

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

FORM 10-Q

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

For the quarterly period ended March 31, 2005

OR

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  
(State or other jurisdiction of  
incorporation or organization)

38-2062816  
(I.R.S. Employer Identification No.)

130 SOUTH CEDAR STREET, MANISTIQUE, MI  
(Address of principal executive offices)

49854  
(Zip Code)

Registrant's telephone number, including area code: (800) 200-7032

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  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of April 30, 2005, there were outstanding 3,428,695 shares of the registrant's common stock, no par value.

MACKINAC FINANCIAL CORPORATION  
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MACKINAC FINANCIAL CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Dollars in Thousands)

	March 31, 2005 <u>(Unaudited)</u>	December 31, 2004	March 31, 2004 <u>(Unaudited)</u>
<b>ASSETS</b>			
Cash and due from banks	\$ 3,656	\$ 4,230	\$ 5,421
Federal funds sold	<u>10,207</u>	<u>39,848</u>	<u>40,698</u>
Cash and cash equivalents	13,863	44,078	46,119
Interest-bearing deposits in other financial institutions	14	18,535	12,695
Securities available for sale	52,298	57,075	65,305
Federal Home Loan Bank stock	4,805	4,754	4,601
Total loans	194,831	203,832	255,021
Allowance for loan losses	<u>(6,836)</u>	<u>(6,966)</u>	<u>(12,730)</u>
Net loans	187,995	196,866	242,291
Premises and equipment	10,588	10,739	13,222
Other real estate held for sale	1,515	1,730	3,861
Other assets	<u>4,138</u>	<u>5,720</u>	<u>12,335</u>
Total assets	<u>\$ 275,216</u>	<u>\$ 339,497</u>	<u>\$ 400,429</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Liabilities:			
Non-interest-bearing deposits	\$ 19,722	\$ 20,956	\$ 24,378
Interest-bearing deposits	<u>185,517</u>	<u>194,694</u>	<u>262,694</u>
Total deposits	205,239	215,650	287,072
Borrowings	38,135	85,039	87,026
Subordinated debentures	-0-	-0-	12,450
Other liabilities	<u>2,988</u>	<u>4,078</u>	<u>4,510</u>
Total liabilities	246,362	304,767	391,058
Shareholders' equity:			
Preferred stock - No par value:			
Authorized -500,000 shares, no shares outstanding	-0-	-0-	-0-
Common stock - No par value:			
Authorized - 18,000,000 shares			
Issued and outstanding - 3,428,695			
3,428,695 and 350,958, respectively	42,335	42,335	16,175
Accumulated deficit	(13,338)	(8,097)	(8,169)
Accumulated other comprehensive income (loss)	<u>(143)</u>	<u>492</u>	<u>1,365</u>
Total shareholders' equity	<u>28,854</u>	<u>34,730</u>	<u>9,371</u>
Total liabilities and shareholders' equity	<u>\$ 275,216</u>	<u>\$ 339,497</u>	<u>\$ 400,429</u>

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	----- March 31, -----	
	2005	2004
Interest income:		
Interest and fees on loans:		
Taxable	\$ 3,059	\$ 3,796
Tax-exempt	242	319
Interest on securities:		
Taxable	462	698
Tax-exempt	42	43
Other interest income	183	120
Total interest income	3,988	4,976
Interest expense:		
Deposits	1,130	1,665
Borrowings	653	1,181
Subordinated debentures	-0-	119
Total interest expense	1,783	2,965
Net interest income	2,205	2,011
Provision for loan losses	-0-	-0-
Net interest income after provision for loan losses	2,205	2,011
Other income:		
Service fees	161	293
Loan and lease fees	7	5
Net security losses	(1)	-0-
Net gains on sales of loans	-0-	12
Gain on sale of property and equipment	2	-0-
Other	15	353
Total other income	184	663
Other expenses:		
Salaries and employee benefits	1,504	1,499
Furniture and equipment	159	258
Occupancy	226	347
Data processing	246	355
Accounting, legal, and consulting fees	318	406
Loan and deposit	293	493
Telephone	60	213
Advertising	139	17
Penalty on prepayment of FHLB borrowings	4,320	-0-
Other	365	753
Total other expenses	7,630	4,341
Loss before provision for income taxes	(5,241)	(1,667)
Provision for income taxes	-0-	-0-
Net loss	\$ (5,241)	\$ (1,667)
Loss per common share:		
Basic	\$ (1.53)	\$ (4.75)
Diluted	\$ (1.53)	\$ (4.75)

See accompanying notes to condensed consolidated financial statements.

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

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	Three Months Ended	
	----- March 31, -----	
	<u>2005</u>	<u>2004</u>
Balance, beginning of period	\$ 34,730	\$ 10,700
Net loss for period	(5,241)	(1,667)
Net unrealized gain (loss) on securities available for sale	<u>(635)</u>	<u>338</u>
Total comprehensive loss	<u>(5,876)</u>	<u>(1,329)</u>
Balance, end of period	<u>\$ 28,854</u>	<u>\$ 9,371</u>

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See accompanying notes to condensed consolidated financial statements.

MACKINAC FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in thousands)  
(Unaudited)

	Three Months Ended	
	----- March 31, -----	
	2005	2004
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Net loss	\$ (5,241)	\$ (1,667)
Adjustments to reconcile net loss to		
net cash provided by (used in) operating activities:		
Depreciation and amortization	248	456
Provision for impairment of other real estate held for sale	-0-	15
Provision for impairment of bank premises and equipment	-0-	193
Loss on sales of securities	-0-	-0-
FHLB stock dividend	(51)	(57)
(Gain) loss on sale of premises, equipment, and other real estate	(4)	24
Change in other assets	1,551	(2,199)
Change in other liabilities	(1,090)	(2,059)
Net cash (used in) operating activities	(4,587)	(5,294)
Cash flows from investing activities:		
Net increase in interest-bearing deposits in other financial institutions	18,521	(6,647)
Purchase of securities available for sale	(16,009)	(5,000)
Proceeds from sales of securities available for sale	18,674	-0-
Proceeds from maturities, calls, or paydowns of securities available for sale	1,447	24,713
Net decrease in loans	8,840	33,236
Purchase of premises and equipment	(36)	(19)
Proceeds from sale of premises, equipment, and other real estate	250	819
Net cash provided by investing activities	31,687	47,102
Cash flows from financing activities:		
Net decrease in deposits	(10,411)	(18,722)
Proceeds from borrowings	1,651	-0-
Principal payments on borrowings	(48,555)	-0-
Net cash used in financing activities	(57,315)	(18,722)
Net change in cash and cash equivalents	(30,215)	23,086
Cash and cash equivalents at beginning of period	44,078	23,033
Cash and cash equivalents at end of period	\$ 13,863	\$ 46,119
Supplemental cash flow information:		
Cash paid for:		
Interest	\$ 1,896	\$ 2,973
Income taxes	-0-	-0-
Transfers of foreclosures from loans to other real estate held for sale	31	314

See accompanying notes to condensed consolidated financial statements.

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 three-month period ended March 31, 2005, are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. 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, 2004.

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 was not changed due to these reclassifications.

**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 during 2000 and applies to officers, employees, and nonemployee directors. This plan was amended as a part of the recently completed 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 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 split), were made available for

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

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

The fair value of each option granted is estimated on the grant date using the Black-Scholes methodology. The following assumptions were made in estimating fair value for options granted for the year ended December 31, 2004. The weighted average fair value of options granted in 2004 as of their grant date, using the assumptions shown below, was calculated at \$2.80 per share. There were no options granted in the first quarter of 2005.

	2004
Dividend yield	0.00%
Risk-free interest rate	3.25%
Weighted average expected life (years)	4.0
Expected volatility	30.00%

The Corporation accounts for stock options using the intrinsic value method. For all options granted, the intrinsic value was zero; therefore, no compensation cost has been recognized for the plans. Had compensation cost been determined on the basis of fair value, net income and earnings per share would have been reduced for the three months ended March 31, 2005 and 2004 as follows (dollars in thousands, except per share data):

	March 31, 2005	March 31, 2004
<u>Net loss:</u>		
As reported	\$ (5,241)	\$ (1,667)
Total stock-based compensation expense determined under fair value-based method	(49)	-0-
Pro forma	\$ (5,290)	\$ (1,667)
 <u>Loss per share - Basic:</u>		
As reported	\$ (1.53)	\$ (4.75)
Pro forma	\$ (1.54)	\$ (4.75)
 <u>Loss per share - Diluted:</u>		
As reported	\$ (1.53)	\$ (4.75)
Pro forma	\$ (1.54)	\$ (4.75)
Weighted average shares outstanding	3,428,695	350,958

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 was not changed due to these reclassifications.

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See accompanying notes to condensed consolidated financial statements.

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

**2. RECENT ACCOUNTING PRONOUNCEMENT**

In December 2004, the FASB re-issued SFAS No. 123 "Accounting for Stock-Based Compensation" which becomes effective for interim periods beginning after June 15, 2005. (Note: This date has now been extended to December 31, 2005). 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 Statement requires entities to recognize the cost of employee services received in exchange for these stock options. This Statement applies to all unvested awards outstanding as of the effective date. The Corporation plans to adopt SFAS No. 123 for the period beginning after December 31, 2005 and does not expect a material impact on the Corporation's Consolidated Financial Statements.

**3. EARNINGS (LOSS) PER SHARE**

Earnings (loss) per share are based upon the weighted average number of shares outstanding.

The following shows the computation of basic and diluted earnings (loss) per share for the three months ended March 31, 2005 and 2004 (dollars in thousands, except per share data):

	Three Months Ended March 31,	
	<u>2005</u>	<u>2004</u>
Basic loss per common share:		
Net loss	\$ <u>(5,241)</u>	\$ <u>(1,667)</u>
Weighted average common shares outstanding	<u>3,428,695</u>	<u>350,958</u>
Basic loss per common share	\$ <u>(1.53)</u>	\$ <u>(4.75)</u>
Diluted loss per common share:		
Net loss	\$ <u>(5,241)</u>	\$ <u>(1,667)</u>
Weighted average common shares outstanding for basic loss per common share	3,428,695	350,958
Add: Dilutive effect of assumed exercise of stock options	<u>-0-</u>	<u>-0-</u>
Average shares and dilutive potential common shares	<u>3,428,695</u>	<u>350,958</u>
Diluted loss per common share	\$ <u>(1.53)</u>	\$ <u>(4.75)</u>

Additional shares issued as a result of option exercises would be antidilutive in both periods due to the consolidated loss and are therefore not shown in the diluted loss per share calculation.

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See accompanying notes to condensed consolidated financial statements.

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

**4. INVESTMENT SECURITIES**

The amortized cost and estimated fair value of investment securities available for sale as of March 31, 2005, December 31, 2004, and March 31, 2004 are as follows (dollars in thousands):

	March 31, 2005		December 31, 2004		March 31, 2004	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
US Agencies	\$ 34,998	\$ 34,466	\$ 21,980	\$ 21,843	\$ 21,021	\$ 21,241
Obligations of states and political subdivisions	3,710	4,004	3,711	4,029	3,772	4,212
Corporate securities	668	675	667	681	666	708
Mortgage-related securities	13,065	13,153	30,225	30,522	38,481	39,144
Total securities available for sale	<u>\$ 52,441</u>	<u>\$ 52,298</u>	<u>\$ 56,583</u>	<u>\$ 57,075</u>	<u>\$ 63,940</u>	<u>\$ 65,305</u>

The amortized cost and estimated fair value of investment securities pledged to treasury deposits and borrowings were \$1.008 million and \$1.001 million, respectively, at March 31, 2005.

**5. LOANS**

The composition of loans at March 31, 2005, December 31, 2004, and March 31, 2004 is as follows (dollars in thousands):

	March 31, 2005	December 31, 2004	March 31, 2004
Commercial real estate	\$ 100,911	\$ 105,619	\$ 142,960
Commercial, financial, and agricultural	43,632	47,446	62,337
One to four family residential real estate	45,425	45,292	46,221
Consumer	2,277	2,379	2,867
Construction	2,586	3,096	636
Total loans	<u>\$ 194,831</u>	<u>\$ 203,832</u>	<u>\$ 255,021</u>

***LOANS – Allowance for loan losses***

An analysis of the allowance for loan losses for the three months ended March 31, 2005, the year ended December 31, 2004, and the three months ended March 31, 2004 is as follows: (dollars in thousands):

	March 31, 2005	December 31, 2004	March 31, 2004
Balance at beginning of period	\$ 6,966	\$ 22,005	\$ 22,005
Provision for loan losses	-0-	-0-	-0-
Recoveries on loans	97	719	113
Loans charged off	(227)	(15,758)	(9,388)
Balance at end of period	<u>\$ 6,836</u>	<u>\$ 6,966</u>	<u>\$ 12,730</u>

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

In the first quarter of 2005, net charge off activity was minimal at \$130,000, or .07% of average loans outstanding. The allowance for loan losses was significantly impacted by loan charge offs in the first quarter of 2004. The Corporation completed the sale of \$25.2 million of loans, primarily nonperforming, during the first quarter of 2004 which resulted in a previously allocated specific reserve on these loans being recognized as a charge off. This specific reserve charge off amounted to \$7.4 million.

The aggregate amount of nonperforming residential and consumer loans was approximately \$981,000, \$888,000 and \$523,000 at March 31, 2005, December 31, 2004, and March 31, 2004, respectively. 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 of interest or principal. The interest income recorded and that which would have been recorded had residential and consumer nonaccrual and renegotiated loans been current, or not troubled, are not material to the consolidated financial statements for the three months ended March 31, 2005 and 2004. The nonperforming commercial loans are reflected in the information regarding impaired loans.

**LOANS – Impaired loans**

Information regarding impaired loans as of March 31, 2005, December 31, 2004, and March 31, 2004 is as follows (dollars in thousands):

	March 31, 2005	December 31, 2004	March 31, 2004	Valuation Reserve		
				March 31, 2005	December 31, 2004	March 31, 2004
Balances, at period end						
Impaired loans with specific valuation reserve	\$ 85	\$ 608	\$ 14,478	\$ 83	\$ 136	\$ 3,069
Impaired loans with no specific valuation reserve	2,187	3,699	7,768	-0-	-0-	-0-
Total impaired loans	<u>\$ 2,272</u>	<u>\$ 4,307</u>	<u>\$ 22,246</u>	<u>\$ 83</u>	<u>\$ 136</u>	<u>\$ 3,069</u>
Impaired loans on nonaccrual basis	\$ 2,272	\$ 4,307	\$ 17,774	\$ 83	\$ 136	\$ 2,861
Impaired loans on accrual basis	-0-	-0-	4,472	-0-	-0-	208
Total impaired loans	<u>\$ 2,272</u>	<u>\$ 4,307</u>	<u>\$ 22,246</u>	<u>\$ 83</u>	<u>\$ 136</u>	<u>\$ 3,069</u>
Average investment in impaired loans	\$ 3,290	\$ 17,036	\$ 33,037			
Interest income recognized during impairment	21	1,053	123			
Interest income that would have been recognized on an accrual basis	55	803	348			
Cash-basis interest income recognized	21	863	15			

The average investment in impaired loans was approximately \$3.290 million for the three-months ended March 31, 2005, \$17.036 million for the year ended December 31, 2004, and \$33.037 million for the three months ended March 31, 2004, respectively. Impacting the impaired loan balances in 2004 were \$40.0 million of loan sales, primarily nonperforming loans, which included \$22.9 million of nonaccrual loans.

**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.

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

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

	March 31, 2005	December 31, 2004	March 31, 2004
Loans outstanding, beginning of period	\$ 63	\$ 6,514	\$ 6,514
New loans	-0-	365	-0-
Net activity on revolving lines of credit	-0-	-0-	-0-
Repayment	(11)	(765)	(166)
Decrease related to retired executive officers and directors	-0-	(6,051)	-0-
Loans outstanding, end of period	<u>\$ 52</u>	<u>\$ 63</u>	<u>\$ 6,348</u>

There were no loans to related parties classified substandard at March 31, 2005, December 31, 2004, and March 31, 2004 respectively.

**6. BORROWINGS**

Borrowings consist of the following at March 31, 2005, December 31, 2004, and March 31, 2004 (dollars in thousands):

	March 31, 2005	December 31, 2004	March 31, 2004
Federal Home Loan Bank advances at rates ranging from 4.35% to 5.16% maturing in 2010 and 2011	\$ 35,000	\$ 83,555	\$ 85,475
Term loan credit, with a correspondent bank, Canadian prime less 1/2%, maturing February 2006	1,651	-0-	-0-
Farmers Home Administration, fixed-rate note payable, maturing August 24, 2024, interest payable at 1%	<u>1,484</u>	<u>1,484</u>	<u>1,551</u>
	<u>\$ 38,135</u>	<u>\$ 85,039</u>	<u>\$ 87,026</u>

In the first quarter of 2005, the Corporation prepaid \$48.555 million of the Federal Home Loan Bank ("FHLB") borrowings and incurred a prepayment penalty of \$4.320 million. This early payoff of FHLB borrowings reduced interest rate risk and better positions the Corporation for future match funding of loan growth.

The Federal Home Loan Bank borrowings are collateralized at March 31, 2005, by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately \$31,839,000; U.S. government agency and mortgage-backed securities with an amortized cost and estimated fair value of \$18,065,000 and \$18,040,000, respectively; and Federal Home Loan Bank stock owned by the Bank totaling \$4,804,700. 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 March 31, 2005.

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling \$547,000 originated and held by the Corporation's wholly owned subsidiary, First Rural Relending, an assignment of a demand deposit account in the amount of \$1,075,000, and guaranteed by the Corporation. The term loan credit is collateralized by an investment security with an amortized cost of \$2.000 million and an estimated fair value of \$1.965 million.

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See accompanying notes to condensed consolidated financial statements.

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

**7. STOCK OPTION PLANS**

A summary of stock option transactions for the three months ended March 31, 2005 and 2004 and the year ended December 31, 2004, is as follows: (Historical stock option information has been adjusted for the 1:20 reverse stock split which occurred in December, 2004).

	<u>March 31, 2005</u>	<u>December 31, 2004</u>	<u>March 31, 2004</u>
Outstanding shares at beginning of period	282,999	27,483	27,483
Granted during the period	-0-	257,152	-0-
Expired during the period	<u>-0-</u>	<u>(1,636)</u>	<u>(270)</u>
Outstanding shares at end of period	<u>282,999</u>	<u>282,999</u>	<u>27,213</u>
Weighted average exercise price per share at end of period	<u>\$ 34.55</u>	<u>\$ 34.55</u>	<u>\$ 280.60</u>
Shares available for grant at end of period	<u>138,899</u>	<u>138,899</u>	<u>18,182</u>

Options granted in 2004 were granted at a price of \$9.75 per share, the approximate fair market value at date of grant. Under these plans, options expire ten years after the date of grant.

Following is a summary of the options outstanding and exercisable at March 31, 2005:

Exercise Price Range	<u>Number</u>		Weighted Average Remaining Contractual Life-Years	Weighted Average Exercise Price
	<u>Outstanding</u>	<u>Exercisable</u>		
\$9.75	257,152	120,861	9.7	\$ 9.75
\$156.00 - \$240.00	11,850	11,850	4.1	182.07
\$300.00 - \$406.60	<u>13,997</u>	<u>13,997</u>	<u>2.9</u>	<u>365.34</u>
	<u>282,999</u>	<u>146,708</u>	<u>9.1</u>	<u>\$ 34.55</u>

**8. SUBORDINATED DEBENTURES**

As part of the recapitalization through the issuance of \$30 million in common stock in a private placement, the subordinated debentures were paid off. This payoff settlement was negotiated with all of the holders of the subordinated debentures. The payment for the debentures was in settlement of \$12,450,000 in principal and accrued interest. The total settlement price was \$6,500,000 and resulted in the Corporation recording a gain on the settlement of \$6,617,000. The settlement of this liability also included the accrued interest of approximately \$1.2 million.

**9. CAPITAL**

On December 16, 2004, the Corporation consummated a recapitalization through the issuance of \$30 million of common stock in a private placement. The net proceeds of this offering amounted to \$26.2 million. This recapitalization provided the funding to enable the Corporation to recapitalize the Bank with a \$15.5 million

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See accompanying notes to condensed consolidated financial statements.

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capital infusion. This capital infusion provided the Bank with enough capital to be deemed a “well capitalized” institution by regulatory standards.

**10. 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):

	March 31, 2005	December 31, 2004	March 31, 2004
Commitments to extend credit:			
Fixed rate	\$ 1,054	\$ 638	\$ 887
Variable rate	12,578	10,889	6,014
Standby letters of credit - Variable rate	11,338	17,970	14,557
Credit card commitments - Fixed rate	2,810	2,995	3,355
	<u>\$ 27,780</u>	<u>\$ 32,492</u>	<u>\$ 24,813</u>

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.

See accompanying notes to condensed consolidated financial statements.

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**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 loans to entities within the hospitality and tourism industry. This concentration represents \$45.4 million, or 31.4%, of the commercial loan portfolio at March 31, 2005. The remainder of the commercial loan portfolio is diversified in such categories as gaming, petroleum, forestry, and agriculture. 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 locality.

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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:

- Impact of continued operating losses;
- 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.

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, 2004. Throughout this discussion, the term "Bank" refers to mBank, formerly known as North Country Bank and Trust, the principal banking subsidiary of the Corporation.

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FINANCIAL OVERVIEW

Year-to-date consolidated net loss was \$5.241 million through March 31, 2005, compared to net loss of \$1.667 million for the same period in 2004. Basic loss per share was \$1.53 for the three months ended March 31, 2005, compared to a loss of \$4.75 for the same period in 2004. There was no provision for loan losses for the three months ended March 31, 2005 and March 31, 2004. Total assets declined \$64.281 million from December 31, 2004 to March 31, 2005. The loan portfolio declined \$9.001 million in the first quarter of 2005, from December 31, 2004 balances of \$203.832 million. Deposits totaled \$205.239 million at March 31, 2005, a decline of \$10.411 million from the \$215.650 million at December 31, 2004.

FINANCIAL CONDITION

**Cash and Cash Equivalents**

Cash and cash equivalents decreased \$30.215 million in 2005. This was due to the utilization of the excess liquidity, which existed at December 31, 2004, to prepay FHLB borrowings in the first quarter of 2005. See further discussion of the change in cash and cash equivalents in the Liquidity section.

**Investment Securities**

Available-for-sale securities decreased \$4.777 million, or 8.4%, from December 31, 2004 to March 31, 2005, with the balance on March 31, 2005, totaling \$52.298 million. The decrease during the first quarter was due to a combination of maturities, calls, and paydowns of agencies and mortgage related securities. In the first quarter of 2005, the Corporation sold \$18.7 million of callable mortgage backed securities and reinvested the proceeds in shorter term US agencies. This repositioning was done with lower interest rate and principal risk in anticipation of future rate increases. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of March 31, 2005, investment securities with an estimated fair value of \$19.041 million were pledged.

**Loans**

Through the first quarter of 2005, loan balances decreased by \$9.001 million, or 4.4% from December 31, 2004 balances of \$203.832 million. During the first quarter, the Bank experienced a high level, \$16.8 million, of loan payoffs along with normal principal reduction of \$2.3 million. These loan payoffs, which included approximately \$2.3 million of nonaccrual loans, were higher than anticipated and are not expected to continue at this level. New loan production in the first quarter totaled \$10.1 million. The Bank recently added additional commercial lending staff and will be adding mortgage lenders later in the year. It is anticipated that with the addition of lending staff, along with the extensive marketing campaign and introduction of new and more competitive loan products, future periods will benefit from increased loan production. The Bank sold \$25.2 million of loans in the first quarter of 2004. This sale was composed of primarily non-performing loans and resulted in a reduction in non-accrual loans of \$17.5 million and a total reduction in non-performing loans of \$18.5 million. This loan sale also reduced concentration exposure in the hotel and tourism industry. 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. As shown in the table below, most segments of the loan portfolio declined in the first quarter of 2005. Management intends to increase lending activities in its market for mortgage, consumer, and commercial loan products while concentrating on loan quality, industry concentration issues, and competitive pricing.

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See accompanying notes to condensed consolidated financial statements.

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Following is a summary of the loan portfolio at March 31, 2005, December 31, 2004, and March 31, 2004 (dollars in thousands):

	March 31, 2005	Percent of Total	December 31, 2004	Percent of Total	March 31, 2004	Percent of Total
Commercial real estate	\$ 100,911	51.79 %	\$ 105,619	51.82 %	\$ 35,117	13.77 %
Commercial, financial, and agricultural	43,632	22.39	47,446	23.28	170,180	66.74
1-4 family residential real estate	45,425	23.32	45,292	22.22	46,221	18.12
Consumer	2,277	1.17	2,379	1.16	2,867	1.12
Construction	2,586	1.33	3,096	1.52	636	.25
<b>Total loans</b>	<b>\$ 194,831</b>	<b>100.00 %</b>	<b>\$ 203,832</b>	<b>100.00 %</b>	<b>\$ 255,021</b>	<b>100.00 %</b>

Following is a table showing the significant industry types in the commercial loan portfolio as of March 31, 2005, December 31, 2004, and March 31, 2004 (dollars in thousands):

	March 31, 2005			December 31, 2004			March 31, 2004		
	Outstanding Balance	Percent of Commerical Loans	Percent of Shareholders' Equity	Outstanding Balance	Percent of Commerical Loans	Percent of Shareholders' Equity	Outstanding Balance	Percent of Commerical Loans	Percent of Shareholders' Equity
Hospitality and tourism	\$ 45,390	31.40 %	157.31 %	\$ 52,659	34.40 %	151.62 %	\$ 54,418	26.50 %	580.70 %
Gaming	12,618	8.73	43.73 %	14,310	9.35	41.20 %	20,746	10.11	221.39 %
Petroleum	7,939	5.49	27.51 %	7,718	5.04	22.22 %	5,331	2.60	56.89 %
Forestry	5,486	3.80	19.01 %	2,245	1.47	6.46 %	1,300	.63	13.87 %
Other	73,110	50.58	253.38 %	76,133	49.74	219.21 %	123,502	60.16	1,317.92 %
<b>Total Commercial Loans</b>	<b>\$ 144,543</b>	<b>100.00 %</b>		<b>\$ 153,065</b>	<b>100.00 %</b>		<b>\$ 205,297</b>	<b>100.00 %</b>	

Management has made considerable progress in reducing concentrations of hospitality and tourism loans, which reduced exposure to this economic segment and lowered overall loan portfolio risk. Management expects further reductions in concentrations of hospitality and tourism loans through a combination of new loans in other industries and paydowns and maturities of current portfolio loans in this sector.

### **Credit Quality**

The allowance for loan losses is maintained by management at a level considered to be adequate to cover probable losses related to specifically identified loans, as well as losses inherent in the balance of the loan portfolio. At March 31, 2005, the allowance for loan losses was 3.51% of total loans outstanding compared to 3.42% at December 31, 2004 and 4.99% at March 31, 2004.

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 to average loans outstanding amounted to .07% and 3.21% for the three months ended March 31, 2005 and 2004, respectively. Net charge-offs for the three-month period ended March 31, 2005, were \$.130 million compared to \$9.275 million for the same period in 2004. Charge-offs during the first quarter of 2004 include \$7.4 million of charge-offs incurred as a result of the sale of \$25.2 million of primarily non-performing loans. The sale of these non-performing loans did not result in any gain or loss since the total reduced carrying value was previously recognized as a specific reserve allocation. The Corporation did not recognize a provision for loan losses for the three months ended March 31, 2005, and March 31, 2004 since the reserve was considered adequate at the end of both periods. There were no new significant problem loans or loan downgrades identified during the first quarter of 2005.

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

	March 31, 2005	December 31, 2004	March 31, 2004
<b>Nonperforming Assets:</b>			
Nonaccrual loans	\$ 2,272	\$ 4,307	\$ 18,297
Loans past due 90 days or more	-0-	-0-	736
Restructured loans	-0-	-0-	48
Total nonperforming loans	<u>2,272</u>	<u>4,307</u>	<u>19,081</u>
Other real estate owned	1,515	1,730	3,861
Total nonperforming assets	<u>\$ 3,787</u>	<u>\$ 6,037</u>	<u>\$ 22,942</u>
Nonperforming loans as a % of loans	<u>1.17%</u> %	<u>2.11%</u> %	<u>7.48%</u> %
Nonperforming assets as a % of assets	<u>1.38%</u> %	<u>1.78%</u> %	<u>5.73%</u> %
<b>Reserve for Loan Losses:</b>			
At period end	\$ 6,836	\$ 6,966	\$ 12,730
As a % of loans	<u>3.51%</u> %	<u>3.42%</u> %	<u>4.99%</u> %
As a % of nonperforming loans	<u>300.88%</u> %	<u>161.74%</u> %	<u>66.72%</u> %
As a % of nonaccrual loans	<u>300.88%</u> %	<u>161.74%</u> %	<u>69.57%</u> %

Following is the allocation of the allowance for loan losses as of March 31, 2005, December 31, 2004, and March 31, 2004 (dollars in thousands):

	March 31, 2005	December 31, 2004	March 31, 2004
Commercial, financial, and agricultural loans	\$ 1,423	\$ 1,419	\$ 6,120
One-to-four family residential real estate loans	97	97	143
Consumer loans	-0-	-0-	-0-
Unallocated and general reserves	<u>5,316</u>	<u>5,450</u>	<u>6,467</u>
Totals	<u>\$ 6,836</u>	<u>\$ 6,966</u>	<u>\$ 12,730</u>

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

	March 31, 2005	December 31, 2004	March 31, 2004
Allowance to total loans	3.51 %	3.42 %	4.99 %
Average loans outstanding, for the quarters and year, respectively	\$ 199,703	\$ 244,730	\$ 288,548
Net charge-offs to average outstanding loans	.07 %	6.15 %	3.21 %
Nonperforming loans to gross loans	1.17 %	2.11 %	7.48 %

Total nonperforming loans decreased \$2.035 million since December 31, 2004. The reduction in nonperforming loans during the first quarter of 2005 is primarily due to the payoff of one major commercial loan that was in

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nonaccrual status. During 2004, nonperforming loans were reduced through a combination of loan sales, charge-offs, and external refinancing. In 2004, the Bank sold \$40 million of primarily nonperforming loans of which \$22.9 million were in a nonaccrual status.

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 intensified the review of the Corporation's loans, related collateral evaluations, and the overall lending process during 2004. The Corporation also utilized a loan review consultant in 2004, 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 2005.

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):

	Three Months Ended <u>March 31, 2005</u>	Year Ended <u>December 31, 2004</u>	Three Months Ended <u>March 31, 2004</u>
Balance at beginning of period	\$ 1,730	\$ 4,356	\$ 4,356
Other real estate transferred from loans	31	4,762	314
Other real estate sold/written down	<u>(246)</u>	<u>(7,388)</u>	<u>(809)</u>
 Balance at end of period	 <u>\$ 1,515</u>	 <u>\$ 1,730</u>	 <u>\$ 3,861</u>

During the first three months of 2005, the Corporation received real estate in lieu of loan payments of \$31,000. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically reevaluates 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.

**Deposits**

The Corporation had a reduction in deposits in the first quarter of 2005. Total deposits decreased by \$10.411 million, or 4.83%, in the first quarter of 2005. This reduction in deposits was primarily due to the non-renewal of Internet deposit maturities during the quarter. Internet deposits decreased by \$8.228 million during the first quarter of 2005 to \$43.602 million at March 31, 2005; while certificates of deposit over \$100,000 showed a slight increase of \$.344 million during the first quarter of 2005 to \$11.070 million at March 31, 2005. The Corporation has initiated an aggressive marketing campaign to introduce new products and offer more competitive deposit pricing in an attempt to gather in market deposits.

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

	<u>March 31,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>	<u>March 31,</u> <u>2004</u>
NOW and money market	\$ 51,701	\$ 53,468	\$ 65,780
Savings and IRAs	25,687	25,570	29,471
Certificates of Deposit <\$100,000	53,458	53,100	62,767
Certificates of Deposit >\$100,000	11,070	10,726	20,860
Internet CDs <\$100,000	39,099	46,227	75,813
Internet CDs >\$100,000	4,503	5,603	8,003
Demand deposit accounts	<u>19,721</u>	<u>20,956</u>	<u>24,378</u>
Total deposits	<u>\$ 205,239</u>	<u>\$ 215,650</u>	<u>\$ 287,072</u>

### **Borrowings**

The Corporation has used alternative funding sources to provide long-term, stable sources of funds. Total borrowings of the Corporation decreased by \$46.9 million from 2004 year-end. In the first quarter of 2005 the Corporation prepaid \$48.555 million of the FHLB borrowings in order to reduce interest rate risk and to better match earning assets and funding sources. The remaining FHLB borrowings carry fixed interest rates and mature in 2010 and 2011. The remaining FHLB borrowings are callable quarterly at the option of the FHLB and can also be converted to variable rates, at the option of the FHLB, should rates rise above certain index levels. These borrowings are secured by a blanket collateral agreement on the Bank's residential mortgage loans and specific assignment of other assets. Management may increase FHLB borrowings in the future as a source for funding future loan production. In the first quarter of 2005, the Bank borrowed \$2 million in Canadian dollars from a correspondent bank in order to reduce the risk of an asset sensitive foreign exchange position. This term loan agreement bears interest at Canadian prime, less ½ percent, and is secured by an investment security with an amortized cost of \$2.000 million and an estimated fair value of \$1.965 million.

### **Subordinated Debentures**

As part of the recapitalization, which occurred in December 2004, the subordinated debentures were paid off. This payoff settlement was negotiated with all of the holders of the subordinated debentures. The payment for the debentures was in settlement of \$12,450,000 in principal and accrued interest. The total settlement price was \$6,500,000 and resulted in the Corporation recording a gain on the settlement of \$6,617,000. The settlement of this liability also included the accrued interest of approximately \$1.2 million.

### **Shareholders' Equity**

Total shareholders' equity decreased \$5.876 million from December 31, 2004 to March 31, 2005. The decrease is comprised of a net loss of \$5.241 million and a decrease in the net unrealized gain on securities of \$.635 million. The Board of Directors does not anticipate declaring any dividends in the near future. The declaration of dividends is contingent on a variety of factors including regulatory and state statutes, and the Corporation's return to profitability.

### **RESULTS OF OPERATIONS**

#### **Net Interest Income**

Net interest income before provision for loan losses for the quarter ended March 31, 2005, increased by \$.194 million, or 9.6% compared to the same period one year ago. This increase in net interest income resulted despite

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significant declines in average earning assets. The prepayment of \$48.555 million of the FHLB borrowings at a weighted average rate of 6.04% contributed to the reduction in cost of funds and benefited the interest margin in the first quarter of 2005. The Corporation also benefited from significant declines in nonperforming loans, \$16.8 million, and also from the increases in the prime rate of 2%, in the last twelve months.

**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. There was no provision for loan losses for the quarter ended March 31, 2005, and March 31, 2004. Management continues to monitor the loan portfolio for changes which may impact the required allowance for loan losses. A provision for loan losses may be required for future periods if credit quality should deteriorates or loan growth is such that the general reserve is no longer deemed adequate.

**Other Income**

Other income decreased by \$479,000 for the quarter ended March 31, 2005, compared to the quarter ended March 31, 2004. Service fees decreased \$132,000, while loan and lease income increased \$2,000 and loan gains declined \$12,000. The decline in service fees is primarily due to the significant decline in deposits from March 31, 2004 to March 31, 2005. Other non-interest income was positively impacted in the first quarter of 2004 from a gain of \$258,000 on the sale of a limited partnership interest.

The following table details noninterest income for the three months ended March 31, 2005 and March 31, 2004 (dollars in thousands):

	Three Months Ended		% Increase (Decrease) 2005-2004
	March 31,		
	2005	2004	
Service fees	\$ 161	\$ 293	(45.05) %
Loan and lease fee income	7	5	40.00
Gain on sale of loans	-0-	12	(100.00)
Gain (loss) on sale of property and equipment	2	-0-	(95.83)
Other non interest income	15	353	(95.75)
Subtotal	<u>185</u>	<u>663</u>	<u>(73.98)</u>
Net Securities gains (losses)	<u>(1)</u>	<u>-0-</u>	<u>100.00</u>
Total noninterest income	<u>\$ 184</u>	<u>\$ 663</u>	<u>74.12 %</u>

**Other Expenses**

Other expenses increased \$3.289 million for the quarter ended March 31, 2005, compared to the same period in 2004. The prepayment penalty on FHLB borrowings incurred by the Corporation in the first quarter of 2005 amounted to \$4.320 million and was the primary reason for the increase. Salaries, commissions, and related benefits increased modestly, by \$5,000, during the first quarter of 2005 compared to the first quarter of 2004. During the first quarter of 2004, the Corporation recognized the cost of closing five branch offices. The total cost associated with those branch office closings in 2004 amounted to \$452,000 of which \$266,000 was recognized in the first quarter of 2004 and is included in other operating expenses. Areas of noninterest expense such as furniture and equipment, occupancy, data processing, and telephone expense declined between periods due to these branch closures and branch sales that occurred later in 2004. Advertising expense at \$139,000 in the first quarter of 2005 increased due to the Corporation's efforts to regain market share by advertising new products and services. The Corporation has engaged a marketing agency to develop an extensive marketing program to launch the Bank's new name, from North Country Bank and Trust to mBank, and create an advertising program to announce new products

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and services. It is anticipated that the increased level of advertising expenses will continue through the remainder of 2005.

The following table details noninterest expense for the three months ended March 31, 2005 and March 31, 2004 (dollars in thousands):

	Three Months Ended		% Increase
	March 31,		(Decrease)
	2005	2004	2005-2004
Salaries, commissions, and related benefits	\$ 1,504	\$ 1,499	.33 %
Furniture and Equipment Expense	159	258	(38.37)
Occupancy Expense	226	347	(34.87)
Data Processing Expense	246	355	(30.70)
Accounting, legal and consulting fees	318	406	(21.67)
Loan and Deposit Expense	293	493	(40.57)
Telephone	60	213	(71.83)
Advertising Expense	139	17	717.65
Penalty - prepayment of FHLB borrowings	4,320	-0-	100.00
Other	365	753	(51.53)
Total noninterest expense	<u>\$ 7,630</u>	<u>\$ 4,341</u>	<u>75.77 %</u>

**Federal Income Taxes**

There was no tax provision for the first quarter of 2005 and 2004. The Corporation's current year net losses are not currently being benefited due to the uncertainty of utilization. The Corporation has approximately \$24.4 million of NOL carryforward along with tax benefit carryforwards of \$1.5 million. The NOL and tax credit carryforward benefit is dependent upon the future profitability and generation of taxable income; therefore no future benefit of these deferred items has been recorded.

**LIQUIDITY**

As a result of the Corporation's renewed capital strength, from the recapitalization in December, 2004, the Corporation is now able to pursue sources of liquidity, such as lines of credit from correspondent banks, borrowings from the Federal Home Loan Bank and possible brokered deposits acquisition. The liquidity issues faced, the Corporation's actions taken to address them, and the liquidity plan for 2005 are discussed below.

During the first quarter of 2005, the Corporation decreased cash and cash equivalents by \$30.215 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was primarily impacted from cash used in financing activities. The Corporation prepaid \$48.555 million in FHLB borrowings in the first quarter of 2005. The Corporation utilized short term liquidity sources such as federal funds sold and time deposits in other financial institutions to fund the prepayment. In the first quarter of 2005, the Corporation funded the reduction of deposits of \$10.411 million primarily through the balance sheet reductions of loans, \$8.840 million, and investments, \$4.112 million. These asset reductions allowed the Corporation to maintain adequate liquidity of \$13.863 million.

It is anticipated that during the remainder of 2005, the Corporation will fund anticipated loan production with a combination of core deposit growth and from the use of Internet deposits and FHLB borrowings.

The Corporation's parent company is dependent upon its primary operating subsidiary, the Bank, for sources of cash to fund its operating needs. At March 31, 2005, the Corporation's parent had a balance of \$1.671 million in cash and cash equivalents and does not anticipate the need for additional sources of funds in the near term.

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See accompanying notes to condensed consolidated financial statements.

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

The Corporation's liquidity plan for 2005 includes strategies to increase core deposits in the Corporation's local markets. The introduction of new products through an extensive advertising campaign commenced in the first quarter of 2005, with a goal of increasing core deposits to reduce the dependency on noncore, out of market, deposits. The Corporation's liquidity plan for 2005 calls for augmenting local deposit growth efforts with Internet CD funding, to the extent necessary. The Corporation has also reestablished borrowing lines at correspondent banks to provide additional sources of liquidity.

CAPITAL AND REGULATORY

During the first quarter of 2005, capital decreased by \$5.876 million, as a result of the net loss of \$5.241 million and the decrease in the unrealized gain on securities available for sale of \$.635 million. This compares to a decrease in capital during the same period in the previous year of \$1.329 million, resulting primarily from a net loss of \$1.667 million and a positive change in the unrealized gain on securities available for sale of \$.338 million.

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 March 31, 2005 and December 31, 2004, the Corporation and the Bank, were well capitalized.

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

The following table details sources of capital for the periods indicated.

	March 31, 2005	December 31, 2004	March 31, 2004
	<u>          </u>	<u>          </u>	<u>          </u>
<b>Capital Structure</b>			
Long-term debt (1)	\$ -0-	\$ -0-	\$ 12,450
Shareholders' equity	28,854	34,730	9,371
Total capitalization	<u>\$ 28,854</u>	<u>\$ 34,730</u>	<u>\$ 21,821</u>
Tangible capital	<u>\$ 28,430</u>	<u>\$ 34,275</u>	<u>\$ 20,324</u>
<b>Intangible Assets</b>			
Core deposit premium	\$ 424	\$ 455	\$ 978
Other identifiable intangibles	-0-	-0-	519
Total intangibles	<u>\$ 424</u>	<u>\$ 455</u>	<u>\$ 1,497</u>
<b>Risk-based capital</b>			
Tier I capital:			
Shareholders' equity	\$ 28,854	\$ 34,730	\$ 9,371
Net unrealized (gains) losses on available for sale securities	143	(492)	(1,365)
Minority interest	80	78	2,263
Less: intangibles	(424)	(455)	(1,497)
Total Tier I capital	<u>\$ 28,653</u>	<u>\$ 33,861</u>	<u>\$ 8,772</u>
Tier II Capital:			
Allowable reserve for loan losses	\$ 2,585	\$ 2,918	\$ 3,495
Qualifying long-term debt	-0-	-0-	5,277
Total Tier II capital	<u>2,585</u>	<u>2,918</u>	<u>8,772</u>
Total capital	<u>\$ 31,238</u>	<u>\$ 36,779</u>	<u>17,544</u>
Risk-adjusted assets	<u>\$ 202,584</u>	<u>\$ 229,355</u>	<u>\$ 270,403</u>
Capital ratios:			
Tier I Capital to risk weighted assets	14.14 %	14.76 %	3.24 %
Total Capital to risk weighted assets	15.42 %	16.04 %	6.49 %
Tier I Capital to average assets	9.67 %	10.68 %	2.13 %

(1) Long term debt in the Corporation's subordinated debentures.

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.

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See accompanying notes to condensed consolidated financial statements.

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

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

	Tier I Capital to Average <u>Assets</u>	Tier I Capital to Risk-Weighted <u>Assets</u>	Total Capital to Risk-Weighted <u>Assets</u>
Regulatory minimum for capital adequacy purposes	4.00%	4.00%	8.00%
The Corporation:			
March 31, 2005	9.67%	14.14%	15.42%
December 31, 2004	10.68%	14.76%	16.04%
The Bank:			
March 31, 2005	9.10%	13.33%	14.61%
December 31, 2004	9.89%	13.96%	15.23%

**History**

In October 2001, the Bank was notified by the FDIC that it was a “troubled institution” within the meaning of FDIC regulations. As a troubled institution, the Bank is required to notify the FDIC 30 days prior to the addition or replacement of a Board member and the employment or changes in responsibilities of a senior executive officer.

In September 2002, a regularly-scheduled safety and soundness examination of the Bank was conducted by its principal regulators, the Michigan Office of Financial and Insurance Services (“OFIS”), and the FDIC. During the course of that examination, the FDIC, the OFIS, and the Federal Reserve Bank of Chicago (“FRB”) requested that the Corporation and the Bank take certain actions, including suspending the payment of dividends and conserving the liquidity of the Corporation.

In response to the concerns expressed by the regulators, the Board of Directors of the Corporation and the Bank adopted resolutions providing for prior regulatory approval of the declaration or payment of any dividend by the Corporation or the Bank, and suspension of interest payments by the Corporation in connection with its trust preferred securities. The agreements relating to the trust preferred securities allow for the suspension of payments for up to 20 quarters. Therefore, the suspension of the interest payments did not violate the agreement.

Following the completion of the regularly-scheduled safety and soundness examination of the Bank by the FDIC and the OFIS in November 2002, and the Bank’s receipt of the related Report of Examination (“Report”), the FDIC and the OFIS, with the consent of the Bank, on March 26, 2003, entered a formal order (the “Order”) under Federal and State banking laws. The Order became effective on April 5, 2003, and was to remain in effect until modified or terminated by action of the FDIC and the OFIS. The Order identified deficiencies in the Bank’s policies and procedures for safe and sound operation, including its directorate and management personnel and practices, credit underwriting, credit administration, and policies regarding asset/liability management, liquidity, funds management and investments, and its compliance with all applicable laws and regulations, including Regulations O and U of the Board of Governors of the Federal Reserve System (the “Board”), the FDIC Rules and Regulations, and the Michigan Banking Code of 1999. The Order also required the Bank to maintain specified capital ratios during the life of the Order.

The Order required the Bank and its directors to take specific steps, within time periods specified in the Order, to address the operational deficiencies, including certain violations of law and regulations, identified by the FDIC and the OFIS in the Order and the Report.

Significant progress was made by the Corporation in addressing all of the deficiencies of the Order. The most significant event, which occurred in mid-December 2004, was the consummation of a \$30 million stock offering through a private placement that resulted in net proceeds of \$26.2 million. This recapitalization allowed the Corporation to inject \$15.5 million of capital into the Bank which satisfied all of the capital requirements of the Order.

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See accompanying notes to condensed consolidated financial statements.

MACKINAC FINANCIAL CORPORATION  
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
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On February 8, 2005, the Order was formally removed; however, the Bank entered into an informal agreement which requires the Bank to maintain a Tier 1 Capital ratio of at least 8%. The Bank is also required to have regulatory approval before paying dividends.

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See accompanying notes to condensed consolidated financial statements.

NORTH COUNTRY 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 loans so it has an opportunity to reprice the loan within 12 to 36 months.

The Corporation also has \$52.3 million of securities; of which \$13.2 million are mortgage-backed 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.

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 speed of change 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 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.

NORTH COUNTRY FINANCIAL CORPORATION  
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following is the Corporation's opportunities at March 31, 2005 (dollars in thousand):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	\$ 142,242	1,415	31,517	19,657	\$ 194,831
Securities	5,814	4,105	36,018	6,361	52,298
Other (1)	15,026	-0-	-0-	-0-	15,026
<b>Total interest-earning assets</b>	<b>163,082</b>	<b>5,520</b>	<b>67,535</b>	<b>26,018</b>	<b>262,155</b>
Interest-bearing obligations:					
Savings deposits	70,856	-0-	-0-	-0-	70,856
Time deposits	27,125	50,373	36,411	752	114,661
Borrowings	-0-	1,718	1,417	35,000	38,135
<b>Total interest-bearing obligations</b>	<b>97,981</b>	<b>52,091</b>	<b>37,828</b>	<b>35,752</b>	<b>223,652</b>
 Gap	 <u>\$ 65,101</u>	 <u>\$ (46,571)</u>	 <u>\$ 29,707</u>	 <u>\$ (9,734)</u>	 <u>\$ 38,503</u>
 Cumulative gap	 <u>\$ 65,101</u>	 <u>\$ 18,530</u>	 <u>\$ 48,237</u>	 <u>\$ 38,503</u>	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at March 31, 2005, the Corporation had a cumulative asset sensitivity gap position of \$18.530 million within the one-year time frame. The Corporation's cumulative asset sensitive gap suggests that if market interest rates increase in the next twelve months, the Corporation's net interest income could increase. Conversely, if market interest rates decrease over the next twelve months, the above GAP position suggests the Corporation's net interest income would increase.

At December 31, 2004, the Corporation had a cumulative asset sensitivity gap position of \$63.804 million within the one-year time frame. The Corporation's cumulative asset sensitive gap suggested that if market interest rates increased in the next twelve months, the Corporation had the potential to earn more net interest income. Conversely, if market interest rates continued to decrease over a twelve-month period, the December 31, 2004, gap position suggested the Corporation's net interest income would decrease.

The decrease in the gap position from December 31, 2004 to March 31, 2005 resulted from the use of short term investments to fund the prepayment of long term liabilities. This was done in order to reduce interest rate risk and better match assets and liabilities. A limitation of the traditional gap analysis is that it does not consider the timing or magnitude of noncontractual 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.

The borrowings in the gap analysis include FHLB advances as fixed-rate advances. A significant portion of 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.

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.

See accompanying notes to condensed consolidated financial statements.

NORTH COUNTRY FINANCIAL CORPORATION  
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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.

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. The Corporation entered into a term loan payable in Canadian dollars during the first quarter of 2005 in order to offset the foreign exchange exposure due to an asset sensitive position. As of March 31, 2005, the Corporation had excess Canadian liabilities of \$.227 million (or \$.207 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.

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See accompanying notes to condensed consolidated financial statements.

MACKINAC FINANCIAL CORPORATION  
ITEM 4. CONTROLS AND PROCEDURES

As of March 31 2005, an evaluation was performed under the supervision of and with the participation of the Corporation's management, including the President 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. Based on that evaluation, the Corporation's management, including the President and Chief Executive Officer, concluded that 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 included in the Corporation's periodic SEC filings as of March 31, 2004.

There was no change in the Corporation's internal control over financial reporting that occurred during the Corporation's fiscal quarter ended March 31, 2005 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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. In addition, the Corporation or the Bank is subject to the litigation and arbitration described below. The litigation and arbitration that is not routine and incidental to the business of banking is described below. The same litigation and arbitration was previously described in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2004,

Securities Litigation

In an action styled *Lanctot v. Littlejohn, et al.*, filed in the U.S. District Court for the Western District of Michigan on June 13, 2003, a shareholder of the Corporation brought a class action against the Corporation, its former chairman, chief executive

officer and director, Ronald G. Ford, and its former chief executive officer and director, Sherry L. Littlejohn, for alleged violations of Federal securities laws.

In another action styled *Rosen v. North Country Financial Corporation, et al.*, filed in the U.S. District Court for the Western District of Michigan on June 23, 2003, a former shareholder of the Corporation brought a class action against the Corporation, its former chairman, chief executive officer and director, Ronald G. Ford, and its former chief executive officer and director, Sherry L. Littlejohn, for alleged violations of Federal securities laws.

On September 2, 2003, pursuant to 15 U.S.C. § 78-u-4(a)(3)(B), plaintiff Charles Lanctot filed a motion requesting the Court to consolidate the two securities class action cases (*Lanctot* and *Rosen*) under the caption *In re North Country Financial Corporation Securities Litigation*, to appoint him as "Lead Plaintiff" in the consolidated cases, and to approve the selection of his counsel as "Lead Plaintiff's Counsel." In an Order dated September 29, 2003, the Court among other things consolidated the *Lanctot* and *Rosen* actions, designated Charles D. Lanctot and John F. Stevens as "Lead Plaintiffs," and designated "Co-Lead Counsel" and "Liaison Counsel" for the class.

On December 1, 2003, the plaintiffs filed their Corrected Consolidated Amended Class Action Complaint ("Amended Complaint"), which added John F. Stevens as a plaintiff. The Amended Complaint, which demanded a jury trial, was brought on behalf of all persons, subject to certain exceptions, who purchased the Corporation's common stock during the period from November 13, 2000, through April 15, 2003. It alleged that the Corporation and the individual defendants violated section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 of the Securities and Exchange Commission (the "SEC") issued under the Exchange Act, by disseminating materially false and misleading statements and/or concealing material adverse facts concerning the financial condition and operations of the Corporation, with knowledge, or in reckless disregard, of the materially false and misleading character thereof. The Amended Complaint also alleged violations of Section 20 of the Exchange Act by the individual defendants, by reason of their control, at relevant times, of the Corporation. Among other things, the Amended Complaint was based upon allegations of deficiencies in the Corporation's policies and procedures for safe and sound operation, including its directorate and management personnel and practices, credit underwriting, credit administration, and policies regarding asset/liability management, liquidity, funds management, and investments, and its compliance with all applicable laws and regulations, including Regulations O and U of the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation ("FDIC") Rules and Regulations, and the Michigan Banking Code of 1999. The Amended Complaint further alleged that the Corporation's acquisition of American Financial Mortgage, which had an "unusually large number of defaulted loans . . . which triggered the attention of banking regulators"; that a Cease and Desist Order, dated March 26, 2002, which was attached as Exhibit 1 to the Amended Complaint, demonstrated how defendants made "false statements" in public filings and other communications, and were required to take "corrective actions;" that various public filings were "false because the Company's operations resulted in an excessive level of adversely classified assets, delinquent loans, and nonaccrual loans as well as an inadequate level of capital protection for the kind and quality of assets held;" that, "according to former employees, loans for Company insiders and their related entities were often approved regardless of the quality of the loan;" and, that the Corporation incorrectly attributed its performance to the World Trade Center disaster and other factors impacting tourism and hospitality businesses, instead of disclosing "insider loans," a "disproportionately high loan concentration" in the hospitality industry, and

## MACKINAC FINANCIAL CORPORATION

information about the Corporation's banking practices and loan loss reserves. The Amended Complaint sought certification of a class consisting of all persons who purchased the common stock of the Corporation on the open market between the dates noted above, compensatory damages on a joint and several basis against all defendants, including the Corporation, plus interest and costs, including attorney's fees and expert's fees.

On January 23, 2004, the Corporation and the other defendants filed their Joint Motion to Dismiss the Corrected Consolidated Amended Class Action Complaint, principally based on the ground that plaintiffs had not adequately plead that the Corporation, through its officers and directors, acted with the intent to defraud the investing public under the standard articulated in *Helwig v. Vencor, Inc.*, 251 F.3d 540 (6<sup>th</sup> Cir. 2001), *cert. dismissed*, 536 U.S. 935, 122 S.Ct. 2616 (2002). During the pendency of the motion to dismiss, a stay of "all discovery and other proceedings" automatically was imposed under 15 U.S.C. § 78u-4(b)(3)(B). Plaintiffs filed their Brief in Opposition to Defendants' Motion to Dismiss on March 8, 2004. Defendants filed a reply brief in support of their Motion to Dismiss on March 23, 2004. The Court scheduled an oral argument on the Motion to Dismiss for May 17, 2004.

Shortly before the hearing on the Motion to Dismiss, Plaintiffs, the Corporation and the individual Defendants and their insurer reached a settlement in principle of all claims asserted in the consolidated actions. On June 18, 2004, the parties submitted to the Court their Stipulation of Settlement, which described in detail the terms and conditions of the settlement. The parties subsequently modified the Stipulation, which was reflected in the Revised and Amended Stipulations of Settlement submitted to the Court.

On August 23, 2004, the Court granted conditional approval of the settlement as set forth in the Second Revised and Amended Stipulation of Settlement. On October 15, 2004, the Court preliminarily certified a class for purposes of settlement only, approved a form of notice of hearing to be distributed to class members, and scheduled a hearing concerning final approval of the settlement. As modified by a Stipulated Order entered on October 29, 2004, the plaintiffs were allowed to mail notice of the proposed settlement to members of the class. Members of the class were permitted to opt out of the class by written request postmarked no later than November 29, 2004. Members of the class who did not opt out and who filed written notice no later than November 24, 2004, were permitted to object to approval of the settlement at the hearing concerning final approval before the Court.

On December 1, 2004, the Court held the hearing concerning final approval of the settlement. At the conclusion of the hearing, the Court entered its Order and Final Judgment, in which the Court (i) certified the action as a class action, (ii) certified the plaintiff class, (iii) determined the settlement (as modified by the Order and Final Judgment) to be fair, reasonable, adequate, and in the best interests of the plaintiff class, (iv) approved the settlement, (v) specified the claims procedure for members of the plaintiff class, (vi) awarded fees to counsel for the plaintiff class, and (vii) dismissed the action as to the plaintiff class and all defendants with prejudice. Under the terms of the settlement approved by the Court, the settlement fund for the plaintiff class and its counsel aggregated \$750,000, of which the Corporation contributed \$250,000, and the individual defendants contributed \$500,000. The amount contributed by the individual defendants was covered by insurance.

### 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 Henrickson, 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. The Complaint, which demands a jury trial, is brought on behalf of the Corporation against the individual defendants. It alleges that the individual defendants have caused loss and damage to the Corporation through breaches of their fiduciary duties of oversight and supervision by failing (i) adequately to safeguard the assets of the Corporation, (ii) to ensure that adequate administrative, operating, and internal controls were in place and implemented, (iii) to ensure that the Corporation was operated in accordance with legally-prescribed procedures, and (iv) to oversee the audit process to ensure that the Corporation's assets were properly accounted for and preserved. The Complaint further alleges that the individual defendants violated Section 14(a) of the Exchange Act by making materially false and misleading statements in the proxy statement mailed to shareholders in connection with the annual meeting of the Corporation held May 29, 2000, and the adoption by the

## MACKINAC FINANCIAL CORPORATION

shareholders at that meeting of the Corporation's 2000 Stock Incentive Plan. The Complaint also alleges that Mr. Ford and Ms. Littlejohn, through a series of compensation arrangements, stock options, and employment agreements obtained by them through improper means resulting from the offices they held with the Corporation, received excessive compensation, to the injury of the Corporation. Among other things, the Complaint is based upon allegations of material misstatements or omissions in filings made by the Corporation with the SEC, and deficiencies in the Corporation's policies and procedures for safe and sound operation, including its directorate and management personnel and practices, credit underwriting, credit administration, and policies regarding asset/liability management, liquidity, funds management, and investments, and its compliance with all applicable laws and regulations, including Regulations O and U of the Board, FDIC Rules and Regulations, and the Michigan Banking Code of 1999. The Complaint seeks (i) rescission of the approval of the 2000 Stock Incentive Plan and return of all stock and options granted under the Plan, (ii) a declaration that the individual defendants breached their fiduciary duty to the Corporation, (iii) an order to the individual defendants to account to the Corporation for all losses and/or damages by reason of the acts and omissions alleged, (iv) an order to each of the individual defendants to remit to the Corporation all salaries and other compensation received for periods during which they breached their fiduciary duties, (v) compensatory damages in favor of the Corporation, (vi) injunctive relief, and (vii) interest, costs, and attorney's and expert's fees.

By letter dated September 17, 2003, and expressly without prejudice to the argument that any such written demand is not required, plaintiff's counsel purported to make a written demand that the Corporation pursue a number of indicated putative claims against: (1) present and former officers and directors of the Corporation who also are the individual defendants in the *Damon* action, and (2) the certified public accounting firm of Wipfli, Ullrich, Bertelson, LLP.

On September 18, 2003, the Corporation filed a motion to dismiss the *Damon* action because plaintiff did not satisfy the mandatory precondition, under Section 493a of the Michigan Business Corporation Act ("MBCA"), M.C.L. § 450.1493a, for filing a shareholder derivative action that the shareholder must first have submitted a written demand that the Corporation pursue in its own right the claims asserted by the shareholder (the plaintiff here). Certain of the individual defendants in the *Damon* action filed their own motion to dismiss on November 25, 2003, in which motion the other individual defendants later joined. The plaintiff filed an Opposition to both motions to dismiss on January 9, 2004, and on January 30, 2004, the defendants filed reply briefs in support of their motions to dismiss.

On March 22, 2004, the Court issued an Opinion and Order granting in part and denying in part the motions to dismiss in the *Damon* case. The Court dismissed the Section 14(a) claim against all of the defendants as barred by the statute of limitations and, as further grounds, dismissed that claim as to those who were not directors at the time of the mailing of the proxy statement. The Court has permitted the plaintiff to proceed with its breach of fiduciary duty claims against the Directors on the grounds that the plaintiff cured its procedural failings by subsequently transmitting a demand letter as required by Section 493 of the MBCA.

On April 19, 2004, the Court entered an Order Granting Stipulation to Grant Plaintiff Leave to File Amended Complaint and to Grant Related Relief to All Parties. On May 14, 2004, the plaintiff filed an Amended Complaint and, thereafter, all Defendants timely filed Answers to the Amended Complaint. In its Answer, the Corporation averred that the plaintiff's claims are asserted for and on behalf of the Corporation, that the plaintiff does not assert any claims against the Corporation and, therefore, the Corporation properly should be realigned as a plaintiff in the action.

During the above described proceedings, 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.

## MACKINAC FINANCIAL CORPORATION

On July 14, 2004, the Court convened a settlement conference among counsel for all parties and counsel for the individual defendants' insurer. Although a settlement was not achieved, at the direction of the Court, the parties' respective counsel agreed to continue settlement discussions.

By Order of the Court dated November 2, 2004, the report of the disinterested person was timely filed with the Corporation on October 23, 2004, and the action was stayed until November 22, 2004. On December 22, 2004, the plaintiff filed a motion with the Court seeking a scheduling conference among the Court and the parties. The Court granted the plaintiff's motion on January 10, 2005. On January 13, 2005, the parties to the action and the individual defendants' insurer entered into an agreement regarding limited disclosure of the report of the disinterested person to the insurer and counsel for the parties on the terms and conditions set forth in the agreement. Also on January 13, 2005, a scheduling conference was held with the Court, and was adjourned to February 14, 2005.

On February 9, 2005, the parties filed a joint status report with the Court. A further status conference was held on February 14, 2005. At that time, the Court entered a Stipulated Protective Order regarding limited dissemination of the report of the disinterested person. Also on February 14, in a separate Order, the Court required the parties to complete their respective review of the report and communicate among themselves regarding their positions. Absent a negotiated resolution, the Corporation was given the opportunity until March 21, 2005, to file an appropriate motion to dismiss. On March 21, 2005, consistently with the determinations of the disinterested person in his report, the Corporation filed with the Court a motion to dismiss (i) all the breach of fiduciary duty claims against defendants Bittner, Bouschor, Gerou, Lindroth, Madigan, Shunk, Hendrickson, and Tolksdorf, (ii) the breach of fiduciary duty claims against defendant Hoffman, except for one claim identified by the disinterested person in his report, and (iii) the excess compensation claims against defendants Ford and Littlejohn. The plaintiff has advised the Corporation that it intends to oppose the motion to dismiss.

### *Damon Trust v. Wipfli*

On August 27, 2004, a second shareholder's derivative action, styled *Virginia M. Damon Trust v. Wipfli Ullrich Bertelson, LLP, and North Country Financial Corporation, Nominal Defendant*, was filed in the Michigan Circuit Court for Grand Traverse County by the same shareholder which brought the derivative action discussed above. The complaint, which demands a jury trial, is brought on behalf of the Corporation against Wipfli Ullrich Bertelson, LLP ("Wipfli") under the Michigan Accountant Liability statute, M.C.L. 600.2962. It alleges that Wipfli damaged the Corporation by (i) failing to conduct and oversee, with the due care and competence required of professional accountants, the annual audit of the Corporation's financial statements for its fiscal years ending December 31, 2000 and December 31, 2001, (ii) failing to provide, with requisite due care and competence, the internal audit, regulatory compliance, and financial reporting services Wipfli had agreed to provide the Corporation after August 28, 2002, when Wipfli resigned as its auditors to undertake such consulting services, (iii) failing to exercise due care and competence required to ensure that the Corporation's financial statements conformed to applicable regulatory accounting principles ("RAP") and generally accepted accounting principles ("GAAP"), (iv) failing to make full disclosure that the Corporation's administrative, operating, and internal controls were inadequate to prevent loss and damage to its assets, and (v) failing to conduct a diligent and careful "review" of the Corporation's quarterly financial statements during its fiscal years 2000 and 2001 and the first and second quarters of 2002.

The complaint further alleges that Wipfli undertook in writing (i) to provide professional services, including auditing services, accounting services for preparation of audited financial statements, advice regarding financial statement disclosure, and preparation of annual reports for regulators, including the annual report required by section 36 of the Federal Deposit Insurance Act, and (ii) to ensure that the Corporation had sufficient systems in place to determine whether it was in compliance with RAP and other regulations of the FDIC and the OFIS. The complaint alleges that Wipfli (i) failed to conduct its audits of the Corporation's financial statements in accordance with generally accepted auditing standards ("GAAS"), (ii) negligently represented that the Corporation's audited annual financial statements for the year ended December 31, 2000 were fairly presented in all material respects, (iii) negligently conducted reviews of the Corporation's quarterly financial statements for the interim quarters of 2000, 2001 and 2002, and (iv) negligently audited the Corporation's financial statements for the fiscal years 2000 and 2001 by failing to obtain or review sufficient documentation, failing to limit the scope of the audit in light of such failure to obtain or review sufficient documentation, failing to verify the accuracy of information obtained from the Corporation for the audit, failing to limit the scope of the audit in light of such failure to verify the accuracy of the information obtained from the Corporation, and substantially underestimating the Corporation's liabilities and misrepresenting its solvency.

## MACKINAC FINANCIAL CORPORATION

The complaint also alleges that Wipfli is a party responsible for the Corporation's liability in any securities fraud action arising out of a material overstatement of its financial results. The complaint claims contribution and indemnification from Wipfli on behalf of the Corporation under the Private Securities Litigation Reform Act of 1995 for any liability it may incur in any such securities fraud action.

On October 12, 2004, Wipfli removed the second shareholder's derivative action to the U.S. District Court for the Western District of Michigan. By stipulation between the respective counsel for the Corporation and the plaintiff, the Corporation was initially granted until December 10, 2004, to file its first response to the Complaint, which period was extended by a Stipulated Order until January, 2005.

On January 10, 2005, the Corporation filed its Answer to the Complaint in the second shareholder's derivative action. Also on that date, a joint status report was filed with the Court by all parties. A scheduling conference was held with the Court on January 13, 2005. On that date, the Court entered a Preliminary Case Management Order, affording the Corporation the opportunity until February 3, 2005, to make a motion to realign the Corporation in, or to dismiss, the litigation.

On February 3, 2005, the Corporation filed a Motion to realign the Corporation as the plaintiff, and to dismiss the Virginia M. Damon Trust as a party, in the second shareholder's derivative action. The plaintiff, Virginia M. Damon Trust, filed a brief opposing the Corporation's motion. Oral argument on the Corporation's motion was held before the Court on March 7, 2005. The Court took the matter under advisement.

### Employment Agreement Arbitration

On September 16, 2003, Ronald G. Ford, the former chairman and chief executive officer and a former director of the Corporation, initiated an arbitration proceeding with the American Arbitration Association ("AAA") against the Corporation seeking monetary damages for alleged breach by the Corporation of his Amended and Restated Employment Agreement, Chairman Agreement, and Amended and Restated Consulting Agreement, each with the Corporation. The Corporation denied the alleged breach and asserted a counterclaim to recover all amounts paid to Mr. Ford under the Chairman Agreement, as required by the Cease and Desist Order entered by the FDIC and the OFIS, in addition to other amounts.

On March 19, 2004, at the request of Mr. Ford, AAA reactivated the arbitration proceeding. Pursuant to its procedures, on June 17, 2004, AAA appointed an arbitrator to preside over the adjudication of these claims and counterclaims.

On July 13, 2004, the arbitrator convened a scheduling conference at which the arbitrator adopted the parties' stipulation to stay the arbitration until the conclusion in the *Damon* action of the court-appointed disinterested person's investigation and recommendations concerning the claims of the Virginia M. Damon Trust, asserted in the name and on behalf of the Corporation, against the Corporation's former and present officers and directors, including Mr. Ford. At a further conference held on October 27, 2004, the arbitrator adopted the parties' stipulation to stay the arbitration until another conference, scheduled for November 18, 2004.

Following a further stipulated stay of the arbitration proceeding, the Corporation and Mr. Ford entered into a Release and Settlement Agreement as of December 7, 2004. The Corporation and Mr. Ford each released certain claims against the other specified in the Release and Settlement Agreement, and the Bank paid Mr. Ford \$20,000 for his minority ownership interest in two subsidiaries of the Bank. The Release and Settlement Agreement, the terms of which were consented to by the FDIC and the Michigan Office of Financial and Insurance Services, resulted in the termination with prejudice of the AAA arbitration proceeding.

Litigation of the types involved in the actions described above can be complex, time-consuming, and often protracted. The Corporation has incurred substantial expense for legal and other professional fees as a result of these actions. The Corporation anticipates that it will incur additional such expenses in connection with the two shareholder's derivative actions described above.

**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.

MACKINAC FINANCIAL CORPORATION  
SIGNATURE

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)

5/13/05  
Date

By: /s/ Paul D. Tobias  
PAUL D. TOBIAS,  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER  
(principal executive officer)

By: /s/ Ernie R. Krueger  
ERNIE R. KRUEGER  
SENIOR VICE PRESIDENT /CONTROLLER  
(principal accounting officer)

## CERTIFICATION

I, Paul D. Tobias, Chairman and Chief Executive Officer of Mackinac Financial Corporation, certify that:

1. I have reviewed this report on Form 10-Q of Mackinac Financial Corporation (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2005

/s/ Paul D. Tobias  
PAUL D. TOBIAS  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER  
(principal executive officer)

CERTIFICATION

I, Eliot R. Stark, Executive Vice President and Chief Financial Officer of Mackinac Financial Corporation, certify that:

1. I have reviewed this report on Form 10-Q of Mackinac Financial Corporation (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2005

/s/ Eliot R. Stark  
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ELIOT R. STARK  
EXECUTIVE VICE PRESIDENT AND  
CHIEF FINANCIAL OFFICER  
(principal financial officer)

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C § 1350, and accompanies the quarterly report on Form 10-Q for the quarter ended March 31, 2005, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Paul D. Tobias, Chairman and Chief Executive Officer of the Issuer, certify that:

- (1) The Form 10-Q fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (2) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operation of the Issuer.

/s/ Paul D. Tobias  
Paul D. Tobias  
Chairman and Chief Executive Officer  
(chief executive officer)  
May 13, 2005

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C § 1350, and accompanies the quarterly report on Form 10-Q for the quarter ended March 31, 2005, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Eliot R. Stark, Executive Vice President of the Issuer, certify that:

- (1) The Form 10-Q fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (2) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operation of the Issuer.

Eliot R. Stark  
Executive Vice President and Chief Financial Officer  
(principal financial officer)  
May 13, 2005