Total assets	**$ 486,760**	$ 419,891	$ 66,869									
NOW and money market deposits	**$ 70,214**	$ 80,274	$ (10,060)	**0.85**	1.75	**448**	1,054	(606)	(132)	(541)	67	
Interest checking	**6,380**	707	5,673	**1.93**	3.02	**92**	16	76	128	(6)	(46)	
Savings deposits	**20,791**	14,275	6,516	**0.73**	1.10	**113**	118	(5)	54	(40)	(19)	
CDs <$100,000	**69,838**	80,291	(10,453)	**2.87**	4.22	**1,497**	2,537	(1,040)	(330)	(814)	104	
CDs >$100,000	**25,823**	26,622	(799)	**2.48**	4.00	**479**	798	(319)	(24)	(303)	8	
Brokered deposits	**173,600**	105,730	67,870	**1.74**	4.30	**2,265**	3,401	(1,136)	2,181	(2,018)	(1,299)	
Borrowings	**36,404**	39,677	(3,273)	**2.84**	4.02	**774**	1,194	(420)	(98)	(349)	27	
Total interest-bearing liabilities	**403,050**	347,576	55,474	**1.88**	3.50	**5,668**	9,118	(3,450)	1,779	(4,071)	(1,158)	
Demand deposits	**31,285**	28,824	2,461									
Other liabilities	**3,624**	3,159	465									
Shareholders equity	**48,801**	40,332	8,469									
Total liabilities and shareholders equity	**$ 486,760**	$ 419,891	$ 66,869									
Rate spread				**3.38%**	2.89%							
Net interest margin/revenue				**3.57%**	3.30%	**$ 11,983**	$ 9,696	$ 2,287	$ 413	$ 1,094	$ 780	

(1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.

(2) The amount of interest income on nontaxable securities and loans has been adjusted to a tax equivalent basis, using a 34% tax

rate. (3) Interest income on loans includes loan fees.

Approximately 65% of the Corporation s loan portfolio repriced downward with prime rate reductions that occurred in 2008. The reduced rates of the Corporation s loan portfolio are reflected in the overall decrease in rates on earning assets from 6.39% in the first nine months of 2008 to 5.26% in the first nine months of 2009. In the three month comparative periods, rates declined on earning assets from 6.11% in 2008 to 5.20% in 2009. During the period of prime rate reductions, the Corporation reduced bank deposit rates in order to mitigate the impact on earnings. The Corporation is somewhat reliant on wholesale funding sources, specifically brokered deposits. The

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Corporation had brokered deposit average balances of $173.600 million in the first nine months of 2009 with an average cost of 1.74% compared to $105.730 million at 4.30% in the first nine months of 2008. The Corporation had average balances of $191.471 million in the third quarter of 2009 with an average cost of 1.46% compared to $103.012 million at 3.59% in the third quarter of 2008.

This repricing of wholesale deposits is the primary reason for the margin improvement in the three and nine month periods ending September 30, 2009.

Provision for Loan Losses

The Corporation records a provision for loan losses when it believes it is necessary to adjust the allowance for loan losses to maintain an adequate level after considering factors such as loan charge-offs and recoveries, changes in identified levels of risk in the loan portfolio, changes in the mix of loans in the portfolio, loan growth, and other economic factors. During the first nine months of 2009, the Corporation recorded a $1.400 million provision for loan loss. During the first nine months of 2008, the Corporation recorded a $1.200 million provision for loan loss. In future periods, loan loss provisions will be required if there is further market deterioration that impacts the credit quality on the existing portfolio.

Noninterest Income

Other income decreased by $1.097 million for the nine months ended September 30, 2009, compared to the nine months ended September 30, 2008. The Corporation recognized a benefit from the settlement of a shareholder lawsuit in the first nine months of 2008, which amounted to $3.475 million. In the third quarter of 2009 the Corporation realized a gain of $1.208 million from the sale of two branch offices. Service fees increased $.153 million, or 25.6% in the first nine months of 2009, while other noninterest income increased $.078 million. Revenue due to loans produced and sold in the secondary market amounted to $.472 million compared to $.113 million a year ago. We expect to continue to benefit from secondary market activity in future periods as the refinancing boom continues. The Corporation is also expecting to increase other income from sources such as fees from the sale of SBA guaranteed loans.

During the third quarter of 2009, the Corporation recognized $2.418 million in noninterest income, compared to $.288 million for the third quarter of 2008. Noninterest income for the third quarter of 2009 includes the $1.208 million gain on the sale of two branch offices and $.644 million of securities gains. Net gains on sales of secondary market loans were $.247 million in the third quarter of 2009, compared to $16,000 in the third quarter of 2008. The increase in noninterest income from these loan sales was attributed to increased activity in mortgage loans, along with the Bank s success in generating SBA loans and subsequent selling of the guaranteed portion of these loans. Management continues to evaluate deposit products and services for ways to better serve its customer base and also enhance service fee income through a broad array of products that price services based on income contribution and cost attributes.

The following table details noninterest income for the three and nine months ended September 30, 2009 and 2008 (dollars in thousands):

	Three Months Ended September 30,		% Increase (Decrease)	**Nine Months Ended September 30,**		% Increase (Decrease)
	2009	2008	2009-2008	**2009**	2008	2009-2008
Service fees	**$ 236**	$ 229	3.1	**$ 750**	$ 597	25.6
Net gains on sale of secondary market loans	**247**	16	1,443.8	**472**	113	317.7
Net gain on sale of branches	**1,208**		N/A	**1,208**		N/A
Proceeds from lawsuit settlements			N/A		3,475	639.4

Other noninterest income	**83**	44	88.6	**174**	96	81.3
Subtotal	**1,774**	289	513.8	**2,604**	4,281	(39.2)
Net security gain (loss)	**644**	(1)	N/A	**644**	64	N/A
Total noninterest income	**$ 2,418**	$ 288	739.6	**$ 3,248**	$ 4,345	(25.2)

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Expenses

Other expenses increased $.555 million for the nine months ended September 30, 2009, compared to the same period in 2008. The most significant increase in other expenses for the year and third quarter was FDIC insurance premiums and loan and deposit expenses related to nonperforming assets. Salaries and employee benefits decreased $.655 million, or 12.1% during the first nine months of 2009 when compared to the same periods in 2008. The decrease was largely caused by a $.425 million severance agreement included in the 2008 nine month period. During the first nine months of 2008, the Corporation settled a long standing derivative shareholder lawsuit. As a part of this settlement, the Corporation received funds amounting to $3.475 million, recorded as other income, and a dismissal of unpaid legal fees, totaling $95,000, related to the defense of prior directors of the Corporation. The reversal of the accrual for these fees contributed to the reduction in professional service fees for the first nine months of 2009, compared to the same period in 2008. Management continually reviews all areas of noninterest expense for cost reduction opportunities that will not impact service quality and employee morale.

The following table details noninterest expense for the three and nine months ended September 30, 2009 and September 30, 2008 (dollars in thousands):

	Three Months Ended September 30,		% Increase (Decrease)	**Nine Months Ended September 30,**		% Increase (Decrease)
	2009	2008	2009-2008%	**2009**	2008	2009-2008%
Salaries and employee benefits	**$ 1,603**	$ 1,534	4.5	**$ 4,761**	$ 5,416	(12.1)
Occupancy	**336**	336	0.0	**1,069**	1,039	2.9
Furniture and equipment	**193**	202	(4.5)	**604**	570	6.0
Data processing	**221**	212	4.2	**665**	649	2.5
Professional service fees	**161**	120	34.2	**458**	352	30.1
Loan and deposit :						
FDIC insurance premiums	**203**	30	N/M	**668**	48	N/M
Other loan and deposit	**199**	146	N/M	**507**	382	N/M
Telephone	**50**	41	22.0	**139**	125	11.2
Advertising	**80**	93	(14.0)	**238**	213	11.7
Other	**397**	221	79.6	**1,043**	803	29.9
Total noninterest expense	**$ 3,443**	$ 2,935	17.3	**$ 10,152**	$ 9,597	5.8

Federal Income Taxes

Current Federal Tax Provision

The Corporation recorded a current period federal tax provision of $1.142 million in the first nine months of 2009, compared to a $.958 million provision in the same period in 2008.

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Deferred Tax Benefit

The Corporation recognized a federal deferred tax benefit of $7.500 million in the third quarter of 2007. The recognition of this deferred tax benefit relates to the generally accepted accounting principles applicable to the probability of utilizing the NOL and tax credit carryforwards of the Corporation. The Corporation, based upon current profitability trends largely supported by expansion of the net interest margin and controlled expenses, determined that the utilization of the NOL carryforward was probable. This tax benefit was recorded by reducing the valuation allowance that was recorded against the deferred tax assets of the Corporation. In 2006, the Corporation recognized a portion of this benefit, $.500 million, based upon the then current probabilities. The $7.500 million recognition is based upon assumptions of a sustained level of taxable income within the NOL carryforward period and takes into account Section 382, establishing annual limitations. A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized. As of September 30, 2009, the Corporation had an NOL carryforward of approximately $34.1 million along with various credit carryforwards of $2.1 million. This NOL and credit carryforward benefit is dependent upon the future profitability of the Corporation. A portion of the NOL, approximately $22 million, and all of the tax credit carryforwards are also subject to the use limitations of Section 382 of the Internal Revenue Code since they originated prior to the December 2004 recapitalization of the Corporation. The Corporation intends to further evaluate the utilization of the NOL and credit carryforwards in subsequent periods to determine if any further adjustment to the valuation allowance is necessary. The determination criteria for recognition of deferred tax benefits will include the assumption of future period taxable income based upon the projected profitability of the Corporation.

LIQUIDITY

Liquidity is defined as the ability to generate cash at a reasonable cost to fulfill lending commitments and support asset growth, while satisfying the withdrawal demands of customers and make payments on existing borrowing commitments. The Bank s principal sources of liquidity are core deposits and loan and investment payments and prepayments. Providing a secondary source of liquidity is the available for sale investment portfolio. As a final source of liquidity, the Bank can exercise existing credit arrangements.

During the first nine months of 2009, the Corporation increased cash and cash equivalents by $13.137 million. As shown on the Corporation s condensed consolidated statement of cash flows, liquidity was impacted by cash provided by financing activities, with a net increase in deposits of $47.484 million, net of branch sales, and an increase of $11.000 million from the issuance of preferred stock. Offsetting the increases provided by financing activities were uses in investing activities, most significantly increase of $50.113 million in securities available for sale, along with an increase in loans of $19.181 million, also net of branch sales. The increase in deposits was composed of an increase in brokered deposits of $41.743 million combined with an increase in bank deposits of $5.711 million, which is net of the deposits of two branches that were sold. The management of bank liquidity for funding of loans and deposit maturities and withdrawals includes monitoring projected loan fundings and scheduled prepayments and deposit maturities within a 30 day period, a 30 to 90 day period and from 90 days until the end of the year. This funding forecast model is completed weekly.

It is anticipated that during the remainder of 2009, the Corporation will fund anticipated loan production with a combination of core deposit growth and noncore funding, primarily brokered CDs.

The Corporation s primary source of liquidity on a stand-alone basis is dividends from the Bank. The Bank is currently prohibited from paying dividends because of a deficit in retained earnings. The Bank, in order to pay dividends in future periods, will need to restate its capital accounts, which requires the approval of the Office of Financial and Insurance Services of the State of Michigan. The Corporation currently has a cash balance of approximately $8.000 million, which represents the remaining balance of the $11.000 million proceeds from the issuance of preferred stock.

Liquidity is managed by the Corporation through its Asset and Liability Committee (ALCO). The ALCO Committee meets monthly to discuss asset and liability management in order to address liquidity and funding needs to provide a process to seek the best alternatives for investments of assets, funding costs, and risk management. The liquidity position of the Bank is managed daily, thus enabling the Bank to adapt its position according to market fluctuations. Core deposits are important in maintaining a strong liquidity position as they represent a stable and relatively low cost source of funds. The Bank s liquidity is best illustrated by the mix in the Bank s core and non-core funding dependence ratio, which explains the degree of reliance on non-core liabilities to fund long-term assets.

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Core deposits are herein defined as demand deposits, NOW (negotiable order withdrawals), money markets, savings and certificates of deposit under $100,000. Non-core funding consists of certificates of deposit greater than $100,000, brokered deposits, and FHLB and Farmers Home Administration borrowings. At September 30, 2009, the Bank s core deposits in relation to total funding were 44.10% compared to 52.64% at September 30, 2008. These ratios indicated at September 30, 2009, that the Bank has increased its reliance on non-core deposits and borrowings to fund the Bank s long-term assets, namely loans and investments. The bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also has correspondent lines of credit available to meet unanticipated short-term liquidity needs. As of September 30, 2009, the Bank had $18.375 million of unsecured lines available and another $10.750 million available if secured. The bank believes that its liquidity position remains strong to meet both present and future financial obligations and commitments, events or uncertainties that have resulted or are reasonably likely to result in material changes with respect to the Bank s liquidity.

From a long-term perspective, the Corporation s liquidity plan for 2009 includes strategies to increase core deposits in the Corporation s local markets. The new deposit products and strategic advertising is expected to aid in efforts of management in growing core deposits to reduce the dependency on non-core deposits, while also reducing interest costs. The Corporation s liquidity plan for 2009 calls for augmenting local deposit growth efforts with wholesale CD funding, to the extent necessary.

CAPITAL AND REGULATORY

As a bank holding company, the Corporation is required to maintain certain levels of capital under government regulation. There are several measurements of regulatory capital and the Corporation is required to meet minimum requirements under each measurement. The federal banking regulators have also established capital classifications beyond the minimum requirements in order to risk-rate deposit insurance premiums and to provide trigger points for prompt corrective action in the event an institution becomes financially troubled. As of September 30, 2009, the Corporation and Bank were well capitalized. The Corporation is currently exploring its alternatives for the possible issuance of equity or debt in order to provide a broader base to support future asset growth. During the first nine months of 2009, total capitalization increased by $14.214 million.

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MACKINAC FINANCIAL CORPORATION
ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The following table details sources of capital for the periods indicated (dollars in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Capital Structure			
Shareholders equity	**$ 55,766**	$ 41,552	$ 41,427
Total capitalization	**$ 55,766**	$ 41,552	$ 41,427
Tangible capital	**$ 55,766**	$ 41,506	$ 41,362
Intangible Assets			
Core deposit premium	**$**	$ 46	$ 65
Other identifiable intangibles			
Total intangibles	**$**	$ 46	$ 65
Regulatory capital			
Tier 1 capital:			
Shareholders equity	**$ 55,766**	$ 41,552	$ 41,427
Net unrealized (gains) losses on available for sale securities	**(1,437)**	(445)	(89)
Less: intangibles		(46)	(65)
Less: disallowed deferred tax asset	**(5,000)**	(6,200)	(6,600)
Total Tier 1 capital	**$ 49,329**	$ 34,861	$ 34,673
Tier 2 Capital:			
Allowable reserve for loan losses	**$ 4,081**	$ 4,277	$ 3,385
Qualifying long-term debt			
Total Tier 2 capital	**4,081**	4,277	3,385
Total capital	**$ 53,410**	$ 39,138	$ 38,058
Risk-adjusted assets	**$ 404,883**	$ 376,986	$ 369,011
Capital ratios:			
Tier 1 Capital to average assets	**9.74%**	8.01%	8.31
Tier 1 Capital to risk weighted assets	**12.18%**	9.25%	9.40
Total Capital to risk weighted assets	**13.19%**	10.38%	10.31

Regulatory capital is not the same as shareholders equity reported in the accompanying condensed consolidated financial statements. Certain assets cannot be considered assets for regulatory purposes, such as acquisition intangibles and noncurrent deferred tax benefits.

Presented below is a summary of the capital position in comparison to generally applicable regulatory requirements:

	Shareholders Equity to Quarter-end Assets	Tangible Equity to Quarter-end Assets	Tier 1 Capital to Average Assets	Tier 1 Capital to Risk-Weighted Assets	Total Capital to Risk-Weighted Assets
Regulatory minumum for capital adequacy purposes	N/A	N/A	4.00%	4.00%	8.00%
Regulatory defined well capitalized guideline	N/A	N/A	5.00%	6.00%	10.00%
The Corporation:					
September 30, 2009	**10.87%**	**10.87%**	**9.74%**	**12.18%**	**13.19%**
September 30, 2008	9.40%	9.38%	8.31%	9.40%	10.31%
The Bank:					
September 30, 2009	**9.46%**	**9.46%**	**8.32%**	**10.40%**	**11.40%**
September 30, 2008	9.31%	9.30%	8.26%	9.32%	10.22%

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MACKINAC FINANCIAL CORPORATION

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

In general, the Corporation attempts to manage interest rate risk by investing in a variety of assets which afford it an opportunity to reprice assets and increase interest income at a rate equal to or greater than the interest expense associated with repricing liabilities.

Interest rate risk is the exposure of the Corporation to adverse movements in interest rates. The Corporation derives its income primarily from the excess of interest collected on its interest-earning assets over the interest paid on its interest-bearing obligations. The rates of interest the Corporation earns on its assets and owes on its obligations generally are established contractually for a period of time. Since market interest rates change over time, the Corporation is exposed to lower profitability if it cannot adapt to interest rate changes. Accepting interest rate risk can be an important source of profitability and shareholder value; however, excess levels of interest rate risk could pose a significant threat to the Corporation s earnings and capital base. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to the Corporation s safety and soundness.

Loans are the most significant earning asset. Management offers commercial and real estate loans priced at interest rates which fluctuate with various indices such as the prime rate or rates paid on various government issued securities. In addition, the Corporation prices the majority of fixed rate loans so it has an opportunity to reprice the loan within 12 to 36 months.

The Corporation also has $80.203 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal. These cash flows are then reinvested into other earning assets at current market rates. The Corporation also has federal funds sold to correspondent banks as well as other interest-bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

The Corporation offers deposit products with a variety of terms ranging from deposits whose interest rates can change on a weekly basis to certificates of deposit with repricing terms of up to five years. Longer term deposits generally include penalty provisions for early withdrawal.

Beyond general efforts to shorten the loan pricing periods and extend deposit maturities, management can manage interest rate risk by the maturity periods of securities purchased, selling securities available for sale, and borrowing funds with targeted maturity periods, among other strategies. Also, the rate of interest rate changes can impact the actions taken since the rate environment affects borrowers and depositors differently.

Exposure to interest rate risk is reviewed on a regular basis. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect of interest rate changes on net interest income and to structure the composition of the balance sheet to minimize interest rate risk and at the same time maximize income. Management realizes certain risks are inherent and that the goal is to identify and minimize the risks. Tools used by management include maturity and repricing analysis and interest rate sensitivity analysis. The Bank has monthly asset/liability meetings with an outside consultant to review its current position and strategize about future opportunities on risks relative to pricing and positioning of assets and liabilities.

The difference between repricing assets and liabilities for a specific period is referred to as the gap. An excess of repricable assets over liabilities is referred to as a positive gap. An excess of repricable liabilities over assets is referred to as a negative gap. The cumulative gap is the summation of the gap for all periods to the end of the period for which the cumulative gap is being measured.

Assets and liabilities scheduled to reprice are reported in the following time frames. Those instruments with a variable interest rate tied to an index and considered immediately repricable are reported in the 1- to 90-day time frame. The estimates of principal amortization and prepayments are assigned to the following time frames.

MACKINAC FINANCIAL CORPORATION

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

The following are the Corporation s repricing opportunities at September 30, 2009 (dollars in thousands):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	$ 252,042	$ 19,109	$ 28,515	$ 84,434	384,100
Securities	15,037	64,360	806		80,203
Other (1)	662			3,794	4,456
Total interest-earning assets	267,741	83,469	29,321	88,228	468,759
Interest-bearing obligations:					
NOW, money market, savings and interest checking	107,650				107,650
Time deposits	26,410	43,077	14,887	672	85,046
Brokered deposits	82,614	55,777	50,712	3,528	192,631
Borrowings	20,000		15,000	1,140	36,140
Total interest-bearing obligations	236,674	98,854	80,599	5,340	421,467
Gap	$ 31,067	$ (15,385)	$ (51,278)	$ 82,888	$ 47,292
Cumulative gap	$ 31,067	$ 15,682	$ (35,596)	$ 47,292	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at September 30, 2009, the Corporation had a cumulative asset sensitivity gap position of $15.682 million within the one-year time frame. The Corporation s cumulative asset sensitive gap suggests that if market interest rates continue to decline in the next twelve months, the Corporation has the potential to lose net interest income. A limitation of the traditional gap analysis is that it does not consider the timing or magnitude of non-contractual repricing or expected prepayments. In addition, the gap analysis treats savings, NOW, and money market accounts as repricing within 90 days, while experience suggests that these categories of deposits are actually comparatively resistant to rate sensitivity. With the Corporation s current portfolio of variable rate loans, approximately 67%, or $250 million, increasing interest rates will result in increased net interest income because repricing on the majority of deposits will lag asset repricing.

A portion, approximately 33%, of the Corporation s variable rate loans contain interest rate floors that are higher than the current prime and LIBOR rates that they are indexed to. The majority of these loans with floor rates will reprice with increases in interest rates greater than 150 basis points. These floors are in place to mitigate margin erosion with additional rate decreases.

At December 31, 2008, the Corporation had a cumulative liability sensitivity gap position of $47.708 million within the one-year time frame.

The borrowings in the gap analysis include $15 million of the FHLB advances as fixed-rate advances. These advances give the FHLB the option to convert from a fixed-rate advance to an adjustable rate advance with quarterly repricing at three-month LIBOR Flat. The exercise of this conversion feature by the FHLB would impact the repricing dates currently assumed in the analysis. In 2008 the FHLB converted $20 million of the $35 million total FHLB borrowings from fixed to variable rate.

The Corporation s primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk and foreign exchange risk. The Corporation has no market risk sensitive instruments held for trading purposes. The Corporation has limited agricultural-related loan assets and therefore has minimal significant exposure to changes in commodity prices. Any impact that changes in foreign exchange rates and commodity prices would have on interest rates are assumed to be insignificant.

Evaluating the exposure to changes in interest rates includes assessing both the adequacy of the process used to control interest rate risk and the quantitative level of exposure. The Corporation s interest rate risk management process seeks to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. In evaluating

MACKINAC FINANCIAL CORPORATION

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

the quantitative level of interest rate risk, the Corporation assesses the existing and potential future effects of changes in interest rates on its financial condition, including capital adequacy, earnings, liquidity, and asset quality. In addition to changes in interest rates, the level of future net interest income is also dependent on a number of variables, including: the growth, composition and levels of loans, deposits, and other earning assets and interest-bearing obligations, and economic and competitive conditions; potential changes in lending, investing, and deposit strategies; customer preferences; and other factors.

FOREIGN EXCHANGE RISK

In addition to managing interest rate risk, management also actively manages risk associated with foreign exchange. The Corporation provides foreign exchange services, makes loans to, and accepts deposits from, Canadian customers primarily at its banking offices in Sault Ste. Marie, Michigan. To protect against foreign exchange risk, the Corporation monitors the volume of Canadian deposits it takes in and then invests these Canadian funds in Canadian commercial loans and securities. As of September 30, 2009, the Corporation had excess Canadian assets of $.468 million (or $.500 million in U.S. dollars). Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation.

OFF-BALANCE-SHEET RISK

Derivative financial instruments include futures, forwards, interest rate swaps, option contracts and other financial instruments with similar characteristics. The Corporation currently does not enter into futures, forwards, swaps or options. However, the Corporation is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the condensed consolidated balance sheets. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates and may require collateral from the borrower if deemed necessary by the Corporation. Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party up to a stipulated amount and with specified terms and conditions.

Commitments to extend credit and standby letters of credit are not recorded as an asset or liability by the Corporation until the instrument is exercised.

IMPACT OF INFLATION AND CHANGING PRICES

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and results of operations in historical dollars, without considering the change in the relative purchasing power of money over time, due to inflation. The impact of inflation is reflected in the increased cost of the Corporation s operations. Nearly all the assets and liabilities of the Corporation are financial, unlike industrial or commercial companies. As a result, the Corporation s performance is directly impacted by changes in interest rates, which are indirectly influenced by inflationary expectations. The Corporation s ability to match the interest sensitivity of its financial assets to the interest sensitivity of its financial liabilities tends to minimize the effect of changes in interest rates on the Corporation s performance. Changes in interest rates do not necessarily move to the same extent as changes in the price of goods and services.

MACKINAC FINANCIAL CORPORATION

ITEM 4 CONTROLS AND PROCEDURES

An evaluation was performed under the supervision of and with the participation of the Corporation s management, including the Chairman and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Corporation s disclosure controls and procedures (as such term is defined in Rules 13-a 15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Corporation s management, including the Chairman and Chief Executive Officer, have concluded that, as of the end of such period, the Corporation s disclosure controls and procedures were effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be disclosed by the Corporation in the reports that it files or submits under the Exchange Act.

There was no change in the Corporation s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Corporation s fiscal quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, the Corporation s internal control over financial reporting.

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MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation and its subsidiaries are subject to routine litigation incidental to the business of banking. The litigation that is not routine and incidental to the business of banking is described below.

Shareholder s Derivative Litigation

Damon Trust v. Bittner, et al.

This matter has been resolved and concluded with the Corporation receiving $3.475 million in settlement proceeds during the second quarter of 2008.

Damon Trust v. Wipfli

This matter has been resolved and concluded with the Corporation receiving $470,000 in settlement proceeds during the first quarter of 2007. Please refer to the Annual Report for a more detailed description and explanation of this litigation.

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MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 3.1	Articles of Incorporation, as amended, incorporated herein by reference to exhibit 3.1 of the Corporation s Quarterly Report on Form 10-Q for the quarter ended September 30, 1999.
Exhibit 3.2	Amended and Restated Bylaws, incorporated herein by reference to exhibit 3.1 of the Corporation s Quarterly Report on Form 10-Q for the quarter ended September 30, 2001.
Exhibit 31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
Exhibit 31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
Exhibit 32.1	Section 1350 Certification of Chief Executive Officer.
Exhibit 32.2	Section 1350 Certification of Chief Financial Officer.

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MACKINAC FINANCIAL CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	MACKINAC FINANCIAL CORPORATION (Registrant)
Date: November 16, 2009	By: /s/ Paul D. Tobias PAUL D. TOBIAS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER (principal executive officer)
	By: /s/ Ernie R. Krueger ERNIE R. KRUEGER, EVP/CHIEF FINANCIAL OFFICER (principal accounting officer)

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