MACKINAC FINANCIAL CORP /MI/
Form 10-Q
November 14, 2007

Table of Contents

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, 2007

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 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 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, 2007, there were outstanding 3,428,695 shares of the registrant s common stock, no par value.

MACKINAC FINANCIAL CORPORATION
INDEX

Table of Contents

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

	September 30, 2007 (unaudited)	December 31, 2006	September 30, 2006 (unaudited)
ASSETS			
Cash and due from banks	**$ 7,364**	$ 4,865	$ 5,537
Federal funds sold	**947**	5,841	11,949
Cash and cash equivalents	**8,311**	10,706	17,486
Interest-bearing deposits in other financial institutions	**6,995**	856	889
Securities available for sale	**17,973**	32,769	36,129
Federal Home Loan Bank stock	**3,794**	3,794	4,152
Loans:			
Commercial	**285,680**	261,726	238,481
Mortgage	**54,962**	58,014	51,341
Installment	**3,507**	2,841	2,792
Total Loans	**344,149**	322,581	292,614
Allowance for loan losses	**(5,022)**	(5,006)	(5,316)
Net loans	**339,127**	317,575	287,298
Premises and equipment	**12,733**	12,453	12,643
Other real estate held for sale	**451**	26	26
Other assets	**11,829**	4,612	4,568
TOTAL ASSETS	**$ 401,213**	382,791	$ 363,191
LIABILITIES AND SHAREHOLDERS EQUITY			
Liabilities:			
Non-interest-bearing deposits	**$ 28,325**	$ 23,471	$ 22,826
Interest-bearing deposits:			
NOW and Money Market	**87,262**	73,188	73,797
Savings	**12,831**	13,365	13,915
CDs<$100,000	**90,220**	89,585	85,236
CDs>$100,000	**24,432**	23,645	20,305
Brokered	**78,301**	89,167	77,415
Total deposits	**321,371**	312,421	293,494

Borrowings		**38,239**		38,307		38,307
Other liabilities		**2,906**		3,273		3,164
Total liabilities		**362,516**		354,001		334,965
Shareholders equity:						
Preferred stock No par value:						
Authorized 500,000 shares, no shares outstanding						
Common stock and additional paid in capital No par value						
Authorized - 18,000,000 shares						
Issued and outstanding - 3,428,695 shares		**42,810**		42,722		42,646
Accumulated deficit		**(4,107)**		(13,745)		(14,083)
Accumulated other comprehensive (loss)		**(6)**		(187)		(337)
Total shareholders equity		**38,697**		28,790		28,226
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$**	**401,213**	$	382,791	$	363,191

See accompanying notes to condensed consolidated financial statements.

1.

Table of Contents

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,	
	2007	2006	**2007**	2006
INTEREST INCOME:				
Interest and fees on loans:				
Taxable	**$ 6,929**	$ 5,635	**$ 19,610**	$ 15,316
Tax-exempt	**118**	189	**432**	575
Interest on securities				
Taxable	**263**	306	**857**	852
Tax-exempt		5		87
Other interest	**209**	268	**575**	631
Total interest income	**7,519**	6,403	**21,474**	17,461
INTEREST EXPENSE:				
Deposits	**3,443**	2,951	**9,932**	7,540
Borrowings	**516**	500	**1,535**	1,355
Total interest expense	**3,959**	3,451	**11,467**	8,895
Net interest income	**3,560**	2,952	**10,007**	8,566
Provision for loan losses	**400**		**400**	(600)
Net interest income after provision for loan losses	**3,160**	2,952	**9,607**	9,166
OTHER INCOME:				
Service fees	**169**	133	**515**	365
Net gains on sale of secondary market loans	**165**	66	**364**	149
Proceeds from settlement of lawsuit			**470**	
Other	**62**	41	**302**	193
Total other income	**396**	240	**1,651**	707
OTHER EXPENSE:				
Salaries and employee benefits	**1,695**	1,487	**5,106**	4,577
Occupancy	**322**	333	**983**	943
Furniture and equipment	**178**	159	**501**	470
Data processing	**196**	176	**577**	512
Professional service fees	**78**	341	**403**	955
Loan and deposit	**63**	78	**214**	305

Telephone	**68**	55	**185**	155
Advertising	**97**	70	**280**	247
Other	**304**	303	**873**	831
Total other expense	**3,001**	3,002	**9,122**	8,995
Income before income taxes	**555**	190	**2,136**	878
Provision for (benefit of) income taxes	**(7,500)**	(500)	**(7,500)**	(500)
NET INCOME	**$ 8,055**	$ 690	**$ 9,636**	$ 1,378
INCOME PER COMMON SHARE:				
Basic	**$ 2.35**	$ .20	**$ 2.81**	$ .40
Diluted	**$ 2.35**	$ .20	**$ 2.81**	$ .40

See accompanying notes to condensed consolidated financial statements.

2.

Table of Contents

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,	
	2007	2006	**2007**	2006
Balance, beginning of period	**$ 30,485**	$ 27,179	**$ 28,790**	$ 26,588
Net income for period	**8,055**	690	**9,636**	1,378
Stock option compensation	**30**	78	**90**	234
Net unrealized gain on securities available for sale	**127**	279	**181**	26
Total comprehensive income	**8,212**	1,047	**9,907**	1,638
Balance, end of period	**$ 38,697**	$ 28,226	**$ 38,697**	$ 28,226

See accompanying notes to condensed consolidated financial statements.

3.

Table of Contents

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

	Nine Months Ended September 30, 2007	2006
Cash Flows From Operating Activities:		
Net income	**$ 9,636**	$ 1,378
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	**547**	762
Provision for loan losses	**400**	(600)
Provision for benefit of income taxes	**(7,500)**	(500)
(Gain) on sales of premises, equipment, and other real estate	**(12)**	(60)
Writedown of other real estate	**40**	
Stock option compensation	**90**	234
Change in other assets	**221**	(68)
Change in other liabilities	**(368)**	79
Net cash provided by (used in) operating activities	**3,054**	1,225
Cash Flows From Investing Activities:		
Net (increase) in loans	**(22,435)**	(53,058)
Net (increase) decrease in interest-bearing deposits in other financial institutions	**(6,139)**	136
Purchase of securities available for sale	**(18,558)**	(5,000)
Proceeds from maturities, calls or paydowns of securities available for sale	**33,715**	3,079
FHLB repurchase of stock		703
Capital expenditures	**(1,231)**	(1,307)
Proceeds from sale of premises, equipment, and other real estate	**317**	1,013
Net cash (used in) investing activities	**(14,331)**	(54,434)
Cash Flows From Financing Activities:		
Net increase in deposits	**8,950**	60,862
Proceeds from issuance of debt		1,959
Principal payments on borrowings	**(68)**	(69)
Net cash provided by financing activities	**8,882**	62,752
Net increase (decrease) in cash and cash equivalents	**(2,395)**	9,543
Cash and cash equivalents at beginning of period	**10,706**	7,943
Cash and cash equivalents at end of period	**$ 8,311**	$ 17,486

Supplemental Cash Flow Information:		
Cash paid during the year for:		
Interest	**$ 9,735**	$ 8,764
Income taxes		
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)	**443**	23

See accompanying notes to condensed consolidated financial statements.

4.

Table of Contents

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, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. 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, 2006.

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 continues to maintain 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 collectibility 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 collectibility.

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

5.

Table of Contents

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

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

made available for grant under these plans. These two 1997 plans expired early in 2007. 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.

The Corporation adopted SFAS No. 123 (Revised) Share Based Payments in the first quarter of 2006. This statement supersedes APB Opinion No. 25 Accounting for Stock Issued to Employees and its related implementation guidance. Under Opinion No. 25, issuing stock options to employees generally resulted in recognition of no compensation cost. This adoption resulted in the recognition of before tax compensation expense in the amount of $90,000 for the nine months ended September 30, 2007, and $234,000 for the same period in 2006. The expense recorded recognizes the current period vesting of options outstanding. The per share impact of this accounting change was $.03 and $.07 in the first nine months of 2007 and 2006, respectively.

2. **RECENT ACCOUNTING PRONOUNCEMENT**

FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued this interpretation to clarify the accounting for uncertainty in tax positions. FIN 48 requires, among other matters, that the Corporation recognize in its financial statements the impact of a tax position, if that position is more likely than not of being sustained on an audit, based on the technical merits of the position. The provisions of FIN 48 were effective as of the beginning of the Corporation s 2007 fiscal year and required any cumulative effect of the change in accounting principle to be recorded as an adjustment to opening retained earnings. The Corporation did not record an adjustment to retained earnings upon adoption of FIN 48. In future periods, The Corporation will, in accordance with FIN 48, evaluate its tax positions to determine whether or not an adjustment to deferred tax balances and related valuation accounts is warranted.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159)

SFAS No. 159 permits an entity to measure certain financial assets and financial liabilities at fair value. The Statement s objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option may be elected on an instrument-by-instrument basis, with a few exceptions, as long as it is applied to the instrument in its entirety. The fair value option election is irrevocable, unless a new election date occurs. The new Statement establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity s election on its earnings but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity (a) makes that choice in the first 120 days of that fiscal year, (2) has not yet issued financial statements, and (3) elects to apply the provisions of SFAS No. 157. The Corporation did not adopt SFAS No. 159 during this early adoption period, and has not determined the impact, if any; the implementation of SFAS No. 159 will have on the consolidated financial statements.

6.

Table of Contents

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 nine months ended September 30, 2007 and 2006 (dollars in thousands, except per share data):

		Net Income	Weighted Average Number of Shares	Income Per Share
	Three Months Ended September 30,			
2007				
Income per share	**Basic and diluted**	**$ 8,055**	**3,428,695**	**$ 2.35**
2006				
Income per share	Basic and diluted	$ 690	3,428,695	$ .20
	Nine Months Ended September 30,			
2007				
Income per share	**Basic and diluted**	**$ 9,636**	**3,428,695**	**$ 2.81**
2006				
Income per share	Basic and diluted	$ 1,378	3,428,695	$ .40

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2007, December 31, 2006 and September 30, 2006 are as follows (dollars in thousands):

	September 30, 2007		December 31, 2006		September 30, 2006	
	Amortized Cost	**Estimated Fair Value**	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
US Agencies	**$ 17,494**	**$ 17,428**	$ 32,445	$ 32,176	$ 35,954	$ 35,536
Obligations of states and political subdivisions	**485**	**545**	511	593	512	593

Total securities available for sale	**$ 17,979**	**$ 17,973**	$ 32,956	$ 32,769	$ 36,466	$ 36,129

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were $17.794 million and $17.729 million, respectively, at September 30, 2007.

Table of Contents

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

5. LOANS

The composition of loans at September 30, 2007, December 31, 2006 and September 30, 2006 is as follows (dollars in thousands):

	September 30, 2007	December 31, 2006	September 30, 2006
Commercial real estate	**$ 161,032**	$ 154,332	$ 146,838
Commercial, financial, and agricultural	**78,822**	71,385	58,548
One to four family residential real estate	**54,962**	58,014	51,341
Construction	**45,826**	36,009	33,095
Consumer	**3,507**	2,841	2,792
Total loans	**$ 344,149**	$ 322,581	$ 292,614

LOANS Allowance for loan losses

An analysis of the allowance for loan losses for the nine months ended September 30, 2007, the year ended December 31, 2006, and the nine months ended September 30, 2006 is as follows: (dollars in thousands):

	September 30, 2007	December 31, 2006	September 30, 2006
Balance at beginning of period	**$ 5,006**	$ 6,108	$ 6,108
Recoveries on loans	**39**	91	59
Loans charged off	**(423)**	(332)	(251)
Provision	**400**	(861)	(600)
Balance at end of period	**$ 5,022**	$ 5,006	$ 5,316

In the first nine months of 2007, net charge off activity was $384,000, or .12% of average loans outstanding compared to net charge-offs of $192,000, or .07% of average loans, in the same period in 2006. During the third quarter of 2007, a provision of $400,000 was made to increase the reserve. This provision was made in accordance with the Corporation s allowance for loan loss reserve policy, which calls for a measurement of the adequacy of the reserve at each quarter end. This process includes an analysis of the loan portfolio to take into account increases in loans outstanding and portfolio composition, historical loss rates, and specific reserve requirements of nonperforming loans. In the first quarter of 2006, the Corporation reduced the allowance for loan losses by recording a negative provision amounting to $600,000. In the fourth quarter of 2006, a reduction of $261,000 was made to the reserve due to the resolution of a problem loan with an excess specific reserve. These reductions in the reserve were made in recognition of the improved credit quality existent in the loan portfolio and are 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. The interest income recorded and that which would have been recorded had nonaccrual and renegotiated loans been current, or not troubled was not material to the consolidated financial statements for the nine months ended September 30, 2007 and 2006.

Table of Contents

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

5. **LOANS** (Continued)

Information regarding impaired loans as of September 30, 2007, December 31, 2006 and September 30, 2006 is as follows (dollars in thousands):

				Valuation Reserve		
	September 30, 2007 (Unaudited)	December 31, 2006	September 30, 2006 (Unaudited)	**September 30, 2007**	December 31, 2006	September 30, 2006
Balances, at period end						
Impaired loans with specific valuation reserve	**$ 2,889**	$ 1,804	$ 1,803	**$ 835**	$ 493	$ 164
Impaired loans with no specific valuation reserve	**283**	1,136	262			
Total impaired loans	**$ 3,172**	$ 2,940	$ 2,065	**$ 835**	$ 493	$ 164
Impaired loans on nonaccrual basis	**$ 3,136**	$ 2,900	$ 2,065	**$ 835**	$ 493	$ 164
Impaired loans on accrual basis	**36**	40				
Total impaired loans	**$ 3,172**	$ 2,940	$ 2,065	**$ 835**	$ 493	$ 164
Average investment in impaired loans	**$ 4,018**	$ 1,192	$ 713			
Interest income recognized during impairment	**71**	7	4			
Interest income that would have been recognized on an accrual basis	**288**	114	56			
Cash-basis interest income recognized	**65**	5	3			

The average investment in impaired loans was approximately $4.018 million for the nine months ended September 30, 2007, $1.192 million for the year ended December 31, 2006, and $.713 million for the nine months ended September 30, 2006, respectively. Additional discussion on impaired loans is presented in the Management s Discussion and Analysis section of this report.

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, 2007	December 31, 2006	September 30, 2006
Loans outstanding beginning of period	**$ 1,621**	$ 578	$ 578
New loans		1,647	1,647
Net activity on revolving lines of credit		271	271
Repayment	**(449)**	(875)	(865)
Loans outstanding end of period	**$ 1,172**	$ 1,621	$ 1,631

There were no loans to related-parties classified substandard at September 30, 2007, December 31, 2006 or September 30, 2006, respectively. In addition to the outstanding balances above, there were unused commitments of $600,000 to related parties at September 30, 2007.

9.

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

6. BORROWINGS

Borrowings consist of the following at September 30, 2007, December 31, 2006 and September 30, 2006 (dollars in thousands):

	September 30, 2007	December 31, 2006	September 30, 2006
Federal Home Loan Bank advances at rates ranging from 4.98% to 5.26% maturing in 2010 and 2011	**$ 35,000**	$ 35,000	$ 35,000
Farmers Home Administration, fixed-rate note payable, maturing August 24, 2024, interest payable at 1%	**1,280**	1,348	1,348
Advance outstanding on line of credit with a correspondent bank, interest payable at the prime rate, 7.75% as of September 30, 2007, maturing May 21, 2008	**1,959**	1,959	1,959
	$ 38,239	$ 38,307	$ 38,307

The Federal Home Loan Bank borrowings are collateralized at September 30, 2007, by the following: a collateral agreement on the Corporation s one to four family residential real estate loans with a book value of approximately $21.362 million; U.S. government agency securities with an amortized cost and estimated fair value of $16.644 million and $16.579 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, 2007.

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling $615,000 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 $794,000, and guaranteed by the Corporation.

7. STOCK OPTION PLANS

A summary of stock option transactions for the nine months ended September 30, 2007 and 2006, and the year ended December 31, 2006, is as follows: (Historical stock option information has been adjusted for the 1:20 reverse stock split which occurred in December 2004).

	September 30, 2007	December 31, 2006	September 30, 2006
Outstanding shares at beginning of year	**446,417**	375,417	375,417
Granted during the period		72,500	
Expired during the period		(1,500)	(1,500)
Outstanding shares at end of period	**446,417**	446,417	373,917

Weighted average exercise price per share at end of period	**$**	**12.29**	$	12.29	$	12.60
Shares available for grant at end of period		**18,488**		18,488		90,988

There were no options granted in the first nine months of 2007 and 2006.

10.

Table of Contents

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

7. STOCK OPTION PLANS (Continued)

Following is a summary of the options outstanding and exercisable at September 30, 2007:

Exercise Price Range	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life-Years	Weighted Average Exercise Price
$9.16	12,500	5,000	8.25	$ 9.16
$9.75	257,152	120,861	7.21	9.75
$10.65	72,500	14,500	9.25	10.65
$11.50	40,000	8,000	8.00	11.50
$12.00	60,000	12,000	7.71	12.00
$156.00 - $240.00	3,545	3,545	3.51	186.75
$300.00 - $406.60	720	720	1.79	345.00
	446,417	164,626	7.67	$ 12.29

8. INCOME TAXES

In the third quarter of 2007, the Corporation reversed a portion of the valuation allowance that pertained to the deferred tax benefit of NOL and tax credit carryforwards. This valuation adjustment, $7.500 million, was recorded as a current period income tax benefit. The recognition of this benefit was in accordance with generally accepted accounting principles, and considered, among other things, the probability of utilizing the NOL and credit carryforwards. Additional discussion on the recognition of this deferred tax benefit is presented in the Management s Discussion and Analysis section of this report.

9. 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.

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, 2007	December 31, 2006	September 30, 2006
Commitments to extend credit:			
Fixed rate	**$ 10,075**	$ 9,288	$ 4,628

Variable rate			**50,728**		44,141		44,142
Standby letters of credit	Variable rate		**5,957**		6,233		6,422
Credit card commitments	Fixed rate		**2,388**		2,391		2,488
		$	**69,148**	$	62,053	$	57,680

11.

Table of Contents

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

9. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

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, 2007 represents $43.422 million, or 18.10%, compared to $35.965 million, or 17.51%, of the commercial loan portfolio on September 30, 2006. 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.

Table of Contents

MACKINAC FINANCIAL CORPORATION

ITEM 2 AGEMENT 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.

MACKINAC FINANCIAL CORPORATION
ITEM 2 AGEMENT 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, 2006. Throughout this discussion, the term Bank refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

Year-to-date consolidated net income was $9.636 million through September 30, 2007, or $2.81 per share, compared to income of $1.378 million, $.40 per share, for the same period in 2006. The income for the three months ended September 30, 2007 amounted to $8.055 million, or $2.35 per share, compared to income of $.690 million, or $.20 per share for the same period in 2006. The results of operations for the first nine months of 2007 include a provision for the benefit of income taxes in the amount of $7.500 million in recognition of a deferred tax benefit, $470,000, of proceeds from the settlement of a lawsuit against the Corporation s former accountants, and a provision for loan losses of $400,000. During the comparable nine month period in 2006, the Bank recorded a $600,000 negative provision for loan losses in recognition of improved credit quality, as well as a $500,000 provision for the benefit of income taxes. Excluding these items provides a more revealing picture of operating results. The adjusted figures show net income in the first nine months of 2007 of $2.066 million, or $.60 per share, compared to an adjusted net income of $.278 million, or $.09 per share, for the same period in 2006. The adjusted 2007 third quarter figures show net income of $.958 million, or $.28 per share, compared to $.190 million, or $.06 per share, in the third quarter of 2006.

Total assets increased $18.422 million from December 31, 2006 to September 30, 2007. The loan portfolio increased $21.568 million in the first nine months of 2007, from December 31, 2006 balances of $322.581 million. Deposits totaled $321.371 million at September 30, 2007, an increase of $8.950 million from the $312.421 million at December 31, 2006.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents decreased $2.395 million in 2007. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Available-for-sale securities decreased $14.796 million, or 45.15%, from December 31, 2006 to September 30, 2007, with the balance on September 30, 2007, totaling $17.973 million. The decrease during the first nine months of 2007 was due to a combination of maturities, calls and paydowns of securities. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of September 30, 2007, investment securities with an estimated fair value of $17.794 million were pledged. During the first nine months of 2007, the Corporation utilized a higher proportion of federal funds to maintain liquidity since yields were comparable to those offered on short-term investment securities.

Loans

Through the third quarter of 2007, loan balances increased by $21.568 million, or 6.69%, from December 31, 2006 balances of $322.581 million. During the first nine months of 2007, the Bank had total loan production of $87 million. This loan production, some of which has not yet funded, was significantly offset by normal principal runoff and amortization, $29 million, and large paydowns and refinancing, which totaled $30 million. In the first nine months of 2007, the Corporation also sold $5.4 million of the guaranteed portion of government sponsored SBA and UDSA loans. 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.

Table of Contents

MACKINAC FINANCIAL CORPORATION

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

Enhancements to the loan approval process and exception reporting further provide for a more effective management of risk in the loan portfolio. 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.

Following is a summary of the loan portfolio at September 30, 2007, December 31, 2006 and September 30, 2006 (dollars in thousands):

	September 30, 2007	**Percent of Total**	December 31, 2006	Percent of Total	September 30, 2006	Percent of Total
Commercial real estate	**$ 161,032**	**46.79%**	$ 154,332	47.84%	$ 146,838	50.18%
Commercial, financial, and agricultural	**78,822**	**22.90**	71,385	22.13	58,548	20.01
One to four family residential real estate	**54,962**	**15.97**	58,014	17.99	51,341	17.55
Construction	**45,826**	**13.32**	36,009	11.16	33,095	11.31
Consumer	**3,507**	**1.02**	2,841	.88	2,792	.95
Total loans	**$ 344,149**	**100.00%**	$ 322,581	100.00%	$ 292,614	100.00%

Following is a table showing the significant industry types in the commercial loan portfolio as of September 30, 2007, December 31, 2006 and September 30, 2006 (dollars in thousands):

	September 30, 2007			December 31, 2006			September 30, 2006		
	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	**$ 43,422**	**18.10%**	**112.21%**	$ 44,308	19.63%	153.90%	$ 35,965	17.51%	127.42%
Hospitality and tourism	**37,479**	**15.63**	**96.85**	30,826	13.66	107.07	37,287	18.15	132.10
Real estate agents & managers	**25,662**	**10.70**	**66.32**	25,071	11.11	87.08	19,744	9.61	69.95
Offices of holding companies	**10,831**	**4.52**	**27.99**	4,989	2.21	17.33	1,496	.73	5.30
Other	**122,460**	**51.05**	**316.46**	120,523	53.39	418.63	110,894	54.00	392.88
Total Commercial	**$ 239,854**	**100.00%**		$ 225,717	100.00%		$ 205,386	100.00%	

Loans

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, 2007. 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, 2007 amounted to $.384 million, or .12% of average loans outstanding, compared to $.192 million, .07% of average loans outstanding, for the same period in 2006. In the third quarter of 2007, the Corporation recorded a $400,000 loan loss provision. This provision requirement was largely impacted by one commercial credit that was originated prior to the current management team. The loan, which currently is performing as agreed, is secured by a hotel property. The borrower has indicated their intent to default the loan unless their request for restructuring is granted. An appraisal was obtained as a part of negotiations and indicated some deterioration of the underlying asset. These facts, coupled with the need to provide an additional loan loss provision for new growth resulted in the $400,000 third quarter provision. The current level of charge-offs is below historical levels and projected charge-off activity, based upon current levels of nonperforming loans, is not expected to attain historical levels. 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. In the first quarter of 2006, a reduction of $600,000 was made to the reserve for loan loss in recognition of improved credit quality. A reduction of $261,000 was recorded in the fourth quarter of 2006 when a large problem loan with a specific reserve was resolved with a loss less than anticipated.

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, 2007	December 31, 2006	September 30, 2006
Nonperforming Assets :			
Nonaccrual loans	**$ 3,136**	$ 2,899	$ 2,065
Loans past due 90 days or more	**36**	40	
Restructured loans			
Total nonperforming loans	**3,172**	2,939	2,065
Other real estate owned	**451**	26	26
Total nonperforming assets	**$ 3,623**	$ 2,965	$ 2,091
Nonperforming loans as a % of loans	**.92%**	.91%	.71%
Nonperforming assets as a % of assets	**.90%**	.77%	.58%
Reserve for Loan Losses:			
At period end	**$ 5,022**	$ 5,006	$ 5,316
As a % of loans	**1.46%**	1.55%	1.82%
As a % of nonperforming loans	**158.32%**	170.33%	257.43%
As a % of nonaccrual loans	**160.14%**	172.68%	257.43%

Following is the allocation of the allowance for loan losses as of September 30, 2007, December 31, 2006 and September 30, 2006 (dollars in thousands):

	September 30, 2007	December 31, 2006	September 30, 2006
Commercial, financial and agricultural loans	**$ 4,803**	$ 3,600	$ 1,431
One to four family residential real estate loans	**31**	23	29
Consumer loans			
Unallocated and general reserves	**188**	1,383	3,856
Totals	**$ 5,022**	$ 5,006	$ 5,316

The Corporation has experienced a significant decline in historical loan charge-offs in the past several years. During this same period, the commercial loan portfolio has grown by $92.854 million from 2005 year end to September 30, 2007. The increased allocation of the reserve from unallocated and general reserves to commercial, financial and agricultural is in recognition of this growth. The increase in nonperforming loans has also resulted in increases for specific reserve allocations. Specific reserve allocations on nonperforming loans totaled $.835 million as of September 30, 2007. The decline of charge-offs in recent years has helped mitigate the need for loan loss provisions, despite increased balances of impaired loans, since the requirement for general reserves significantly decreased.

MACKINAC FINANCIAL CORPORATION

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

The following ratios assist management in the determination of the Corporation s credit quality (dollars in thousands):

	September 30, 2007	December 31, 2006	September 30, 2006
Total loans, at period end	**$ 344,149**	$ 322,581	$ 292,614
Average loans for the year	**$ 327,810**	$ 278,953	$ 271,351
Allowance for loan losses	**$ 5,022**	$ 5,006	$ 5,316
Allowance to total loans at period end	**1.46**%	1.55%	1.82%
Net charge-offs during the period	**$ 384**	$ 241	$ 192
Net charge-offs to average loans	**.12**%	.08%	.07%
Net charge-offs to beginning allowance balance	**7.67**%	3.95%	1.52%
Nonaccrual loans at end of period	**$ 3,136**	$ 2,899	$ 2,065
Loans past due 90 days or more	**36**	40	
Restructured loans			
Total nonperforming loans	**$ 3,172**	$ 2,939	$ 2,065
Nonperforming loans to total loans at end of period	**.92**%	.91%	.71%

Total nonperforming loans increased $.233 million since December 31, 2006. The increase was due to several commercial credits that were added during the first nine months of 2007 and reflects reductions for problem loans which were resolved during the current year. Management believes that the current reserve levels provide for all projected losses on these problem loans.

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 provided findings similar to management on the overall adequacy of the reserve. The Corporation has engaged this same consultant for loan review during 2007.

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, which is grouped with other assets on the condensed consolidated balance sheet.

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

	September 30, 2007	December 31, 2006	September 30, 2006
Balance at beginning of period	**$ 26**	$ 945	$ 945

Other real estate transferred from loans due to foreclosure (net of adjustments made through the allowance for loan losses)		**443**		23		23
Other real estate sold/written down		**(18)**		(942)		(942)
Balance at end of period	$	451	$	26	$	26

During the first nine months of 2007, the Corporation received real estate in lieu of loan payments of $.443 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. Write-downs on other real estate may be recorded based on subsequent evaluations of current realizable fair values.

Table of Contents

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

Deposits

The Corporation had an increase in deposits in the first nine months of 2007. Total deposits increased by $8.950 million, or 2.87%, in the first nine months of 2007. Core deposits increased from $199.609 million at 2006 year end to $218.638 million, an increase of $19.029 million. During the first nine months of 2007, the Corporation reduced its wholesale funding, brokered deposits, by $10.866 million. The Corporation utilizes brokered deposits to fulfill the shortfall between increases in bank deposits compared to loan funding needs. During the first nine months of 2007, the Corporation was able to reduce its reliance on brokered deposits as the growth in core deposits provided funding for loans.

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

	September 30, 2007	**% of Total**	December 31, 2006	% of Total	September 30, 2006	% of Total
Non-interest-bearing	**$ 28,325**	**8.81%**	$ 23,471	7.51%	$ 22,826	7.78%
NOW and money market	**87,262**	**27.15**	73,188	23.43	73,797	25.14
Savings	**12,831**	**3.99**	13,365	4.28	13,915	4.74
Certificates of Deposit <$100,000	**90,220**	**28.07**	89,585	28.67	85,236	29.04
Total core deposits	**218,638**	**68.02**	199,609	63.89	195,774	66.70
Certificates of Deposit >$100,000	**24,432**	**7.61**	23,645	7.57	20,305	6.92
Brokered CDs	**78,301**	**24.37**	89,167	28.54	77,415	26.38
Total non-core deposits	**102,733**	**31.98**	112,812	36.11	97,720	33.30
Total deposits	**$ 321,371**	**100.00%**	$ 312,421	100.00%	$ 293,494	100.00%

Borrowings

The Corporation historically used alternative funding sources to provide long-term, stable sources of funds. These borrowings were initially carried with fixed interest rates and stated maturities through 2011. The advances gave the FHLB the option to convert the above listed convertible-fixed-rate advances to adjustable rate advances, repricing quarterly at three month LIBOR Flat, on the original call date and quarterly thereafter. During 2006, $20.0 million of the advances were converted from fixed to adjustable rate by the FHLB. This shift from fixed to variable rate did not have a material impact on the Corporation s net interest margin.

Shareholders Equity

Total shareholders equity increased $9.907 million from December 31, 2006 to September 30, 2007. The increase is comprised of net income of $9.636 million, contributed capital of $90,000 in recognition of stock option expense and a $.181 million increase in the market value of securities. The Board of Directors does not anticipate declaring any dividends in the near future.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income before provision for loan losses for the nine months ended September 30, 2007, increased by $1.441 million, or 16.8%, compared to the same period one year ago. This increase in net interest income was a result of the combination of increased average balances and increased rates. The Corporation, through the first nine months of 2006, benefited from prime rate increases as more assets were repricing upwards than liabilities. The benefits from the 2006 prime rate increases continued through the first nine months of 2007. This asset sensitive position has been declining in recent periods as the Corporation initiated steps as a part of its ALCO Committee to reduce interest rate risk. More discussion is included relative to repricing and asset sensitivity under the caption Interest Rate Risk elsewhere in this report.

Table of Contents

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

In the third quarter of 2007, net interest income totaled $3.560 million compared to $2.952 million for the same three month period in 2006. The increase of $.608 million is attributed largely to increased loan balances of $51.535 million between periods. The Corporation also benefitted from increased rates, as the overall yield on earning assets increased from 7.29% in the third quarter of 2006 to 7.84% in 2007. The increase in yields was due primarily to repricing of loans and investments. This increased yield on earning assets was partially offset by similar increases in the cost of interest bearing liabilities, which increased from 4.43% in the third quarter of 2006 to 4.65% in 2007.

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. All average balances are daily average balances.

	Three Months Ended										
								2007-2006			
	Average Balances			**Average Rates**		**Interest**		Income/		Ra	
	September 30,		Increase/	September 30,		September 30,		Expense	Volume	Rate	Volu
llars in thousands)	**2007**	2006	(Decrease)	**2007**	2006	**2007**	2006	Variance	Variance	Variance	Vari
ans (1,2)	**$ 340,391**	$ 289,210	$ 51,181	**8.21**	7.99%	**$ 7,047**	$ 5,824	$ 1,223	$ 1,031	$ 163	
able securities	**22,979**	33,482	(10,503)	**4.54**	3.63	**263**	306	(43)	(96)	77	(
ntaxable securities		354	(354)		5.60		5	(5)	(5)	(5)	
deral funds sold	**9,339**	18,142	(8,803)	**5.14**	5.07	**121**	232	(111)	(113)	3	
her interest-earning assets	**7,838**	7,099	739	**4.45**	2.01	**88**	36	52	4	44	
al earning assets	**380,547**	348,287	32,260	**7.84**	7.29	**7,519**	6,403	1,116	821	282	
serve for loan losses	**(4,839)**	(5,384)	545								
sh and due from banks	**7,110**	5,354	1,756								
angible assets	**152**	252	(100)								
her assets	**17,135**	14,123	3,012								
al assets	**$ 400,105**	$ 362,632	$ 37,473								
W and money market deposits	**$ 83,186**	$ 71,232	$ 11,954	**3.60**	3.40	**755**	610	145	102	37	
ings deposits	**12,900**	14,198	(1,298)	**1.54**	1.59	**50**	57	(7)	(5)	(2)	
s <$100,000	**93,223**	83,777	9,446	**4.92**	4.49	**1,155**	949	206	107	89	
s >$100,000	**24,590**	19,832	4,758	**5.15**	4.72	**319**	236	83	57	21	
kered deposits	**85,203**	83,895	1,308	**5.42**	5.20	**1,164**	1,099	65	17	47	
rowings	**38,325**	36,454	1,871	**5.34**	5.44	**516**	500	16	26	(9)	
al interest-bearing liabilities	**337,427**	309,388	28,039	**4.65**	4.43	**3,959**	3,451	508	304	183	
mand deposits	**28,191**	23,674	4,517								
her liabilities	**2,303**	1,529	774								
reholders equity	**32,184**	28,041	4,143								
al liabilities and shareholders equity	**$ 400,105**	$ 362,632	$ 37,473								

e spread	**3.19**	2.86%						
t interest margin/revenue	**3.71**	3.36%	**$ 3,560**	$ 2,952	$ 608	$ 517	$ 99	$

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

(2) Interest income on loans includes loan fees.

	Nine Months Ended										
									2007-2006		
	Average Balances			**Average Rates**		**Interest**		Income/			R
	September 30,		Increase/	September 30,		September 30,		Expense	Volume	Rate	Vo
rs in thousands)	**2007**	2006	(Decrease)	**2007**	2006	**2007**	2006	Variance	Variance	Variance	Va
s (1,2)	**$ 327,810**	$ 271,351	$ 56,459	**8.17**	7.83%	**$ 20,042**	$ 15,891	$ 4,151	$ 3,306	$ 699	
ble securities	**26,111**	31,949	(5,838)	**4.39**	3.57	**857**	852	5	(156)	197	
axable securities		2,104	(2,104)		5.53		87	(87)	(87)	(87)	
ral funds sold	**9,183**	12,467	(3,284)	**5.26**	4.91	**361**	458	(97)	(121)	32	
interest-earning assets	**6,254**	6,208	46	**4.57**	3.73	**214**	173	41	1	39	
earning assets	**369,358**	324,079	45,279	**7.77**	7.20	**21,474**	17,461	4,013	2,943	880	
rve for loan losses	**(4,936)**	(5,618)	682								
and due from banks	**6,315**	5,880	435								
gible assets	**173**	285	(112)								
assets	**16,687**	17,020	(333)								
assets	**$ 387,597**	$ 341,646	$ 45,951								
and money market deposits	**$ 75,957**	$ 69,718	$ 6,239	**3.53**	3.13	**2,005**	1,633	372	146	207	
gs deposits	**13,155**	14,721	(1,566)	**1.61**	1.39	**158**	153	5	(16)	24	
<$100,000	**93,898**	80,803	13,095	**4.94**	4.22	**3,467**	2,549	918	413	434	
>$100,000	**24,276**	16,919	7,357	**5.04**	4.55	**915**	576	339	250	62	
ered deposits	**83,094**	71,257	11,837	**5.45**	4.93	**3,387**	2,629	758	437	276	
owings	**38,637**	36,827	1,810	**5.31**	4.92	**1,535**	1,355	180	67	108	

interest-bearing liabilities	**329,017**	290,245	38,772	**4.66**	4.10	**11,467**	8,895	2,572	1,297	1,111	
and deposits	**25,144**	21,053	4,091								
r liabilities	**2,809**	2,908	(99)								
eholders equity	**30,627**	27,440	3,187								
liabilities and shareholders equity	**$ 387,597**	$ 341,646	$ 45,951								
spread				**3.11**	3.10%						
nterest margin/revenue				**3.62**	3.53%	**$ 10,007**	$ 8,566	$ 1,441	$ 1,646	$ (231)	$

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

(2) Interest income on loans includes loan fees.

19.

Table of Contents

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

Provision for Loan Losses

The Corporation records a provision for loan losses at a level it believes is necessary to maintain the allowance at an adequate level after considering factors such as loan charge-offs and recoveries, changes in the mix of loans in the portfolio, loan growth, and other economic factors. Management, on a quarterly basis, recalculates the required loan loss reserve based upon consistently applied criteria which includes, among other factors, loan type, historical charge-off information by loan type, and a loan grading system applied for evaluating credit risk. Management continues to monitor the loan portfolio for changes which may impact the required allowance for loan losses. The Corporation recorded a $400,000 provision for loan loss in the 2007 third quarter. This third quarter provision was made largely to provide for the anticipated loss on a large commercial credit which was still performing as of September 30th, under the terms of the original loan agreement. The Bank was notified by the borrower, late in the third quarter that they would default the loan unless their request for restructuring was granted. The third quarter provision was due in part to provide for the anticipated loss on this loan.

Other Income

Other income increased by $.944 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006. The Corporation recognized a benefit from the settlement of a lawsuit against its former accountants in the first nine months of 2007, which amounted to $.470 million. Service fees increased $.150 million in the first nine months of 2007 primarily due to the Bank s overdraft protection program which was initiated late in 2006. Net gains on sales of loans amounted to $.364 million compared to $.149 million a year ago. This source of noninterest income includes mortgage loans sold to the secondary market and fees from the sale of SBA and USDA guaranteed loans.

During the third quarter of 2007, the Corporation recognized $.396 million in other income, compared to $.240 million for the third quarter of 2006. The largest increase was from gains on sales of loans which increased by $.099 million between periods due primarily to gains on the sale of the guaranteed portion of SBA and USDA loans, which totaled $.121 million in the third quarter. Service fees increased for the third quarter of 2007 by $.036 million to $.169 million when compared to $.133 million in the third quarter of 2006.

The following table details noninterest income for the three and nine months ended September 30, 2007 and 2006 (dollars in thousands):

	Three Months Ended September 30,		% Increase (Decrease)	**Nine Months Ended September 30,**		% Increase (Decrease)
	2007	2006	2007-2006	**2007**	2006	2007-2006
Service fees	**$ 169**	$ 133	27.1	**$ 515**	$ 365	41.1
Net gains on sale of loans	**165**	66	150.0	**364**	149	144.3
Proceeds from settlement of lawsuit			0.0	**470**		100.0
Other	**62**	42	47.6	**302**	194	55.7
Subtotal	**396**	241	64.3	**1,651**	708	133.2
Net securities gains		(1)	100.0		(1)	100.0
Total other income	**$ 396**	$ 240	65.0	**$ 1,651**	$ 707	133.5

Other Expenses

Other expenses increased $.127 million for the nine months ended September 30, 2007, compared to the same period in 2006. Salaries, commissions, and related benefits increased $.529 million during the first nine months of 2007, compared to the first nine months of 2006. This increase reflects the annual salary increases and staffing additions. The Corporation, in an attempt to increase core deposit balances, added three Treasury Management Specialists to focus on generating business related transactional deposit balances. The most significant decrease in 2007 expenses was in professional services, due primarily from reduced legal costs. In 2006, significant legal costs were incurred in pursuit of legal action against the Corporation s former accountants. The $.065 million increase in

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

data processing costs is the result of increased deposit balances and activity, along with added data processing services. The $.091 million decrease in loan and deposit expense is due in large part to the reduction in FDIC insurance premiums, which amounted to $.076 million in the first nine months of 2006, compared to $.027 million in 2007, a reduction of $.049 million. This reduction in premium was due to lower premium assessments and is expected to continue for the near term. Management continually reviews all areas of noninterest expense for cost reduction opportunities that will not negatively impact service quality and employee morale.

The Corporation s other expense in the third quarter of 2007 totaled $3.001 million, compared to $3.002 million in the third quarter of 2006. The increase in noninterest expense between periods was composed of increases in salary and employee benefits, due primarily to staffing increases; occupancy, due to the relocation of a branch office in the third quarter of 2006; and data processing, due to increased services and volume. These increased expenses were partially offset by reductions in professional service fees.

The following table details noninterest expense for the three and nine months ended September 30, 2007 and September 30, 2006 (dollars in thousands):

	Three Months Ended September 30,		% Increase (Decrease)	**Nine Months Ended September 30,**		% Increase (Decrease)
	2007	2006	2007-2006%	**2007**	2006	2007-2006%
Salaries and employee benefits	**$ 1,695**	$ 1,487	14.0	**$ 5,106**	$ 4,577	11.6
Occupancy	**322**	333	(3.3)	**983**	943	4.2
Furniture and equipment	**178**	159	11.9	**501**	470	6.6
Data processing	**196**	176	11.4	**577**	512	12.7
Professional service fees	**78**	341	(77.1)	**403**	955	(57.8)
Loan and deposit	**63**	78	(19.2)	**214**	305	(29.8)
Telephone	**68**	55	23.6	**185**	155	19.4
Advertising	**97**	70	38.6	**280**	247	13.4
Other	**304**	303	0.3	**873**	831	5.1
Total other expense	**$ 3,001**	$ 3,002	(0.0)	**$ 9,122**	$ 8,995	1.4

Federal Income Taxes

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, $500,000, 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, 2007, the Corporation had an NOL carryforward of approximately $36.0 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 s results of operations for the nine month periods in 2007 and 2006 do not reflect the impact of federal income taxes due to the NOL carryforwards, a portion of which was utilized in each period to offset current federal taxes. In 2006, a $500,000 benefit was recognized and a portion of the NOL carryforward was utilized to offset current year tax expense. 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

Table of Contents

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

projected profitability of the Corporation. The Corporation, in future periods, will record a current federal tax provision on income.

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 2007, the Corporation decreased cash and cash equivalents by $2.395 million. As shown on the Corporation s condensed consolidated statement of cash flows, liquidity was primarily impacted by cash provided by investing activities, a net increase in loans of $22.435 million and a net reduction in securities available for sale of $18.558 million. The net increases in assets were offset by a similar increase in deposit liabilities of $8.950 million. This increase in deposits was composed of a decrease in brokered deposits of $10.866 million combined with an increase in bank deposits of $19.816 million. 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 2007, 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 has a $6 million correspondent bank line of credit available for short-term liquidity. This line of credit has an outstanding balance of $1.959 million as of September 30, 2007. The Corporation is currently exploring alternative opportunities for longer term sources of liquidity and permanent equity to support projected asset growth.

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. 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, 2007, the Bank s core deposits in relation to total funding were 61.13% compared to 57.23% at September 30, 2006. These ratios indicated at September 30, 2007, that the Bank has decreased 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, 2007, the Bank had $14.875 million of unsecured lines available and another $9.768 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 2007 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 2007 calls for augmenting local deposit growth efforts with wholesale CD funding, to the extent necessary.

Table of Contents

MACKINAC FINANCIAL CORPORATION

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

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, 2007, 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 2007, total capitalization increased by $9.907 million.

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

	September 30, 2007	December 31, 2006	September 30, 2006
Capital Structure			
Shareholders equity	**$ 38,697**	$ 28,790	$ 28,226
Total capitalization	**$ 38,697**	$ 28,790	$ 28,226
Tangible capital	**$ 38,554**	$ 28,585	$ 27,989
Intangible Assets			
Core deposit premium	**$ 143**	$ 205	$ 237
Other identifiable intangibles			
Total intangibles	**$ 143**	$ 205	$ 237
Regulatory capital			
Tier 1 capital:			
Shareholders equity	**$ 38,697**	$ 28,790	$ 28,226
Net unrealized (gains) losses on available for sale securities	**6**	187	337
Minority interest			
Less: intangibles	**(143)**	(205)	(237)
Less: disallowed deferred tax asset	**(7,000)**		
Total Tier 1 capital	**$ 31,560**	$ 28,772	$ 28,326
Tier 2 Capital:			
Allowable reserve for loan losses	**$ 4,379**	$ 4,113	$ 3,800
Qualifying long-term debt			
Total Tier 2 capital	**4,379**	4,113	3,800

Total capital	**$ 35,939**	$ 32,885	$ 32,126
Risk-adjusted assets	**$ 349,678**	$ 328,133	$ 302,523
Capital ratios:			
Tier 1 Capital to average assets	**8.03%**	7.85%	7.81%
Tier 1 Capital to risk weighted assets	**9.03%**	8.77%	9.36%
Total Capital to risk weighted assets	**10.28%**	10.02%	10.62%

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.

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, 2007	**9.65%**	**9.61%**	**8.03%**	**9.03%**	**10.28%**
December 31, 2006	7.52%	7.47%	7.85%	8.77%	10.02%
The Bank:					
September 30, 2007	**10.05%**	**10.02%**	**8.46%**	**9.51%**	**10.76%**
December 31, 2006	7.97%	7.92%	8.33%	9.31%	10.57%

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 $17.973 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.

Table of Contents

MACKINAC FINANCIAL CORPORATION

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

The following is the Corporation s opportunities at September 30, 2007 (dollars in thousands):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	$ 236,843	$ 8,049	$ 28,915	$ 70,342	344,149
Securities	3,499	11,996	2,000	478	17,973
Other (1)	7,942			3,794	11,736
Total interest-earning assets	248,284	20,045	30,915	74,614	373,858
Interest-bearing obligations:					
NOW, Money Market, and Savings	100,093				100,093
Time deposits	45,668	57,753	10,442	789	114,652
Brokered deposits	52,753	25,548			78,301
Borrowings	21,959			16,280	38,239
Total interest-bearing obligations	220,473	83,301	10,442	17,069	331,285
Gap	$ 27,811	$ (63,256)	$ 20,473	$ 57,545	$ 42,573
Cumulative gap	$ 27,811	$ (35,445)	$ (14,972)	$ 42,573	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at September 30, 2007, the Corporation had a cumulative liability sensitivity gap position of $35.445 million within the one-year time frame. The Corporation s cumulative liability sensitive gap suggests that if market interest rates increase in the next twelve months, the Corporation has the potential to earn less net interest income. Conversely, if market interest rates decreased in the next twelve months, the above GAP position suggests the Corporation s net interest income would increase. 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.

At December 31, 2006, the Corporation had a cumulative liability sensitivity gap position of $36.811 million within the one-year time frame. The decrease in the gap position from December 31, 2006, to September 30, 2007, was insignificant.

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 2006, 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 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.

MACKINAC FINANCIAL CORPORATION

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

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, 2007, the Corporation had excess Canadian assets of $.310 million (or $.309 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.

Table of Contents

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, 2007 that has materially affected, or is reasonably likely to materially affect, the Corporation s internal control over financial reporting.

Table of Contents

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.

In an action styled *Virginia M. Damon Trust v. North Country Financial Corporation, Nominal Defendant, and Dennis Bittner, Bernard A. Bouschor, Ronald G. Ford, Sherry L. Littlejohn, Stanley J. Gerou II, John D. Lindroth, Stephen Madigan, Spencer Shunk, Michael Hendrickson, Glen Tolksdorf, and Wesley Hoffman*, filed in the U.S. District Court for the Western District of Michigan on July 1, 2003, a shareholder of the Corporation has brought a shareholder s derivative action under Section 27 of the Exchange Act against the Corporation and certain of its current and former directors and senior executive officers.

On November 11, 2003, the Corporation filed a motion, as permitted by section 495 of the MBCA, M.C.L.§ 450.1495, requesting the Court to appoint a disinterested person to conduct a reasonable investigation of the claims made by the plaintiff and to make a good faith determination whether the maintenance of the derivative action is in the best interests of the Corporation. After additional written submissions to the Court by the defendants and the plaintiff concerning the issues presented by this motion, and after several conferences with the Court, on May 20, 2004, the Court entered an Order adopting the parties written stipulations concerning the appointment of a disinterested person and the manner of conducting the investigation of the claims made by the plaintiff and making recommendations as to whether the maintenance of the derivative action is in the best interests of the Corporation. The Corporation is a named nominal defendant which requires the Corporation to cooperate with the defendants defense of the plaintiff s action. The Corporation is assisting the defendants in the discovery phase of this litigation and is incurring legal fees as a consequence of that cooperation. However, in total, the Corporation s primary purpose will be to monitor the process of this legal action and the Corporation does not expect to incur substantial legal fees related to the case.

Damon Trust v. Wipfli

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

Table of Contents

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.

Table of Contents

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 14, 2007

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)

30.