

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, 2006

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, 2006, there were outstanding 3,428,695 shares of the registrant's common stock, no par value.

MACKINAC FINANCIAL CORPORATION
INDEX

PART I.	FINANCIAL INFORMATION	<u>Page No.</u>
Item 1.	<u>Financial Statements</u>	
	Condensed Consolidated Balance Sheets - March 31, 2006 (Unaudited), December 31, 2005 and March 31, 2005 (Unaudited)	1
	Condensed Consolidated Statements of Operations - Three Months Ended March 31, 2006 (Unaudited) and March 31, 2005 (Unaudited)	2
	Condensed Consolidated Statements of Changes in Shareholders' Equity - Three Months Ended March 31, 2006 (Unaudited) and March 31, 2005 (Unaudited)	3
	Condensed Consolidated Statements of Cash Flows - Three Months Ended March 31, 2006 (Unaudited) and March 31, 2005 (Unaudited)	4
	Notes to Condensed Consolidated Financial Statements (Unaudited)	5
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	23
Item 4.	Controls and Procedures	26
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	27
Item 6.	Exhibits and Reports on Form 8-K	32
	SIGNATURES	33

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

	Three Months Ended March 31,	
	2006	2005
Interest income:		
Interest and fees on loans:		
Taxable	\$ 4,499	\$ 3,059
Tax-exempt	194	242
Interest on securities:		
Taxable	273	462
Tax-exempt	41	42
Other interest income	168	183
Total interest income	5,175	3,988
Interest expense:		
Deposits	2,080	1,130
Borrowings	416	653
Total interest expense	2,496	1,783
Net interest income	2,679	2,205
Provision for loan losses	(600)	-
Net interest income after provision for loan losses	3,279	2,205
Other income:		
Service fees	111	161
Loan and lease fees	17	7
Net security losses	-	(1)
Net gains on sales of loans	40	-
Gain on sale of property and equipment	-	2
Other	48	15
Total other income	216	184
Other expense:		
Salaries and employee benefits	1,594	1,504
Occupancy	317	226
Furniture and equipment	156	159
Data processing	154	246
Accounting, legal and consulting fees	200	318
Loan and deposit	129	293
Telephone	49	60
Advertising	70	139
Penalty on prepayment of FHLB borrowings	-	4,320
Other	328	365
Total other expense	2,997	7,630
Income (loss) before provision for income taxes	498	(5,241)
Provision for income taxes	-	-
Net income (loss)	\$ 498	\$ (5,241)
Income (loss) per common share:		
Basic	\$.15	\$ (1.53)
Diluted	\$.15	\$ (1.53)

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	<u>2006</u>	<u>2005</u>
Balance, beginning of period	\$ 26,588	\$ 34,730
Stock option compensation	79	-
Net income (loss) for period	498	(5,241)
Net unrealized gain (loss) on securities available for sale	<u>8</u>	<u>(635)</u>
Total comprehensive income (loss)	<u>506</u>	<u>(5,876)</u>
Balance, end of period	<u>\$ 27,173</u>	<u>\$ 28,854</u>

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2006	2005
<u>Cash Flows From Operating Activities:</u>		
Net income (loss)	\$ 498	\$ (5,241)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	243	248
FHLB stock dividend	-	(51)
(Gain) loss on sale of assets	-	(4)
Change in other assets	(134)	1,551
Change in other liabilities	(38)	(1,090)
Net cash provided by (used in) Operating activities	<u>569</u>	<u>(4,587)</u>
<u>Cash Flows From Investing Activities:</u>		
Net decrease in interest-bearing deposits in other financial institutions	172	18,521
Payment for purchases of securities available for sale	-	(16,009)
Proceeds from sale of securities available for sale	-	18,674
Proceeds from calls and maturities of securities available for sale	70	1,447
Net (increase) decrease in loans	(25,400)	8,840
Capital expenditures	(535)	-
Proceeds from sale of premises, equipment and other real estate	-	214
Purchase of minority interest in subsidiary of mBank	79	-
Net cash provided (used in) by Investing activities	<u>(25,614)</u>	<u>31,687</u>
<u>Cash Flows From Financing Activities:</u>		
Net increase (decrease) in deposits	35,322	(10,411)
Proceeds from issuance of debt	-	1,651
Principal payments on borrowings	-	(48,555)
Net cash provided by (used in) Financing activities	<u>35,322</u>	<u>(57,315)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	10,277	(30,215)
Cash and Cash Equivalents at Beginning of Period	<u>7,943</u>	<u>44,078</u>
Cash and Cash Equivalents at End of Period	<u>\$ 18,220</u>	<u>\$ 13,863</u>
<u>Supplemental Cash Flow Information:</u>		
Cash Paid During the Period for:		
Interest	\$ 2,382	\$ 1,896
Income taxes	-	-
<u>Noncash Investing and Financing Activities:</u>		
Transfers of Foreclosures from Loans to Other Real Estate Held for Sale	7	31

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, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. 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, 2005.

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 December 2004 stock offering and recapitalization. The amendment, approved by shareholders, increased the shares available under this plan by 428,587 shares from the original 25,000 (adjusted for the 1:20 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 grant under

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Corporation adopted SFAS No. 123 (Revised) "Share Based Payments" in the first quarter of 2006. This Statement supersedes APB Opinion No. 25 "Accounting for Stock Issued to Employees" and its related implementation guidance. Under Opinion No. 25, issuing stock options to employees generally resulted in recognition of no compensation cost. This adoption resulted in the recognition of after tax compensation expense in the amount of \$79,000 for the three months ended March 31, 2006. The expense recorded recognizes the current period vesting of options outstanding. The first quarter 2005 after tax compensation expense, using this same accounting treatment would have amounted to \$19,000. The per share impact of this accounting change was negligible for 2006.

2. RECENT ACCOUNTING PRONOUNCEMENT

The Corporation adopted SFAS No. 123 (Revised) "Share Based Payments" in the first quarter of 2006. The Corporation does not expect a material impact on the results of operations for 2006 as a result of this change, with \$79,000 reported as expense in the first quarter.

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, 2006 and 2005 (dollars in thousands, except per share data):

Additional shares issued as a result of option exercises would not be dilutive in either three month period.

	Three Months Ended March 31,	
	2006	2005
Basic loss per common share:		
Net income (loss)	\$ 498	\$ (5,241)
Weighted average common shares outstanding	3,428,695	3,428,695
Basic income (loss) per common share	\$.15	\$ (1.53)
Diluted income (loss) per common share:		
Net loss	\$ 498	\$ (5,241)
Weighted average common shares outstanding for basic income per common share	3,428,695	3,428,695
Add: Dilutive effect of assumed exercise of stock options	-	-
Average shares and dilutive potential common shares	3,428,695	3,428,695
Diluted income (loss) per common share	\$.15	\$ (1.53)

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, 2006, December 31, 2005, and March 31, 2005 are as follows (dollars in thousands):

	March 31, 2006		December 31, 2005		March 31, 2005	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
US Agencies	\$ 30,971	\$ 30,338	\$ 30,980	\$ 30,354	\$ 34,998	\$ 34,466
Obligations of states and political subdivisions	3,524	3,802	3,593	3,856	3,710	4,004
Corporate securities	-	-	-	-	668	675
Mortgage-related securities	-	-	-	-	13,065	13,153
Total securities available for sale	<u>\$ 34,495</u>	<u>\$ 34,140</u>	<u>\$ 34,573</u>	<u>\$ 34,210</u>	<u>\$ 52,441</u>	<u>\$ 52,298</u>

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were \$24.519 million and \$23.990 million respectively at March 31, 2006.

5. LOANS

The composition of loans at March 31, 2006, December 31, 2005, and March 31, 2005 is as follows (dollars in thousands):

	March 31, 2006	December 31, 2005	March 31, 2005
Commercial real estate	\$ 134,089	\$ 118,637	\$ 100,911
Commercial, financial and agricultural	56,958	56,686	43,632
One to four family residential real estate	50,119	44,660	45,425
Consumer	2,300	2,285	2,277
Construction	21,005	17,503	2,586
Total loans	<u>\$ 264,471</u>	<u>\$ 239,771</u>	<u>\$ 194,831</u>

LOANS – Allowance for loan losses

An analysis of the allowance for loan losses for the three months ended March 31, 2006, the year ended December 31, 2005, and the three months ended March 31, 2005 is as follows (dollars in thousands):

	March 31, 2006	December 31, 2005	March 31, 2005
Balance at beginning of period	\$ 6,108	\$ 6,966	\$ 6,966
Provision for loan losses	(600)	-	-
Recoveries on loans	12	134	97
Loans charged off	(105)	(992)	(227)
Balance at end of period	<u>\$ 5,415</u>	<u>\$ 6,108</u>	<u>\$ 6,836</u>

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

5. **LOANS** (Continued)

In the first quarter of 2006, net charge-off activity was minimal at \$93,000, or .04% of average loans outstanding compared to net charge-offs of \$130,000, or .07% of average loans, in the first quarter of 2005. In the first quarter of 2006 the Corporation reduced the allowance for loan losses by recording a negative provision amounting to \$600,000. This reduction in the reserve was made in recognition of the improved credit quality existent in the loan portfolio and is discussed in more detail under "Management's Discussion and Analysis."

LOANS – Impaired loans

Nonperforming loans are those which are contractually past due 90 days or more as to interest or principal payments, on nonaccrual status, or loans, the terms of which have been renegotiated to provide a reduction or deferral on interest or principal. The interest income recorded and that which would have been recorded had nonaccrual and renegotiated loans been current, or not troubled was not material to the consolidated financial statements for the three months ended March 31, 2006 and 2005.

Information regarding impaired loans as of March 31, 2006, December 31, 2005, and March 31, 2005 is as follows (dollars in thousands):

	March 31, 2006	December 31, 2005	March 31, 2005	Valuation Reserve		
				March 31, 2006	December 31, 2005	March 31, 2005
Balances, at period end						
Impaired loans with specific valuation reserve	\$ -	\$ -	\$ 85	\$ -	\$ -	\$ 83
Impaired loans with no specific valuation reserve		114	2,187			-
Total impaired loans	\$ -	\$ 114	\$ 2,272	\$ -	\$ -	\$ 83
Impaired loans on nonaccrual basis	\$ -	\$ 15	\$ 2,272	\$ -	\$ -	\$ 83
Impaired loans on accrual basis		99	-			-
Total impaired loans	\$ -	\$ 114	\$ 2,272	\$ -	\$ -	\$ 83
Average investment in impaired loans	\$ 71	\$ 1,922	\$ 3,290			
Interest income recognized during impairment	1	78	21			
Interest income that would have been recognized on an accrual basis	-	134	55			
Cash-basis interest income recognized	-	76	21			

The average investment in impaired loans was approximately \$.071 million for the three-months ended March 31, 2006, \$1.9 million for the year ended December 31, 2005, and \$3.290 million for the three months ended March 31, 2005, respectively. Impacting the impaired loan balances in 2005 was a sale of nonperforming assets in late December which included \$1.0 million of nonaccrual loans.

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

5. **LOANS** (Continued)

LOANS – Related parties

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

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

	March 31, 2006	December 31, 2005	March 31, 2005
Loans outstanding, beginning of period	\$ 578	\$ 63	\$ 63
New loans	-	56	-
Net activity on revolving lines of credit	805	578	-
Repayment	-	(119)	(11)
Change in related party interest	(491)	-	-
	<u>\$ 892</u>	<u>\$ 578</u>	<u>\$ 52</u>

There were no loans to related parties classified substandard at March 31, 2006, December 31, 2005, and March 31, 2005 respectively. In addition to the outstanding balances above, there were unused commitments to related parties amounting to approximately \$320,000.

6. **BORROWINGS**

Borrowings consist of the following at March 31, 2006, December 31, 2005, and March 31, 2005 (dollars in thousands):

	March 31, 2006	December 31, 2005	March 31, 2005
Federal Home Loan Bank advances at rates ranging from 4.35% to 5.16% maturing in 2010 and 2011	\$ 35,000	\$ 35,000	\$ 35,000
Term loan credit, with a correspondent bank, Canadian prime less 1/2%	-	-	1,651
Farmers Home Administration, fixed-rate note payable, maturing August 24, 2024, interest payable at 1%	1,417	1,417	1,484
	<u>\$ 36,417</u>	<u>\$ 36,417</u>	<u>\$ 38,135</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, 2006, by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately \$21.740 million; U.S. government agencies with an amortized cost and estimated fair value of \$24.519 million and \$23.990 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling \$4.855 million. Prepayment of the remaining advances is subject to the provisions and conditions of

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

6. BORROWINGS (Continued)

the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of March 31, 2006.

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling \$774,000 originated and held by the Corporation's wholly owned subsidiary, First Rural Relending and an assignment of a demand deposit account in the amount of \$785,000, and guaranteed by the Corporation.

7. STOCK OPTION PLANS

A summary of stock option transactions for the three months ended March 31, 2006 and 2005 and the year ended December 31, 2005, is as follows: (Historical stock option information has been adjusted for the 1:20 reverse stock split which occurred in December, 2004).

	March 31, 2006	December 31, 2005	March 31, 2005
Outstanding shares, at beginning of period	375,417	282,999	282,999
Granted during the period	-	112,500	-
Expired during the period	1,500	20,082	-
	<u>373,917</u>	<u>375,417</u>	<u>282,999</u>
Weighted average exercise price per share at end of period	<u>\$ 12.60</u>	<u>\$ 14.15</u>	<u>\$ 34.55</u>
Shares available for grant, at end of period	<u>90,988</u>	<u>89,488</u>	<u>138,899</u>

There were no options granted in the first quarter of 2006 or 2005.

Following is a summary of the options outstanding and exercisable at March 31, 2006:

Exercise Price Range	Number		Weighted Average Remaining Contractual Life-Years	Weighted Average Exercise Price
	Outstanding	Exercisable		
\$9.16	12,500	2,500	9.8	\$ 9.16
\$9.75	257,152	120,861	8.7	9.75
\$11.50	40,000	8,000	9.5	11.50
\$12.00	60,000	12,000	9.2	12.00
\$156.00 - \$240.00	3,545	3,545	5.0	186.75
\$300.00 - \$406.60	720	720	3.3	345.00
	<u>373,917</u>	<u>147,626</u>	<u>8.9</u>	<u>\$ 12.60</u>

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

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

9. COMMITMENTS, CONTINGENCIES, AND CREDIT RISK

Financial Instruments With Off-Balance-Sheet Risk

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

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

	March 31, 2006	December 31, 2005	March 31, 2005
Commitments to extend credit:			
Fixed rate	\$ 1,815	\$ 2,118	\$ 1,054
Variable rate	37,889	31,557	12,578
Standby letters of credit - Variable rate	9,290	10,493	11,338
Credit card commitments - Fixed rate	3,068	3,135	2,810
	<u>\$ 52,062</u>	<u>\$ 47,303</u>	<u>\$ 27,780</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.

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

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

9. COMMITMENTS, CONTINGENCIES, AND CREDIT RISK (Continued)

and tourism industry. This concentration represents \$38.045 million, or 19.91%, of the commercial loan portfolio at March 31, 2006. 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.

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

FORWARD-LOOKING STATEMENTS

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

- Impact of continued operating losses;
- Asset growth of the Corporation may be constrained in order to maintain regulatory defined "well capitalized" equity to asset ratios;
- The highly regulated environment in which the Corporation operates could adversely affect its ability to carry out its strategic plan due to restrictions on new products, funding opportunities or new market entrances;
- General economic conditions, either nationally or in the state(s) in which the Corporation does business;
- Legislation or regulatory changes which affect the business in which the Corporation is engaged;
- Changes in the interest rate environment which increase or decrease interest rate margins;
- Changes in securities markets with respect to the market value of financial assets and the level of volatility in certain markets such as foreign exchange;
- Significant increases in competition in the banking and financial services industry resulting from industry consolidation, regulatory changes and other factors, as well as action taken by particular competitors;
- The ability of borrowers to repay loans;
- The effects on liquidity of unusual decreases in deposits;
- Changes in consumer spending, borrowing, and saving habits;
- Technological changes;
- Acquisitions and unanticipated occurrences which delay or reduce the expected benefits of acquisitions;
- Difficulties in hiring and retaining qualified management and banking personnel;
- The Corporation's ability to increase market share and control expenses;
- The effect of compliance with legislation or regulatory changes;
- The effect of changes in accounting policies and practices;
- The costs and effects of existing and future litigation and of adverse outcomes in such litigation.

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

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

The following discussion will cover results of operations, asset quality, financial position, liquidity, interest rate sensitivity, and capital resources for the periods indicated. The information included in this discussion is intended to assist readers in their analysis of, and should be read in conjunction with, the consolidated financial statements and related notes and other supplemental information presented elsewhere in this report. This discussion should be read in conjunction with the consolidated financial statements and footnotes contained in the Corporation's Annual Report and Form 10-K for the year-ended December 31, 2005. Throughout this discussion, the term "Bank" refers to mBank, formerly known as North Country Bank and Trust, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

Year-to-date consolidated net income was \$.498 million through March 31, 2006, compared to net loss of \$5.241 million for the same period in 2005. Basic income per share was \$.15 for the three months ended March 31, 2006, compared to a loss of \$1.53 for the same period in 2005. The results of operations for the first quarter of 2006 include a \$600,000 negative loan loss provision, which reduced the Corporation's allowance for loan loss reserve in recognition of improved credit quality. The first quarter of 2005 results include a penalty of \$4.320 million on the prepayment of \$48.555 million of the FHLB borrowings. Excluding the provision and the prepayment penalty, the net loss in the first quarter of 2006 amounted to \$.102 million, compared to an adjusted loss of \$.921 million for the same period in 2005. Total assets increased \$35.869 million from December 31, 2005, to March 31, 2006. The loan portfolio increased \$24.700 million in the first quarter of 2006, from December 31, 2005 balances of \$239.771 million. Deposits totaled \$267.954 million at March 31, 2006, an increase of \$35.322 million from the \$232.632 million at December 31, 2005.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents increased \$10.277 million in the first quarter of 2006. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Available-for-sale securities decreased \$.070 million, or .20%, from December 31, 2005, to March 31, 2006, with the balance on March 31, 2006, totaling \$34.140 million. The decrease during the first quarter was due to a combination of maturities, calls, and paydowns of securities. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of March 31, 2006, investment securities with an estimated fair value of \$20.130 million were pledged.

Loans

Through the first quarter of 2006, loan balances increased by \$24.700 million, or 10.3% from December 31, 2005 balances of \$239.771 million. During the first quarter, the Bank experienced loan production of \$30.1 million. 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, all segments of the loan portfolio increased in the first quarter of 2006. Management intends to continue loan growth within its markets for mortgage, consumer, and commercial loan products while concentrating on loan quality, industry concentration issues, and competitive pricing.

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

Following is a summary of the loan portfolio at March 31, 2006, December 31, 2005, and March 31, 2005 (dollars in thousands):

	March 31, 2006	Percent of Total	December 31, 2005	Percent of Total	March 31, 2005	Percent of Total
Commercial real estate	\$ 134,089	50.70 %	\$ 118,637	49.48 %	\$ 100,911	51.79 %
Commercial, financial, and agricultural	56,958	21.54	56,686	23.64	43,632	22.39
1-4 family residential real estate	50,119	18.95	44,660	18.63	45,425	23.32
Consumer	2,300	.87	2,285	.95	2,277	1.17
Construction	21,005	7.94	17,503	7.30	2,586	1.33
Total loans	\$ 264,471	100.00 %	\$ 239,771	100.00 %	\$ 194,831	100.00 %

Following is a table showing the significant industry types in the commercial loan portfolio as of March 31, 2006, December 31, 2005, and March 31, 2005 (dollars in thousands):

	March 31, 2006			December 31, 2005			March 31, 2005		
	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity
Hospitality and tourism	\$ 38,045	19.91 %	140.01 %	\$ 37,681	21.49 %	141.72 %	\$ 45,390	31.40 %	157.31 %
Gaming	7,181	3.76	26.43	7,553	4.31	28.41	12,618	8.73	43.73
Petroleum	6,664	3.49	24.52	6,508	3.71	24.48	7,939	5.49	27.51
Forestry	5,332	2.79	19.62	5,370	3.06	20.20	5,486	3.80	19.01
Other	133,825	70.05	492.49 %	118,211	67.43	444.60 %	73,110	50.58	253.38 %
Total Commercial Loans	\$ 191,047	100.00 %		\$ 175,323	100.00 %		\$ 144,543	100.00 %	

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, 2006, the allowance for loan losses was 2.05% of total loans outstanding compared to 2.55% at December 31, 2005 and 3.51% at March 31, 2005.

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 amounted to \$.093 million, .04% of average loans outstanding, compared to \$.130 million, .07% of average loans outstanding, for the three months ended March 31, 2006 and 2005, respectively. The Corporation, in recognition of the continued improvement in credit quality which has occurred since 2004, reduced the reserve for loan loss by \$600,000 in the first quarter of 2006. The reduction of the reserve results in a current reserve balance that is more representative of the relevant risk inherent within the Corporation's loan portfolio. The current level of charge-offs is below historical levels and projected charge-off activity, based upon current levels of nonperforming loans, is not expected to attain historical levels. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity. There were no new significant problem loans or loan downgrades identified during the first quarter of 2006.

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

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

	March 31, 2006	December 31, 2005	March 31, 2005
Nonperforming Assets:			
Nonaccrual loans	\$ -	\$ 15	\$ 2,272
Loans past due 90 days or more	-	99	-
Restructured loans	-	-	-
Total nonperforming loans	-	114	2,272
Other real estate owned	952	945	1,515
Total nonperforming assets	<u>\$ 952</u>	<u>\$ 1,059</u>	<u>\$ 3,787</u>
Nonperforming loans as a % of loans	<u>-</u>	<u>0.05 %</u>	<u>1.17 %</u>
Nonperforming assets as a % of assets	<u>0.28</u>	<u>0.35 %</u>	<u>1.38 %</u>
Reserve for Loan Losses:			
At period end	<u>\$ 5,415</u>	<u>\$ 6,108</u>	<u>\$ 6,836</u>
As a % of loans	<u>2.05 %</u>	<u>2.55 %</u>	<u>3.51 %</u>
As a % of nonperforming loans	<u>N/A</u>	<u>5,357.89 %</u>	<u>300.88 %</u>
As a % of nonaccrual loans	<u>N/A</u>	<u>N/M %</u>	<u>300.88 %</u>

Following is the allocation of the allowance for loan losses as of March 31, 2006, December 31, 2005, and March 31, 2005 (dollars in thousands):

	March 31, 2006	December 31, 2005	March 31, 2005
Commercial, financial, and agricultural loans	\$ 1,279	\$ 1,492	\$ 1,423
One to four family residential real estate loans	43	17	97
Consumer loans	-	-	-
Unallocated and general reserves	4,093	4,599	5,316
Totals	<u>\$ 5,415</u>	<u>\$ 6,108</u>	<u>\$ 6,836</u>

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

	March 31, 2006	December 31, 2005	March 31, 2005
Allowance to total loans	2.05 %	2.55 %	3.51 %
Average loans outstanding, for the quarters and year, respectively	\$ 250,735	\$ 207,928	\$ 199,703
Net charge-offs to average outstanding loans	0.04 %	.41 %	.07 %
Nonperforming loans to gross loans	0.00 %	.05 %	1.17 %

Total nonperforming loans decreased \$.114 million since December 31, 2005. During 2005, nonperforming loans were reduced through a combination of loan sales, charge-offs, and external refinancing. Late in 2005, the Bank sold \$2.1 million of nonperforming assets, which included \$1.0 million of nonperforming loans.

Management continues to address market issues impacting its loan customer base. In conjunction with the Corporation's senior lending staff and the bank regulatory examinations, management reviews the Corporation's loans, related collateral evaluations, and the overall lending process. The Corporation also utilizes a loan review

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

consultant to perform a review of the loan portfolio. The opinion of this consultant upon completion of the independent review provided findings similar to management on the overall adequacy of the reserve. The Corporation has engaged this same consultant for loan review during 2006.

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, 2006</u>	Year Ended <u>December 31, 2005</u>	Three Months Ended <u>March 31, 2005</u>
Balance at beginning of period	\$ 945	\$ 1,730	\$ 1,730
Other real estate transferred from loans due to foreclosure	7	632	31
Other real estate transferred to premises and equipment	-	(358)	-
Other real estate sold/written down	-	<u>(1,059)</u>	<u>(246)</u>
Balance at end of period	<u>\$ 952</u>	<u>\$ 945</u>	<u>\$ 1,515</u>

During the first three months of 2006, the Corporation received real estate in lieu of loan payments of \$7,000. 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 an increase in deposits in the first quarter of 2006. Total deposits increased by \$35.322 million, or 15.18%, in the first quarter of 2006. This growth in deposits included \$26.414 million of non-core deposits, mostly brokered certificates of deposit. The Corporation continues to evaluate its deposit products and pricing alternatives in an effort to fund loan growth as economically as possible.

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

	<u>March 31,</u> <u>2006</u>	<u>% of Total</u>	<u>December 31,</u> <u>2005</u>	<u>% of Total</u>	<u>March 31,</u> <u>2005</u>	<u>% of Total</u>
Demand deposit accounts	\$ 20,463	7.64 %	\$ 19,684	8.46 %	\$ 19,721	9.61 %
NOW and money market	67,467	25.18	64,566	27.75	51,701	25.19
Savings and IRAs	22,903	8.55	22,555	9.70	25,687	12.52
Certificates of Deposit <\$100,000	<u>72,605</u>	<u>27.10</u>	<u>67,725</u>	<u>29.11</u>	<u>53,458</u>	<u>26.05</u>
Total core deposits	183,438	68.46	174,530	75.02	150,567	73.36
Certificates of Deposit >\$100,000	15,246	5.69	12,335	5.30	11,070	5.39
Internet CDs <\$100,000	26,231	9.79	28,113	12.08	39,099	19.05
Internet CDs >\$100,000	7,700	2.87	7,698	3.31	4,503	2.19
Brokered CDs	<u>35,339</u>	<u>13.19</u>	<u>9,956</u>	<u>4.28</u>	-	-
Total non-core deposits	84,516	31.54	58,102	24.98	54,672	26.64
Total deposits	<u>\$ 267,954</u>	<u>100.00 %</u>	<u>\$ 232,632</u>	<u>100.00 %</u>	<u>\$ 205,239</u>	<u>100.00 %</u>

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

Borrowings

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 was repaid in 2005.

Shareholders' Equity

Total shareholders' equity increased \$.585 million from December 31, 2005 to March 31, 2006. The increase is comprised of net income, contributed capital of \$79,000 in recognition of stock option expense and an \$8,000 increase in the market value of securities. 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, 2006, increased by \$.474 million, or 21.50% compared to the same period one year ago. This increase in net interest income was a result of the combination of increased average balances and increased rates. The Corporation continues to benefit from prime rate increases due to the amount of assets repricing with each increase. This benefit has been declining in recent periods as the Corporation initiated steps as a part of its ALCO Committee to reduce interest rate risk. More discussion is included relative to repricing and asset sensitivity under the caption "Interest Rate Risk" elsewhere in this report.

The following table presents the amount of interest income from average interest-earning assets and the yields earned on those assets, as well as the interest expense on average interest-bearing obligations and the rates paid on those obligations. All average balances are daily average balances.

	Three Months Ended											
	Average Balances			Average Rates		Interest		2006-2005				
	March 31,		Increase/ (Decrease)	March 31,		March 31,		Income/ Expense Variance	Volume Variance	Rate Variance	Rate/ Volume Variance	
(dollars in thousands)	2006	2005		2006	2005	2006	2005					
Loans (1,2)	\$ 250,735	\$ 199,703	\$ 51,032	7.59 %	6.70 %	\$ 4,693	\$ 3,301	\$ 1,393	\$ 844	\$ 437	112	
Taxable securities	31,029	50,475	(19,446)	3.57	3.71	273	462	(189)	(178)	(18)	7	
Nontaxable securities	3,214	3,315	(101)	5.17	5.14	41	42	(1)	(1)	-	-	
Federal funds sold	9,424	16,521	(7,097)	4.43	2.26	103	92	11	(40)	89	(38)	
Other interest-earning assets	5,776	10,730	(4,954)	4.63	3.48	65	91	(26)	(42)	30	(14)	
Total earning assets	300,178	280,744	19,434	6.99	5.76	5,175	3,988	1,188	583	538	67	
Reserve for loan losses	(6,049)	(6,953)	904									
Cash and due from banks	6,339	5,047	1,292									
Intangible assets	319	440	(121)									
Other assets	18,222	17,576	646									
Total assets	\$ 319,009	\$ 296,854	\$ 22,155									
NOW and money market deposits	\$ 67,892	\$ 53,033	\$ 14,859	2.86	1.56	478	204	274	57	170	47	
Savings deposits	15,336	18,372	(3,036)	1.22	1.02	46	46	-	(8)	9	(1)	
Time deposits	149,108	116,565	32,543	4.23	3.06	1,556	880	677	246	336	94	
Borrowings	36,417	52,011	(15,594)	4.63	5.09	416	653	(237)	(196)	(59)	18	
Total interest-bearing liabilities	268,753	239,981	28,772	3.77	3.01	2,496	1,783	714	99	456	158	
Demand deposits	19,384	21,064	(1,680)									
Other liabilities	3,817	5,117	(1,300)									
Shareholders' equity	27,055	30,692	(3,637)									
Total liabilities and shareholders' equity	\$ 319,009	\$ 296,854	\$ 22,155									
Rate spread				3.22 %	2.75 %							
Net interest margin/revenue				3.62 %	3.19 %	\$ 2,679	\$ 2,205	\$ 474	\$ 484	\$ 82	\$ (91)	

(1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.
(2) Interest income on loans includes loan fees.

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

Provision for Loan Losses

The Corporation records a provision for loan losses at a level it believes is necessary to maintain the allowance at an adequate level after considering factors such as loan charge-offs and recoveries, changes in the mix of loans in the portfolio, loan growth, and other economic factors. In recognition of the improved credit quality, the Corporation reduced its loan loss reserve by \$600,000 in the first quarter of 2006. There was no provision for loan losses in the first quarter of 2005. 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 deteriorate or loan growth is such that the general reserve is no longer deemed adequate.

Other Income

Other income increased by \$.032 for the quarter ended March 31, 2006, compared to the quarter ended March 31, 2005. Service fees decreased \$.050 million, while loan and lease income increased \$.010 million and other noninterest income increased \$.033 million. The decline in service fees is primarily due to the introduction of new "no fee" deposit products in an attempt to stimulate growth in transactional account deposits. In the first quarter of 2006, the Corporation recognized \$40,000 of revenue due to mortgage loans produced and sold in the secondary market. The secondary market activity is expected to have a greater impact in future quarters. Other noninterest income was positively impacted in the first quarter of 2006 from a gain due to foreign currency transactions which amounted to \$22,000.

The following table details noninterest income for the three months ended March 31, 2006, and March 31, 2005 (dollars in thousands):

<u>Noninterest Income</u>	Three Months Ended		% Increase (Decrease) 2006-2005
	March 31,		
	<u>2006</u>	<u>2005</u>	
Service fees	\$ 111	\$ 161	(31.06) %
Loan and lease fee income	17	7	142.86
Gain on sale of loans	40	-	100.00
Gain (loss) on sale of property and equipment	-	2	(100.00)
Other noninterest income	48	15	220.00
Subtotal	<u>216</u>	<u>185</u>	<u>16.76</u>
Net Securities gains (losses)	<u>-</u>	<u>(1)</u>	<u>100.00</u>
Total noninterest income	<u>\$ 216</u>	<u>\$ 184</u>	<u>17.39 %</u>

Other Expenses

Other expenses decreased \$4.633 million for the quarter ended March 31, 2006, compared to the same period in 2005. 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 decrease. Salaries, commissions, and related benefits increased modestly, by \$90,045, during the first quarter of 2006, compared to the first quarter of 2005. The \$92,000 decrease in data processing costs is the result of a full systems conversion which occurred in the fourth quarter of 2005. The \$164,000 decrease in loan and deposit expense is due in large part to the reduction in FDIC insurance premiums which amounted to \$138,000 in the first quarter of 2005 compared to \$23,000 in 2006, a reduction of \$115,000. This reduction in premium was due to the improved capital position of the Bank which resulted in the removal of the Cease and Desist Order in the first quarter of 2005. Management continually reviews all areas of noninterest expense for cost reduction opportunities that will not impact service quality and employee morale.

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

The following table details noninterest expense for the three months ended March 31, 2006 and March 31, 2005 (dollars in thousands):

<u>Noninterest Expenses</u>	Three Months Ended		% Increase
	March 31,		(Decrease)
	<u>2006</u>	<u>2005</u>	<u>2006-2005</u>
Salaries, commissions, and related benefits	\$ 1,594	\$ 1,504	5.98 %
Occupancy	317	226	40.27
Furniture and equipment	156	159	(1.89)
Data processing	154	246	(37.40)
Accounting, legal, and consulting fees	200	318	(37.11)
Loan and deposit	129	293	(55.97)
Telephone	49	60	(18.33)
Advertising	70	139	(49.64)
Penalty - prepayment of FHLB borrowings	-	4,320	(100.00)
Other	328	365	(10.14)
Total noninterest expense	<u>\$ 2,997</u>	<u>\$ 7,630</u>	<u>(60.72) %</u>

Federal Income Taxes

There was no tax provision for the first quarter of 2006 and 2005. The Corporation's results of operations for 2006 and 2005 do not reflect the impact of federal income taxes due to large NOL carryforwards. The Corporation has approximately \$36.5 million of NOL carryforward along with various tax credit carryforwards of \$2.1 million. The NOL and tax credit carryforward benefit is dependent upon the future profitability of the Corporation; therefore no future benefit of these deferred items has been recorded. The Corporation will reevaluate these deferred items in future periods to determine whether or not recognition of all or a portion of the benefit is appropriate in accordance with FASB Statement No. 109, "Accounting for Income Taxes."

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 issuance of subordinated debt. The liquidity issues faced, the Corporation's actions taken to address them, and the liquidity plan for 2006 are discussed below.

During the first quarter of 2006, the Corporation increased cash and cash equivalents by \$10.277 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was primarily impacted from growth in loans funded by deposits. 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 2006, the Corporation funded loan growth of \$25.400 million, with deposit growth which amounted to \$35.322 million. The excess deposit growth resulted in an increase in federal funds balances.

It is anticipated that during the remainder of 2006, the Corporation will fund anticipated loan production with a combination of core deposit growth and noncore funding, primarily brokered CD's.

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, 2006, the Corporation's parent had a balance of \$1.026 million in cash and cash equivalents. The Corporation is currently negotiating a line of credit with a correspondent bank. This line of credit will provide additional resources necessary to provide additional capital infusions to the Bank if needed.

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

The Corporation's liquidity plan for 2006 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 2006 calls for augmenting local deposit growth efforts with brokered CD funding, to the extent necessary. The Corporation has also reestablished Bank borrowing lines at correspondent banks to provide additional sources of liquidity.

CAPITAL AND REGULATORY

During the first quarter of 2006, capital increased by \$.585 million, as a result of the net income of \$.498 million. This compares to a decrease in capital during the same period in the previous year of \$.876 million, resulting primarily from a net loss of \$.241 million and a decrease in the unrealized gain on securities available for sale of \$.635 million. The increase in the 2006 first quarter is comprised of net income, contributed capital of \$79,000 in recognition of stock option expense and an increase of \$8,000 in the market value of securities.

The Corporation and the Bank are 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. Although the Corporation and the Bank are well capitalized, the Bank is operating under an informal agreement which requires a minimum Tier 1 Capital ratio of 8%.

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

	March 31, 2006	December 31, 2005	March 31, 2005
Capital Structure			
Shareholders' equity	\$ 27,173	\$ 26,588	\$ 28,854
Total capitalization	<u>\$ 27,173</u>	<u>\$ 26,588</u>	<u>\$ 28,854</u>
Tangible capital	<u>\$ 26,874</u>	<u>\$ 26,258</u>	<u>\$ 28,430</u>
Intangible Assets			
Core deposit premium	\$ 299	\$ 330	\$ 424
Other identifiable intangibles	-	-	-
Total intangibles	<u>\$ 299</u>	<u>\$ 330</u>	<u>\$ 424</u>
Regulatory capital			
Tier 1 capital:			
Shareholders' equity	\$ 27,173	\$ 26,588	\$ 28,854
Net unrealized (gains) losses on available for sale securities	355	363	143
Minority interest	60	-	80
Less: intangibles	(299)	(330)	(424)
Total Tier 1 capital	<u>\$ 27,289</u>	<u>\$ 26,621</u>	<u>\$ 28,653</u>
Tier 2 Capital:			
Allowable reserve for loan losses	\$ 3,517	\$ 3,184	\$ 2,585
Qualifying long-term debt	-	-	-
Total Tier 2 capital	<u>3,517</u>	<u>3,184</u>	<u>2,585</u>
Total capital	<u>\$ 30,806</u>	<u>\$ 29,805</u>	<u>\$ 31,238</u>
Risk-adjusted assets	<u>\$ 279,442</u>	<u>\$ 251,796</u>	<u>\$ 202,584</u>
Capital ratios:			
Tier 1 Capital to risk weighted assets	8.54 %	9.23 %	14.14 %
Total Capital to risk weighted assets	9.74 %	10.57 %	15.42 %
Tier 1 Capital to average assets	11.00 %	11.84 %	9.67 %

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

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

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

	Tier 1 Capital to Average <u>Assets</u>	Tier 1 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%
Regulatory defined well capitalized guideline	5.00%	6.00%	10.00%
The Corporation:			
March 31, 2006	8.54%	9.74%	11.00%
December 31, 2005	9.23%	10.57%	11.84%
The Bank:			
March 31, 2006	8.20%	9.36%	10.62%
December 31, 2005	8.80%	10.09%	11.35%

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

INTEREST RATE RISK

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

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

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

The Corporation also has \$34.140 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal. These cash flows are then reinvested into other earning assets at current market rates.

The Corporation also has federal funds sold to correspondent banks as well as other interest-bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

The Corporation offers deposit products with a variety of terms ranging from deposits whose interest rates can change on a weekly basis to certificates of deposit with repricing terms of up to five years.

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 repriceable assets over liabilities is referred to as a positive gap. An excess of repriceable 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 repriceable, are reported in the 1- to 90-day time frame. The estimates of principal amortization and prepayments are assigned to the following time frames.

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

The following is the Corporation's opportunities at March 31, 2006 (dollars in thousand):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	\$ 181,629	7,505	56,556	18,781	\$ 264,471
Securities	-	3,449	27,310	3,381	34,140
Other (1)	17,708	-	-	-	17,708
Total interest-earning assets	<u>199,337</u>	<u>10,954</u>	<u>83,866</u>	<u>22,162</u>	<u>316,319</u>
Interest-bearing obligations:					
NOW, Money Market and Savings	82,771	-	-	-	82,771
Time deposits	49,444	92,175	22,338	763	164,720
Borrowings	-	-	35,000	1,417	36,417
Total interest-bearing obligations	<u>132,215</u>	<u>92,175</u>	<u>57,338</u>	<u>2,180</u>	<u>283,908</u>
Gap	<u>\$ 67,122</u>	<u>\$ (81,221)</u>	<u>\$ 26,528</u>	<u>\$ 19,982</u>	<u>\$ 32,411</u>
Cumulative gap	<u>\$ 67,122</u>	<u>\$ (14,099)</u>	<u>\$ 12,429</u>	<u>\$ 32,411</u>	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at March 31, 2006, the Corporation had a cumulative liability sensitivity gap position of \$14.099 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggests that if market interest rates continue to increase in the next twelve months, the Corporation has the potential to earn less net interest income. Conversely, if market interest rates decrease in the next twelve months, the above GAP position suggests the Corporation's net interest income would increase.

At December 31, 2005, the Corporation had a cumulative liability sensitivity gap position of \$1.311 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggested that if market interest rates increased in the next twelve months, the Corporation had the potential to earn less net interest income. Conversely, if market interest rates continued to decrease over a twelve-month period, the December 31, 2005, gap position suggested the Corporation's net interest income would increase.

The increase in the gap position from December 31, 2005 to March 31, 2006 resulted from the use of short term liabilities to fund loan growth. 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 non-contractual repricing or expected prepayments. In addition, the gap analysis treats savings, NOW, and savings 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. 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.

MACKINAC FINANCIAL CORPORATION

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

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, 2006, the Corporation had excess Canadian liabilities of \$.036 million (or \$.031 million in U.S. dollars). Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation.

OFF-BALANCE-SHEET RISK

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

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

IMPACT OF INFLATION AND CHANGING PRICES

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

MACKINAC FINANCIAL CORPORATION
ITEM 4. CONTROLS AND PROCEDURES

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

There was no change in the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Corporation's fiscal quarter ended March 31, 2006 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 an informal agreement with regulatory authorities and the litigation described below. Information regarding the informal agreement is contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the caption "Capital and Regulatory" in this report, and is incorporated here by reference. The litigation that is not routine and incidental to the business of banking is described below.

Shareholder's Derivative Litigation

Damon Trust v. Bittner, et al.

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

MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION (Continued)

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.

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, consistent 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 opposed the motion to dismiss.

In an Order dated September 6, 2005, the Court stayed the proceedings in this case against defendant Littlejohn, in light of her filing for personal bankruptcy under Chapter 7 of the Bankruptcy Code in the U.S. Bankruptcy Court for the Western District of Michigan on August 9, 2005.

MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION (Continued)

In an Opinion and Order, each dated September 7, 2005, the Court granted the Corporation's motion and dismissed with prejudice (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 Court directed that the case proceed with the claim against defendant Hoffman with respect to his involvement in defendant Ford's December 21, 2001 employment agreement, and with respect to the breach of fiduciary duty claims against defendants Ford and Littlejohn, subject to the stay regarding proceedings against defendant Littlejohn.

A Case Management Order was entered by the Court on September 16, 2005. The Court also scheduled a mediation among the parties, the Corporation, and its insurer for November 15, 2005.

On October 21, 2005, without the required permission of the Court, the plaintiff filed a Third Amended Complaint which (A) deleted (i) substantive allegations previously asserted against defendants Bittner, Bouschor, Gerou, Lindroth, Madigan, Shunk, Hendrickson, and Tolksdorf, (ii) the claim brought under Section 14 of the Exchange Act, (iii) allegations that the defendants engaged in acts to "artificially inflate the price" of the Corporation's stock, and (iv) the previous allegations quantifying damages to the Corporation at \$40 million (instead alleging "million of dollars" in damages), and (B) otherwise appears to have been drafted to comport with the Court's Opinion and Order dated September 7, 2005. The Third Amended Complaint continues to include allegations against defendant Littlejohn, notwithstanding the Court's September 6, 2005 Order staying the case against her because of her personal bankruptcy filing. Before the defendants responded to the Third Amended Complaint, the Court entered an Order on October 31, 2005, striking the Third Amended Complaint because the required permission of the Court was not obtained for its filing. The Court's Order affords plaintiff seven days in which to submit a stipulated order for filing of the Third Amended Complaint, or the filing of a motion to permit its filing. Plaintiff subsequently filed a motion for leave to file a Third Amended Complaint, and the Court has taken the motion under advisement after conducting a hearing on the motion on December 6, 2005.

The mediation scheduled by the Court among the parties, the Corporation, and its insurer was held on November 15, 2005. No settlement was reached. A continuation of the mediation has been scheduled for April 26, 2006 by the parties, which are conducting discovery in preparation for the mediation.

On November 22, 2005, the U.S. Bankruptcy Court for the Western District of Michigan entered an Order granting the plaintiff's motion to lift the automatic stay under 11 U.S.C. § 362 and to permit plaintiff to continue the *Damon* action against defendant Littlejohn, to the extent that plaintiff limits its recovery to insurance proceeds. On December 14, 2005, the Bankruptcy Court entered an order discharging defendant Littlejohn as a debtor in bankruptcy.

On March 3, 2006, the Court amended the Case Management Order to extend the discovery and motion cutoff deadlines in the *Damon* case.

Prosecution of this case is the responsibility of the plaintiff and its counsel. The Corporation's role will be to monitor the case and to respond to discovery requests from the parties. Any settlement or judgment ultimately obtained by plaintiff in this action, net of fees and expenses of counsel for plaintiff, will inure to the benefit of the Corporation.

If a settlement is not reached as a result of the mediation, the Corporation will incur additional legal fees and expenses in monitoring the plaintiff's prosecution of the case on behalf of the Corporation and in responding to the parties' requests for discovery directed to it. At this time the Corporation cannot accurately estimate the amount of any such future legal fees and expenses.

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

MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION (Continued)

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.

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.

In an Order dated September 29, 2005, the Court realigned the Corporation as the plaintiff and made the Corporation exclusively responsible for prosecuting all further aspects of the case, including any settlement. In the same Order, the Court stated that the Virginia M. Damon Trust would remain as a nominal plaintiff in the case, entitled to notice.

A Case Management Order was entered by the Court on January 27, 2006. The Court also scheduled a mediation among the parties for June, 2006. The parties have jointly retained a facilitator to conduct a non-binding mediation on June 20 and 21, 2006. Pursuant to the Court's order, the parties intend to exchange documents and expert reports prior to that mediation.

MACKINAC FINANCIAL CORPORATION
PART II. OTHER INFORMATION (Continued)

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 actions described above. The Corporation does not believe that legal costs associated with the *Damon* action noted above will be material for 2006. The amount of the costs to be incurred for 2006 pertaining to the *Wipfli* action is unknown; however, the Corporation believes it will not be in excess of \$200,000.

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

SIGNATURES

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

MACKINAC FINANCIAL CORPORATION

(Registrant)

Date: May 12, 2006

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 12, 2006

/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 12 ,2006

/s/ Eliot R. Stark
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, 2006, (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 12, 2006

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, 2006, (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 12, 2006