MACATAWA BANK CORP
Form 10-Q
July 26, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from _______ to _______

Commission file number: 000-25927

MACATAWA BANK CORPORATION
(Exact name of registrant as specified in its charter)

Michigan	38-3391345
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

10753 Macatawa Drive, Holland, Michigan 49424
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (616) 820-1444

Indicate by checkmark 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 period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company x

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

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 27,082,825 shares of the Company's Common Stock (no par value) were outstanding as of July 26, 2012.

Forward-Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and Macatawa Bank Corporation. Forward-looking statements are identifiable by words or phrases such as "outlook", "plan" or "strategy"; that an event or trend "may", "should", "will", "is likely", or is "probable" to occur or "continue", has "begun" or "is scheduled" or "on track" or that the Company or its management "anticipates", "believes", "estimates", "plans", "forecasts", "intends", "predicts", "projects", or "expects" a particular result, or is "committed", "confident", "optimistic" or has an "opinion" that an event will occur, or other words or phrases such as "ongoing", "future", "signs", "efforts", "tend", "exploring", "appearing", "until", "near term", "going forward", "starting", “initiative” and variations of such words and similar expressions. Such statements are based upon current beliefs and expectations and involve substantial risks and uncertainties which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These statements include, among others, statements related to trends in credit quality metrics, future capital levels, real estate valuation, future levels of repossessed and foreclosed properties and non-performing assets and losses and costs associated with administration and disposition of repossessed and foreclosed properties and non-performing assets, future levels of loan charge-offs, future levels of other real estate owned, future levels of provisions for loan losses, the rate of asset dispositions, dividends, future growth and funding sources, future cost of funds, future liquidity levels, future profitability levels, future trust service income levels, future FDIC assessment levels, future net interest margin levels, building our investment portfolio, diversifying our credit risk, the effects on earnings of changes in interest rates, future economic conditions, future effects of new or changed accounting standards, future loss recoveries and the future level of other revenue sources. Management's determination of the provision and allowance for loan losses, the appropriate carrying value of intangible assets (including goodwill, mortgage servicing rights and deferred tax assets) and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other-than-temporary and the amount of any impairment) involves judgments that are inherently forward-looking. All statements with references to future time periods are forward-looking. All of the information concerning interest rate sensitivity is forward-looking. Our ability to sell other real estate owned at its carrying value or at all, successfully implement new programs and initiatives, increase efficiencies, obtain continuing regulatory approval to make interest payments on our subordinated notes, maintain our current levels of deposits and other sources of funding, maintain liquidity, respond to declines in collateral values and credit quality, increase loan volume, originate high quality loans, maintain or improve mortgage banking income, realize the benefit of our deferred tax assets, resume payment of dividends and improve profitability is not entirely within our control and is not assured. The future effect of changes in the real estate, financial and credit markets and the national and regional economy on the banking industry, generally, and Macatawa Bank Corporation, specifically, are also inherently uncertain. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("risk factors") that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Macatawa Bank Corporation does not undertake to update forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2011. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

INDEX

Index

Part I Financial Information
Item 1.

MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
As of June 30, 2012 (unaudited) and December 31, 2011

(dollars in thousands, except per share data)	June 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks	$25,673	$30,971
Federal funds sold and other short -term investments	218,721	212,071
Cash and cash equivalents	244,394	243,042
Securities available for sale, at fair value	96,518	54,746
Securities held to maturity (fair value 2012 and 2011 - $300)	300	300
Federal Home Loan Bank (FHLB) stock	11,236	11,236
Loans held for sale, at fair value	6,630	1,026
Total loans	1,036,965	1,070,975
Allowance for loan losses	(27,180)	(31,641)
Net loans	1,009,785	1,039,334
Premises and equipment – net	54,534	55,358
Accrued interest receivable	3,525	3,595
Bank-owned life insurance	26,404	25,957
Other real estate owned	62,046	66,438
Other assets	4,963	6,635
Total assets	$1,520,335	$1,507,667
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$330,626	$324,253
Interest-bearing	904,891	891,036
Total deposits	1,235,517	1,215,289
Other borrowed funds	127,489	148,603
Long-term debt	41,238	41,238
Subordinated debt	1,650	1,650
Accrued expenses and other liabilities	12,042	6,461
Total liabilities	1,417,936	1,413,241
Commitments and contingent liabilities	---	---
Shareholders' equity		
Preferred stock, no par value, 500,000 shares authorized;		
Series A Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 31,290 shares issued and outstanding	30,604	30,604
Series B Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 2,600 shares issued and outstanding	2,560	2,560

Common stock, no par value, 200,000,000 shares authorized; 27,082,825 and 27,082,823 shares issued and outstanding at June 30, 2012 and December 31, 2011	187,709	187,709
Retained deficit	(119,154)	(126,825)
Accumulated other comprehensive income	680	378
Total shareholders' equity	102,399	94,426
Total liabilities and shareholders' equity	$1,520,335	$1,507,667

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

Three and Six Month Periods Ended June 30, 2012 and 2011

(unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Interest income				
Loans, including fees	$13,237	$15,194	$26,763	$30,776
Securities				
Taxable	384	85	701	112
Tax-exempt	65	---	108	---
FHLB Stock	84	74	169	150
Federal funds sold and other short-term investments	130	137	257	305
Total interest income	13,900	15,490	27,998	31,343
Interest expense				
Deposits	1,525	2,416	3,175	5,327
Debt and other borrowed funds	1,053	1,292	2,221	2,636
Total interest expense	2,578	3,708	5,396	7,963
Net interest income	11,322	11,782	22,602	23,380
Provision for loan losses	(1,750)	(2,000)	(5,350)	(3,450)
Net interest income after provision for loan losses	13,072	13,782	27,952	26,830
Noninterest income				
Service charges and fees	776	969	1,571	1,918
Net gains on mortgage loans	780	262	1,251	697
Trust fees	598	620	1,207	1,270
Gain on sale of securities	59	---	59	---
ATM and debit card fees	1,064	1,027	2,045	1,946
Other	723	738	1,578	1,464
Total noninterest income	4,000	3,616	7,711	7,295
Noninterest expense				
Salaries and benefits	5,723	5,600	11,443	10,947
Occupancy of premises	941	989	1,912	2,001
Furniture and equipment	858	829	1,685	1,646
Legal and professional	180	322	392	591
Marketing and promotion	210	224	420	448
Data processing	368	334	719	638
FDIC assessment	479	841	1,188	1,819
ATM and debit card processing	308	311	596	581
Bond and D&O Insurance	215	378	483	757
Losses on repossessed and foreclosed properties	1,934	2,121	3,531	4,613
Administration and disposition of problem assets	1,256	1,620	2,718	3,562

Other	1,414	1,428	2,905	2,830
Total noninterest expenses	13,886	14,997	27,992	30,433
Income before income tax	3,186	2,401	7,671	3,692
Income tax expense (benefit)	---	---	---	---
Net income	3,186	2,401	7,671	3,692
Dividends declared on preferred shares	---	---	---	---
Net income available to common shares	$3,186	$2,401	$7,671	$3,692
Basic earnings per common share	$0.12	$0.13	$0.28	$0.2
Diluted earnings per common share	$0.12	$0.13	$0.28	$0.2
Cash dividends per common share	$---	$---	$---	$---

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Three and Six Month Periods Ended June 30, 2012 and 2011
(unaudited)

(dollars in thousands)	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net income	$3,186	$2,401	$7,671	$3,692
Other comprehensive income, net of tax:				
Net unrealized gains on securities available for sale arising during period	385	149	361	152
Less: reclassification adjustment for gain recognized in earnings, net of tax	(59)	---	(59)	---
Other comprehensive income, net of tax	326	149	302	152
Comprehensive income	$3,512	$2,550	$7,973	$3,844

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Six Month Periods Ended June 30, 2012 and 2011
(unaudited)

(dollars in thousands, except per share data)	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Retained Deficit	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, January 1, 2011	$30,604	$2,560	$167,321	$(132,654)	$ 11	$ 67,842
Net income for six months ended June 30, 2011				3,692		3,692
Net change in unrealized gain on securities available for sale, net of tax					152	152
Net proceeds from sale of 8,912,372shares of common stock on June 7, 2011 and June 29, 2011			19,426			19,426
Conversion of subordinated note to 491,830shares of common stock on June 29, 2011			1,003			1,003
Stock compensation expense			38			38
Balance, June 30, 2011	$30,604	$2,560	$187,788	$(128,962)	$ 163	$ 92,153
Balance, January 1, 2012	$30,604	$2,560	$187,709	$(126,825)	$ 378	$ 94,426
Net income for six months ended June 30, 2012				7,671		7,671
Net change in unrealized gain on securities available for sale, net of tax					302	302
Balance, June 30, 2012	$30,604	$2,560	$187,709	$(119,154)	$ 680	$ 102,399

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Month Periods Ended June 30, 2012 and 2011
(unaudited)

(dollars in thousands)	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash flows from operating activities		
Net income	$ 7,671	$ 3,692
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,416	1,539
Stock compensation expense	---	38
Provision for loan losses	(5,350)	(3,450)
Origination of loans for sale	(59,412)	(28,945)
Proceeds from sales of loans originated for sale	55,059	31,712
Net gains on mortgage loans	(1,251)	(697)
Gain on sale of securities	(59)	---
Write-down of other real estate	3,550	5,351
Net gain on sales of other real estate	(20)	(745)
Decrease (increase) in accrued interest receivable and other assets	1,579	(230)
Earnings in bank-owned life insurance	(447)	(466)
Increase in accrued expenses and other liabilities	911	1,193
Net cash from operating activities	3,647	8,992
Cash flows from investing activities		
Loan originations and payments, net	27,174	88,137
Purchases of securities available for sale	(67,461)	(21,415)
Proceeds from:		
Maturities and calls of securities available for sale	25,613	7,988
Sale of securities available for sale	4,050	---
Principal paydowns on securities	1,035	87
Sales of other real estate	8,587	11,330
Redemption of FHLB stock	---	696
Additions to premises and equipment	(407)	(533)
Net cash from investing activities	(1,409)	86,290
Cash flows from financing activities		
Net increase (decrease) in in-market deposits	20,228	(39,255)
Decrease in brokered deposits	---	(34,809)
Proceeds from other borrowed funds	---	10,000
Repayments of other borrowed funds	(21,114)	(21,066)
Proceeds from issuance of subordinated note	---	1,000
Proceeds from sale of common stock, net	---	19,426
Net cash from financing activities	(886)	(64,704)
Net change in cash and cash equivalents	1,352	30,578
Cash and cash equivalents at beginning of period	243,042	236,127

Cash and cash equivalents at end of period	$	244,394	$	266,705
Supplemental cash flow information				
Interest paid	$	4,727	$	7,446
Federal income taxes		100		---
Supplemental noncash disclosures:				
Transfers from loans to other real estate		7,725		23,384
Securities purchased not settled		4,670		---
Conversion of subordinated note to 491,830 shares of common stock		---		1,003

See accompanying notes to consolidated financial statements.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Macatawa Bank Corporation ("the Company", "our", "we") and its wholly-owned subsidiary, Macatawa Bank ("the Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The Bank operates 26 full service branch offices providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan.

The Company owns all of the common stock of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and are not consolidated with the Company under accounting principles generally accepted in the United States of America.

Basis of Presentation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) believed necessary for a fair presentation have been included.

Operating results for the three and six month periods ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, valuation of deferred tax assets, loss contingencies, fair value of other real estate owned and fair values of financial instruments are particularly subject to change.

Regulatory Developments:

Termination of Consent Order with Macatawa Bank and its Regulators

On February 22, 2010, the Bank entered into a Consent Order with the Federal Deposit Insurance Corporation (“FDIC”) and the Michigan Office of Financial and Insurance Regulation ("OFIR"), the primary banking regulators of the Bank. The Bank agreed to the terms of the negotiated Consent Order without admitting or denying any charges of unsafe or unsound banking practices. The Consent Order imposed no fines or penalties on the Bank. As a result of the improvement in our financial condition and results of operations, our implementation of additional corporate governance practices and disciplined business and banking principles, and our compliance with the Consent Order, upon completion of the Bank’s 2011 joint examination by the FDIC and OFIR, the FDIC and OFIR terminated the Consent Order effective March 2, 2012.

In connection with the termination of the Consent Order, the Bank reached an understanding with the regulators in the form of a memorandum of understanding ("MOU"), which maintains many of the controls and procedures put in place by the Bank in response to the Consent Order, including: maintenance of a Tier 1 Leverage Capital Ratio of at least 8%, formulating and submitting a written plan of action on each asset classified as Substandard in the Report of Examination ("ROE"), charge-off of all assets classified as "Loss" in the ROE, submission of a written Profit Plan, Board review of the adequacy of the allowance for loan losses each quarter and the receipt of prior written consent of the FDIC and OFIR before the Bank declares or pays any dividends. We believe the Bank was in compliance in all material respects with all of the provisions of the MOU as of June 30, 2012.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Written Agreement with Macatawa and its Regulator

The Company has formally entered into a Written Agreement with the Federal Reserve Bank of Chicago ("FRB"). The Written Agreement became effective on July 29, 2010, when it was executed and published by the FRB, and was assigned an effective date of July 23, 2010. Among other things, the Written Agreement provides that: (i) the Company must take appropriate steps to fully utilize its financial and managerial resources to serve as a source of strength to Macatawa Bank; (ii) the Company may not declare or pay any dividends without prior FRB approval; (iii) the Company may not take dividends or any other payment representing a reduction in capital from Macatawa Bank without prior FRB approval; (iv) the Company may not make any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without prior FRB approval; (v) the Company may not incur, increase or guarantee any debt without prior FRB approval; (vi) the Company may not purchase or redeem any shares of its stock without prior FRB approval; (vii) the Company must submit a written capital plan to the FRB within 60 days of the Written Agreement; and (viii) the Company may not appoint any new director or senior executive officer, or change the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, without prior regulatory approval. The Company separately requested and received approval from the FRB to make the second quarter 2012 quarterly interest payments on its $1.65 million in outstanding subordinated debt. Each quarter the Company requests approval from the FRB to make the next quarter's interest payment on its subordinated debt and is continuing to accrue the interest amounts due. We believe that as of June 30, 2012, the Company was in compliance in all material respects with all the provisions of the Written Agreement.

Reclassifications: Some items in the prior period financial statements were reclassified to conform to the current presentation.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses inherent in our loan portfolio, increased by the provision for loan losses and recoveries, and decreased by charge-offs of loans. Management believes the allowance for loan losses balance to be adequate based on known and inherent risks in the portfolio, past loan loss experience, information about specific borrower situations and estimated collateral values, economic conditions and other relevant factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Management continues its collection efforts on previously charged-off balances and applies recoveries as additions to the allowance for loan losses.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current qualitative factors. The Company maintains a loss migration analysis that tracks loan losses and recoveries based on loan class and the loan risk grade assignment for commercial loans. At June 30, 2012, an 18 month annualized historical loss experience was used for commercial loans and a 12 month historical loss experience period was applied to residential mortgage and consumer loan portfolios. These historical loss percentages are adjusted (both upwards and downwards) for certain qualitative factors, including economic trends, credit quality trends, valuation trends, concentration risk, quality of loan review, changes in personnel, external factors and other considerations.

A loan is impaired when, based on current information and events, it is believed to be probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified and a concession has been made, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Index

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Commercial and commercial real estate loans with relationship balances exceeding $500,000 and an internal risk grading of 6 or worse are evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated and the loan is reported at the present value of estimated future cash flows using the loan's existing interest rate or at the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment and they are not separately identified for impairment disclosures. Troubled debt restructurings are also considered impaired with impairment generally measured at the present value of estimated future cash flows using the loan's effective rate at inception or using the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure, primarily other real estate owned, are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed unless they add value to the property.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

We recognize a tax position as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. We recognize interest and penalties related to income tax matters in income tax expense.

The realization of deferred tax assets (net of a recorded valuation allowance) is largely dependent upon future taxable income, future reversals of existing taxable temporary differences and the ability to carryback losses to available tax years. In assessing the need for a valuation allowance, we consider all relevant positive and negative evidence, including taxable income in carry-back years, scheduled reversals of deferred tax liabilities, expected future taxable income and available tax planning strategies.

As of January 1, 2010, we no longer have the ability to carryback losses to prior years. The realization of our deferred tax assets is largely dependent on generating income in future years. At June 30, 2012, the need to maintain a full valuation allowance was based primarily on our net operating losses for recent years and the continuing weak economic conditions that could impact our ability to generate future earnings. The valuation allowance may be reversed to income in future periods to the extent that the related deferred tax assets are realized or the valuation allowance is no longer required.

Adoption of New Accounting Standards: The FASB has issued ASU 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. The ASU is intended to improve financial reporting of repurchase agreements ("repos") and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. In a typical repo transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Codification Topic 860, Transfers and Servicing, prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repo agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred financial assets. The amendments to the Codification in this ASU are intended to improve the accounting for these transactions by removing from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets. The guidance in the ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Adoption of this ASU did not have any effect as the Company does not currently hold any such repurchase agreements.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The FASB has issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the Codification in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. Disclosure of the fair value levels of our financial assets and financial liabilities was added to Note 5 upon adoption of this standard in the first quarter of 2012.

The FASB has issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU amends accounting standards to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in the ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We early adopted this standard with our 2011 annual financial statements by adding a statement of comprehensive income.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 – SECURITIES

The amortized cost and fair value of securities at period-end were as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2012				
Available for Sale:				
U.S. Treasury and federal agency securities	$30,283	$248	$(6)	$30,525
U.S. Agency MBS and CMOs	23,248	162	(41)	23,369
Tax-exempt state and municipal bonds	15,304	153	(77)	15,380
Taxable state and municipal bonds	20,920	548	(20)	21,448
Corporate bonds and other debt securities	4,216	23	(5)	4,234
Other equity securities	1,500	62	---	1,562
	$95,471	$1,196	$(149)	$96,518
Held to Maturity				
State and municipal bonds	$300	$---	$---	$300
December 31, 2011				
Available for Sale:				
U.S. Treasury and federal agency securities	$27,408	$205	$---	$27,613
U. S. Agency MBS and CMOs	3,853	33	---	3,886
Tax-exempt state and municipal bonds	4,292	116	---	4,408
Taxable state and municipal bonds	16,531	239	(54)	16,716
Corporate bonds	1,081	1	(1)	1,081
Other equity securities	1,000	42	---	1,042
	$54,165	$636	$(55)	$54,746
Held to Maturity:				
State and municipal bonds	$300	$---	$---	$300

Proceeds from the sale of securities available for sale were $4.1 million for the three and six month periods ended June 30, 2012, resulting in net gains of $59,000. There were no sales of securities in the three and six month periods ended June 30, 2011.

Contractual maturities of debt securities at June 30, 2012 were as follows (dollars in thousands):

	Held–to-Maturity Securities		Available-for-Sale Securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$---	$---	$---	$---
Due from one to five years	---	---	30,826	31,383

Due from five to ten years	---	---	33,715	34,069
Due after ten years	300	300	29,430	29,504
	$300	$300	$93,971	$94,956

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 – SECURITIES (Continued)

Securities with unrealized losses at June 30, 2012 and December 31, 2011, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
June 30, 2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$2,014	$(6)	$---	$---	$2,014	$(6)
U.S. Agency MBS and CMOs	11,532	(41)	---	---	11,532	(41)
Tax-exempt state and municipal bonds	7,654	(77)	---	---	7,654	(77)
Taxable state and municipal bonds	1,407	(20)	---	---	1,407	(20)
Corporate bonds and other debt securities	536	(5)	---	---	536	(5)
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	$23,143	$(149)	$---	$---	$23,143	$(149)

	Less than 12 Months		12 Months or More		Total	
December 31, 2011	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$ ---	$ ---	$ ---	$ ---	$ ---	$ ---
U.S. Agency MBS and CMOs	---	---	---	---	---	---
Tax-exempt state and municipal bonds	---	---	---	---	---	---
Taxable state and municipal bonds	6,196	(54)	---	---	6,196	(54)
Corporate bonds	539	(1)			539	(1)
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	$ 6,735	$ (55)	$ ---	$ ---	$ 6,735	$ (55)

Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management determined that no OTTI charges were necessary during the three and six month periods ended June 30, 2012 and 2011.

At both June 30, 2012 and December 31, 2011, securities with a carrying value of approximately $2.0 million were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law.

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS

Portfolio loans were as follows (dollars in thousands):

	June 30, 2012	December 31, 2011
Commercial and industrial	$ 221,628	$ 227,051
Commercial real estate:		
Residential developed	28,464	33,829
Unsecured to residential developers	589	5,937
Vacant and unimproved	60,115	66,046
Commercial development	4,772	4,586
Residential improved	79,169	82,337
Commercial improved	283,293	304,070
Manufacturing and industrial	75,531	71,462
Total commercial real estate	531,933	568,267
Consumer		
Residential mortgage	170,983	156,891
Unsecured	1,776	1,952
Home equity	96,535	101,074
Other secured	14,110	15,740
Total consumer	283,404	275,657
Total loans	1,036,965	1,070,975
Allowance for loan losses	(27,180)	(31,641)
	$ 1,009,785	$ 1,039,334

Activity in the allowance for loan losses by portfolio segment was as follows (dollars in thousands):

Three months ended June 30, 2012:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,507	$ 17,565	$ 4,366	$ 13	$ 29,451
Charge-offs	(21)	(799)	(79)	---	(899)
Recoveries	110	201	67	---	378
Provision for loan losses	(958)	(1,728)	900	36	(1,750)
Ending balance	$ 6,638	$ 15,239	$ 5,254	$ 49	$ 27,180

Commercial Commercial

Three months ended June 30, 2011:	and Industrial	Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,191	$ 30,707	$ 4,423	$ 22	$ 42,343
Charge-offs	(783)	(3,129)	(518)	---	(4,430)
Recoveries	1,083	387	94	---	1,564
Provision for loan losses	(2,000)	(1,150)	1,116	34	(2,000)
Ending balance	$ 5,491	$ 26,815	$ 5,115	$ 56	$ 37,477

- 15 -

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

Six months ended June 30, 2012:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 6,313	$ 20,475	$ 4,821	$ 32	$ 31,641
Charge-offs	(989)	(2,506)	(901)	---	(4,396)
Recoveries	280	4,885	120	---	5,285
Provision for loan losses	1,034	(7,615)	1,214	17	(5,350)
Ending balance	$ 6,638	$ 15,239	$ 5,254	$ 49	$ 27,180

Six months ended June 30, 2011:	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 7,012	$ 34,973	$ 5,415	$ 26	$ 47,426
Charge-offs	(1,587)	(5,526)	(1,449)	---	(8,562)
Recoveries	1,277	637	149	---	2,063
Provision for loan losses	(1,211)	(3,269)	1,000	30	(3,450)
Ending balance	$ 5,491	$ 26,815	$ 5,115	$ 56	$ 37,477

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method (dollars in thousands):

June 30, 2012:

	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 4,230	$ 3,717	$ 2,520	$ ---	$ 10,467
Collectively evaluated for impairment	2,408	11,522	2,734	49	16,713
Total ending allowance balance	$ 6,638	$ 15,239	$ 5,254	$ 49	$ 27,180
Loans:					
Individually reviewed for impairment	$ 12,829	$ 51,901	$ 16,199	$ ---	$ 80,929
Collectively evaluated for impairment	208,799	480,032	267,205	---	956,036
Total ending loans balance	$ 221,628	$ 531,933	$ 283,404	$ ---	$ 1,036,965

December 31, 2011:

	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:					

Ending allowance attributable to loans:					
Individually reviewed for impairment	$ 3,478	$ 4,367	$ 1,752	$ ---	$ 9,597
Collectively evaluated for impairment	2,835	16,108	3,069	32	22,044
Total ending allowance balance	$ 6,313	$ 20,475	$ 4,821	$ 32	$ 31,641
Loans:					
Individually reviewed for impairment	$ 17,331	$ 52,195	$ 15,085	$ ---	$ 84,611
Collectively evaluated for impairment	209,720	516,072	260,572	---	986,364
Total ending loans balance	$ 227,051	$ 568,267	$ 275,657	$ ---	$ 1,070,975

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2012 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$4,819	$2,446	$---
Commercial real estate:			
Residential developed	6,481	5,584	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	2,115	1,418	---
Commercial development	217	217	---
Residential improved	5,056	4,190	---
Commercial improved	7,671	6,576	---
Manufacturing and industrial	4,496	4,496	---
	26,036	22,481	---
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	200	200	---
Other secured	---	---	---
	200	200	---
	$31,055	$25,127	$---
With an allowance recorded:			
Commercial and industrial	$10,383	$10,383	$4,230
Commercial real estate:			
Residential developed	2,648	2,648	1,200
Unsecured to residential developers	---	---	---
Vacant and unimproved	2,995	2,995	651
Commercial development	---	---	---
Residential improved	9,062	9,062	789
Commercial improved	9,900	9,900	904
Manufacturing and industrial	4,815	4,815	173
	29,420	29,420	3,717
Consumer:			
Residential mortgage	15,213	15,213	2,469
Unsecured	---	---	---
Home equity	786	786	51
Other secured	---	---	---

	15,999	15,999	2,520
	$55,802	$55,802	$10,467
Total	$86,857	$80,929	$10,467

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2011 (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
With no related allowance recorded:			
Commercial and industrial	$3,485	$3,485	$---
Commercial real estate:			
Residential developed	6,432	2,021	---
Unsecured to residential developers	---	---	---
Vacant and unimproved	5,226	4,265	---
Commercial development	---	---	---
Residential improved	1,943	1,858	---
Commercial improved	5,428	5,162	---
Manufacturing and industrial	3,997	3,997	---
	23,026	17,303	---
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	200	200	---
Other secured	---	---	---
	200	200	---
	$26,711	$20,988	$---
With an allowance recorded:			
Commercial and industrial	$17,052	$13,846	$3,478
Commercial real estate:			
Residential developed	4,941	4,941	1,960
Unsecured to residential developers	---	---	---
Vacant and unimproved	3,378	2,462	154
Commercial development	220	220	17
Residential improved	12,312	11,809	1,176
Commercial improved	10,590	10,555	844
Manufacturing and industrial	4,905	4,905	216
	36,346	34,892	4,367
Consumer:			
Residential mortgage	14,235	14,114	1,713
Unsecured	---	---	---
Home equity	771	771	39
Other secured	---	---	---
	15,006	14,885	1,752

	$68,404	$63,623	$9,597
Total	$95,115	$84,611	$9,597

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

The following table presents information regarding average balances of impaired loans and interest recognized on impaired loans for the three and six month periods ended June 30, 2012 and 2011 (dollars in thousands):

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Average of impaired loans during the period:				
Commercial and industrial	$14,788	$6,608	$16,874	$5,532
Commercial real estate:				
Residential developed	8,351	12,111	8,445	14,414
Unsecured to residential developers	---	795	---	864
Vacant and unimproved	3,862	6,197	3,672	5,483
Commercial development	217	223	218	567
Residential improved	13,440	9,741	13,993	9,144
Commercial improved	17,280	17,823	16,690	20,158
Manufacturing and industrial	9,299	6,632	9,384	7,613
Consumer	16,136	12,381	16,030	12,594
Interest income recognized during impairment:				
Commercial and industrial	465	79	827	65
Commercial real estate	626	446	1,211	969
Consumer	144	97	278	207
Cash-basis interest income recognized				
Commercial and industrial	487	70	815	122
Commercial real estate	627	398	1,215	907
Consumer	139	102	276	213

Index

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 – LOANS (Continued)

Nonaccrual loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of June 30, 2012:

	Nonaccrual	Over 90 days Accruing
Commercial and industrial	$6,146	$27
Commercial real estate:		
Residential developed	5,461	---
Unsecured to residential developers	---	---
Vacant and unimproved	118	---
Commercial development	422	---
Residential improved	2,149	---
Commercial improved	2,710	---
Manufacturing and industrial	257	---
	11,117	---
Consumer:		
Residential mortgage	978	---
Unsecured	21	---
Home equity	590	---
Other secured	---	---