

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 June 30, 2009

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: (888) 343-8147

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

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller reporting company

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

Yes  No

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

MACKINAC FINANCIAL CORPORATION

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MACKINAC FINANCIAL CORPORATION

PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS  
(Dollars in Thousands)

	<u>June 30,</u> <u>2009</u> <u>(unaudited)</u>	<u>December 31,</u> <u>2008</u>	<u>June 30,</u> <u>2008</u> <u>(unaudited)</u>
<b>ASSETS</b>			
Cash and due from banks	\$ 12,189	\$ 10,112	\$ 7,115
Federal funds sold	-	-	19,274
Cash and cash equivalents	<u>12,189</u>	<u>10,112</u>	<u>26,389</u>
Interest-bearing deposits in other financial institutions	618	582	387
Securities available for sale	95,620	47,490	23,230
Federal Home Loan Bank stock	3,794	3,794	3,794
Loans:			
Commercial	296,392	296,088	292,645
Mortgage	71,777	70,447	65,869
Installment	3,835	3,745	3,608
Total Loans	<u>372,004</u>	<u>370,280</u>	<u>362,122</u>
Allowance for loan losses	<u>(4,119)</u>	<u>(4,277)</u>	<u>(3,585)</u>
Net loans	<u>367,885</u>	<u>366,003</u>	<u>358,537</u>
Premises and equipment	11,064	11,189	11,377
Other real estate held for sale	4,950	2,189	3,395
Other assets	<u>10,184</u>	<u>10,072</u>	<u>10,218</u>
<b>TOTAL ASSETS</b>	<u>\$ 506,304</u>	<u>451,431</u>	<u>\$ 437,327</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Liabilities:			
Non-interest-bearing deposits	\$ 33,368	\$ 30,099	\$ 27,741
Interest-bearing deposits:			
NOW, money market, checking	75,974	70,584	78,703
Savings	21,411	20,730	15,171
CDs<\$100,000	72,139	73,752	78,678
CDs>\$100,000	25,455	25,044	28,252
Brokered	<u>184,805</u>	<u>150,888</u>	<u>128,431</u>
Total deposits	<u>413,152</u>	<u>371,097</u>	<u>356,976</u>
Long-term borrowings	36,210	36,210	36,280
Other liabilities	3,003	2,572	3,096
Total liabilities	<u>452,365</u>	<u>409,879</u>	<u>396,352</u>
Shareholders' equity:			
Preferred stock outstanding	10,418	-	-
Common stock and additional paid in capital - No par value			
Authorized - 18,000,000 shares			
Issued and outstanding - 3,419,736 shares	43,468	42,815	42,773
Accumulated deficit	(1,158)	(1,708)	(1,672)
Accumulated other comprehensive income (loss)	<u>1,211</u>	<u>445</u>	<u>(126)</u>
Total shareholders' equity	<u>53,939</u>	<u>41,552</u>	<u>40,975</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 506,304</u>	<u>\$ 451,431</u>	<u>\$ 437,327</u>

See accompanying notes to condensed consolidated financial statements.

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

(Dollars in thousands except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(Unaudited)		(Unaudited)	
<b>INTEREST INCOME:</b>				
Interest and fees on loans:				
Taxable	\$ 5,104	\$ 5,604	\$ 10,106	\$ 11,704
Tax-exempt	84	102	174	210
Interest on securities:				
Taxable	673	271	1,132	537
Tax-exempt	3	2	4	3
Other interest income	14	81	16	170
Total interest income	<u>5,878</u>	<u>6,060</u>	<u>11,432</u>	<u>12,624</u>
<b>INTEREST EXPENSE:</b>				
Deposits	1,566	2,551	3,344	5,616
Borrowings	261	391	542	845
Total interest expense	<u>1,827</u>	<u>2,942</u>	<u>3,886</u>	<u>6,461</u>
Net interest income	4,051	3,118	7,546	6,163
Provision for loan losses	150	750	700	750
Net interest income after provision for loan losses	<u>3,901</u>	<u>2,368</u>	<u>6,846</u>	<u>5,413</u>
<b>NONINTEREST INCOME:</b>				
Service fees	271	194	514	368
Net security gains	-	-	-	65
Net gains on sale of secondary market loans	84	49	142	97
Proceeds from lawsuit settlement	-	3,475	-	3,475
Other	84	29	174	52
Total noninterest income	<u>439</u>	<u>3,747</u>	<u>830</u>	<u>4,057</u>
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	1,561	2,075	3,158	3,882
Occupancy	355	348	733	703
Furniture and equipment	222	190	411	368
Data processing	224	216	444	437
Professional service fees	144	79	297	232
Loan and deposit	512	144	773	254
Telephone	46	39	89	84
Advertising	80	60	158	120
Other	326	320	646	582
Total noninterest expense	<u>3,470</u>	<u>3,471</u>	<u>6,709</u>	<u>6,662</u>
Income before provision for income taxes	870	2,644	967	2,808
Provision for income taxes	271	875	278	900
<b>NET INCOME</b>	<u>599</u>	<u>1,769</u>	<u>689</u>	<u>1,908</u>
<b>Preferred dividend expense</b>	138	-	138	-
<b>NET INCOME AVAILABLE TO COMMON SHAREHOLDERS</b>	<u>\$ 461</u>	<u>\$ 1,769</u>	<u>\$ 551</u>	<u>\$ 1,908</u>
<b>INCOME PER COMMON SHARE:</b>				
Basic	<u>\$ .13</u>	<u>\$ .52</u>	<u>\$ .16</u>	<u>\$ .56</u>
Diluted	<u>\$ .13</u>	<u>\$ .52</u>	<u>\$ .16</u>	<u>\$ .56</u>

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		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Balance, beginning of period	\$ 41,864	\$ 39,633	\$ 41,551	\$ 39,321
Net income for period	461	1,769	551	1,908
Net unrealized gain (loss) on securities available for sale	561	(338)	766	(186)
Total comprehensive income	1,022	1,431	1,317	1,722
Stock option compensation	17	21	35	42
Repurchase of common stock - oddlot shares	-	(110)	-	(110)
Issuance of preferred stock	10,382	-	10,382	-
Issuance of common stock warrants	618	-	618	-
Accretion of preferred stock discount	36	-	36	-
Balance, end of period	<u>\$ 53,939</u>	<u>\$ 40,975</u>	<u>\$ 53,939</u>	<u>\$ 40,975</u>

See accompanying notes to condensed consolidated financial statements.

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

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>
<b><u>Cash Flows from Operating Activities:</u></b>		
Net income	\$ 551	\$ 1,908
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,000	607
Provision for deferred taxes	218	900
Provision for loan losses	700	750
(Gain) on sales/calls of securities available for sale	-	(65)
(Gain) loss on sale of premises, equipment and other real estate	4	(5)
Writedown of other real estate	-	201
Stock option compensation	35	42
Change in other assets	(762)	283
Change in other liabilities	430	313
Net cash provided by operating activities	<b>2,176</b>	<b>4,934</b>
<b><u>Cash Flows from Investing Activities:</u></b>		
Net (increase) in loans	(5,383)	(10,792)
Net (increase) decrease in interest-bearing deposits in other financial institutions	(36)	1,423
Purchase of securities available for sale	(50,216)	(24,481)
Proceeds from sales, maturities or calls of securities available for sale	2,856	22,766
Capital expenditures	(463)	(266)
Proceeds from sale of premises, equipment, and other real estate	88	73
Net cash (used in) investing activities	<b>(53,154)</b>	<b>(11,277)</b>
<b><u>Cash Flows from Financing Activities:</u></b>		
Net increase in deposits	42,055	36,149
Issuance of Preferred Stock Series A Capital	11,000	-
Net (decrease) in federal funds purchased	-	(7,710)
Net (decrease) in line of credit	-	(1,959)
Net (decrease) repurchase of common stock - oddlot shares	-	(110)
Net cash provided by financing activities	<b>53,055</b>	<b>26,370</b>
Net increase in cash and cash equivalents	2,077	20,027
Cash and cash equivalents at beginning of period	<b>10,112</b>	<b>6,362</b>
Cash and cash equivalents at end of period	<b>\$ 12,189</b>	<b>\$ 26,389</b>
<b><u>Supplemental Cash Flow Information:</u></b>		
Cash paid during the year for:		
Interest	\$ 3,989	\$ 5,086
Income taxes	60	-
<b><u>Noncash Investing and Financing Activities:</u></b>		
Transfers of foreclosures from loans to other real estate held for sale (net of adjustments made through the allowance for loan losses)	\$ 3,276	\$ 2,237

See accompanying notes to condensed consolidated financial statements.

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

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**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 six month period ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. The unaudited consolidated financial statements and footnotes thereto should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008.

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

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

**Allowance for Loan Losses**

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

The Corporation 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 collectability of the principal is unlikely. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require additions to the allowance for loan losses based on their judgments of collectability.

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

**Stock Option Plans**

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

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

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

directors, were approved in 1997. A total of 30,000 shares (adjusted for the 1:20 reverse stock split), were made available for grant under these plans. Options under all of the plans are granted at the discretion of a committee of the Corporation's Board of Directors. Options to purchase shares of the Corporation's stock are granted at a price equal to the market price of the stock at the date of grant. The committee determines the vesting of the options when they are granted as established under the plan.

**2. RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*. SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Although there is new terminology, the standard is based on the same principles as those that currently exist in the auditing standards. The standard also includes a required disclosure of the date through which the entity has evaluated subsequent events and whether the evaluation date is the date of issuance or the date the financial statements were available to be issued. The standard is effective for interim or annual periods ending after June 15, 2009. The Corporation has complied with the disclosure requirements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. ("FIN") 46(R)*. SFAS No. 167 was issued to improve financial reporting for enterprises with variable interest entities to address (1) the effects of certain provisions of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, as a result of the elimination of the qualifying special-purpose entity concept in SFAS No. 166, *Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140*, and (2) constituent concerns about the application of certain key provisions of FIN 46(R), including those in which the accounting and disclosures under FASB Interpretation No. 46 do not always provide timely and useful information about an enterprise's involvement in a variable interest entity. SFAS No. 167 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier adoption of SFAS No. 167 is prohibited. The Corporation is currently evaluating the effect the adoption of SFAS No. 167 will have on its consolidated financial statements.

In June 2009, the FASB Issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162*. The *FASB Accounting Standards Codification* (Codification) will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of the federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Corporation will comply with the requirements of the Statement beginning in the third quarter of 2009.

In April 2009, the FASB issued the following three FSPs intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities:

FSP FAS 157-4, *"Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly,"* provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have decreased significantly. FSP FAS 157-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of FSP FAS 157-4 were effective for the Corporation's interim period ending on June 30, 2009. The adoption of FSP FAS 157-4 did not affect the consolidated financial statements for the Corporation as of June 30, 2009.

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

**2. RECENT ACCOUNTING PRONOUNCEMENTS** (Continued)

FSP FAS 107-1 and APB 28-1, “*Interim Disclosures about Fair Value of Financial Instruments*,” requires disclosures about fair value of financial instruments in interim reporting periods of publicly traded companies that were previously only required to be disclosed in annual financial statements. The provisions of FSP FAS 107-1 and APB 28-1 were effective for the Corporation’s interim period ending on June 30, 2009. As FSP FAS 107-1 and APB 28-1 amended only the disclosure requirements about fair value of financial instruments in interim periods, the adoption of FSP FAS 107-1 and APB 28-1 did not affect the consolidated financial statements for the Corporation as of June 30, 2009.

FSP FAS 115-2 and FAS 124-2, “*Recognition and Presentation of Other-Than-Temporary Impairments*,” amends current other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentations and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The provisions of FSP FAS 115-2 and FAS 124-2 were effective for the Corporation’s interim period ending on June 30, 2009. The adoption of FSP FAS 115-2 and FAS 124-2 did not affect the consolidated financial statements for the Corporation as of June 30, 2009.

In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 165, *Subsequent Events*, we have evaluated subsequent events through the date of this filing, August 13, 2009. We do not believe there are any material subsequent events which would require further disclosure, other than the subsequent sale of two branch offices. Please refer to footnote 12 for further discussion.

**3. EARNINGS PER SHARE**

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Net income	\$ 599	\$ 1,769	\$ 689	\$ 1,908
Preferred stock dividends	138	-	138	-
Net income available to common shareholders	<u>\$ 461</u>	<u>\$ 1,769</u>	<u>\$ 551</u>	<u>\$ 1,908</u>
Weighted average shares outstanding	3,419,736	3,419,933	3,419,736	3,424,314
Effect of dilutive stock options outstanding	-	-	-	-
Diluted weighted average shares outstanding	3,419,736	3,419,933	3,419,736	3,424,314
Earnings per common share:				
Basic	\$ .13	\$ .52	\$ .16	\$ .56
Diluted	\$ .13	\$ .52	\$ .16	\$ .56

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 June 30, 2009, December 31, 2008 and June 30, 2008 are as follows (dollars in thousands):

	<u>June 30, 2009</u>		<u>December 31, 2008</u>		<u>June 30, 2008</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
US Agencies - MBS	\$ 74,390	\$ 75,788	\$ 46,316	\$ 46,941	\$ 22,696	\$ 22,623
Asset backed - government guaranteed	13,936	14,285	-	-	-	-
Obligations of states and political subdivisions	1,259	1,287	498	549	550	607
Corporate bonds	4,201	4,260	-	-	-	-
Total securities available for sale	<u>\$ 93,786</u>	<u>\$ 95,620</u>	<u>\$ 46,814</u>	<u>\$ 47,490</u>	<u>\$ 23,246</u>	<u>\$ 23,230</u>

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were \$18.095 million and \$18.730 million, respectively, at June 30, 2009.

**5. LOANS**

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

	<u>June 30, 2009</u>	<u>December 31, 2008</u>	<u>June 30, 2008</u>
Commercial real estate	\$ 196,895	\$ 185,241	\$ 186,108
Commercial, financial, and agricultural	73,372	79,734	77,473
One to four family residential real estate	65,564	65,595	60,882
Construction:			
Commercial	26,125	31,113	29,064
Consumer	6,213	4,852	4,987
Consumer	<u>3,835</u>	<u>3,745</u>	<u>3,608</u>
Total loans	<u>\$ 372,004</u>	<u>\$ 370,280</u>	<u>\$ 362,122</u>

**LOANS – Allowance for loan losses**

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

	<u>June 30, 2009</u>	<u>December 31, 2008</u>	<u>June 30, 2008</u>
Balance at beginning of period	\$ 4,277	\$ 4,146	\$ 4,146
Recoveries on loans	45	121	9
Loans charged off	(903)	(2,290)	(1,320)
Provision for loan losses	<u>700</u>	<u>2,300</u>	<u>750</u>
Balance at end of period	<u>\$ 4,119</u>	<u>\$ 4,277</u>	<u>\$ 3,585</u>

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

5. **LOANS** (Continued)

In the first half of 2009, net charge off activity was \$.858 million, or .23% of average loans outstanding compared to net charge-offs of \$1.311 million, or .36% of average loans, in the first half of 2008. In the first half of 2009, the Corporation recorded a provision for loan loss in the amount of \$700,000 compared to \$750,000 in the first half of 2008, which is discussed in more detail under “Management’s Discussion and Analysis.”

**LOANS – Impaired loans**

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

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

	June 30, 2009	December 31, 2008	June 30, 2008	Valuation Reserve		
				June 30, 2009	December 31, 2008	June 30, 2008
Balances, at period end						
Impaired loans with specific valuation reserve	\$ 7,708	\$ 3,730	\$ 4,052	\$ 1,556	\$ 994	\$ 946
Impaired loans with no specific valuation reserve	<u>2,167</u>	<u>1,157</u>	<u>561</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total impaired loans	<u>\$ 9,875</u>	<u>\$ 4,887</u>	<u>\$ 4,613</u>	<u>\$ 1,556</u>	<u>\$ 994</u>	<u>\$ 946</u>
Impaired loans on nonaccrual basis	\$ 9,277	\$ 4,887	\$ 4,613	\$ 1,556	\$ 994	\$ 946
Impaired loans on accrual basis	<u>598</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total impaired loans	<u>\$ 9,875</u>	<u>\$ 4,887</u>	<u>\$ 4,613</u>	<u>\$ 1,556</u>	<u>\$ 994</u>	<u>\$ 946</u>
Average investment in impaired loans	\$ 9,452	\$ 4,834	\$ 4,779			
Interest income recognized during impairment	11	60	46			
Interest income that would have been recognized on an accrual basis	338	377	225			
Cash-basis interest income recognized	11	60	46			

The average investment in impaired loans was approximately \$9.452 million for the six months ended June 30, 2009, \$4.834 million for the year ended December 31, 2008, and \$4.779 million for the six months ended June 30, 2008, respectively. Additional discussion on impaired loans is presented in the “Management’s Discussion and Analysis” section of this report.

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):

	<b>June 30, 2009</b>	December 31, 2008	June 30, 2008
Loans outstanding beginning of period	\$ 6,516	\$ 1,720	\$ 1,720
New loans	900	372	-
Net activity on revolving lines of credit	398	2,378	479
Repayment	(205)	(687)	(41)
Change in related party interest	-	2,733	2,733
	<u>\$ 7,609</u>	<u>\$ 6,516</u>	<u>\$ 4,891</u>

There were no loans to related parties classified substandard at June 30, 2009, December 31, 2008 or June 30, 2008, respectively. In addition to the outstanding balances above, there were unused commitments of \$.197 million to related parties at June 30, 2009.

6. **LONG-TERM BORROWINGS**

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

	<b>June 30, 2009</b>	December 31, 2008	June 30, 2008
Federal Home Loan Bank fixed rate advances at rates ranging from 4.98% to 5.16% maturing in December 2010	\$ 15,000	\$ 15,000	\$ 15,000
Federal Home Loan Bank variable rate advances at rates ranging from 1.04% to 1.16% maturing in January and February 2011	20,000	20,000	20,000
Farmers Home Administration, fixed-rate note payable, maturing August 24, 2024 interest payable at 1%	1,210	1,210	1,280
	<u>\$ 36,210</u>	<u>\$ 36,210</u>	<u>\$ 36,280</u>

The Federal Home Loan Bank borrowings are collateralized at June 30, 2009, by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately \$26.839 million; mortgage related and municipal securities with an amortized cost and estimated fair value of \$17.020 million and \$17.655 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling \$3.794 million. Prepayment of the remaining advances is subject to the provisions and conditions of the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of June 30, 2009.

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling \$.300 million originated and held by the Corporation's wholly owned subsidiary, First Rural Relending, and an assignment of a demand deposit account in the amount of \$1.012 million, and guaranteed by the Corporation.

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

**7. STOCK OPTION PLANS**

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

	<u>June 30, 2009</u>	December 31, 2,008	June 30, 2008
Outstanding shares at beginning of year	446,237	446,417	446,417
Granted during the period	-	-	-
Expired during the period	<u>35,180</u>	180	180
Outstanding shares at end of period	<u>411,057</u>	<u>446,237</u>	<u>446,237</u>
Weighted average exercise price per share at end of period	<u>\$ 12.03</u>	<u>\$ 12.14</u>	<u>\$ 12.14</u>
Shares available for grant at end of period	<u>24,780</u>	<u>18,488</u>	<u>18,488</u>

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

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

Exercise Price Range	Number		Remaining Contractual Life-Years	Weighted Average Exercise Price
	Outstanding	Exercisable		
\$9.16	12,500	5,000	6.5	\$ 9.16
\$9.75	257,152	120,861	5.5	9.75
\$10.65	57,500	11,500	7.5	10.65
\$11.50	40,000	8,000	6.3	11.50
\$12.00	40,000	8,000	6.0	12.00
\$156.00 - \$240.00	3,545	3,545	1.7	186.75
\$300.00	360	360	.8	300.00
	<u>411,057</u>	<u>157,266</u>	<u>5.9</u>	<u>\$ 12.03</u>

**8. INCOME TAXES**

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

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

MACKINAC FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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**8. INCOME TAXES** (Continued)

The Corporation recorded the future benefits from these carryforwards at such time as it became “more likely than not” that they would be utilized prior to expiration. Please refer to further discussion on income taxes contained in “Management’s Discussion and Analysis.” The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL, approximately \$20 million, and all of the credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is \$1.4 million for the NOL and the equivalent value of tax credits, which is approximately \$.477 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December, 2004.

**9. FAIR VALUE MEASUREMENTS**

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

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

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

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

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

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

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

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

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

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

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

MACKINAC FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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**9. FAIR VALUE MEASUREMENTS** (Continued)

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

	June 30, 2009		December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 12,189	\$ 12,189	\$ 10,112	\$ 10,112
Interest bearing deposits	618	618	582	582
Securities available for sale	95,620	95,620	47,490	47,490
Federal Home Loan Bank stock	3,794	3,794	3,794	3,794
Net loans	367,885	371,578	366,003	372,080
Cash surrender value - life insurance	1,421	1,421	1,397	1,397
Other Real Estate	4,950	4,950	2,189	2,189
Accrued interest receivable	1,595	1,595	1,457	1,457
Total financial assets	<u>\$ 488,072</u>	<u>\$ 491,765</u>	<u>\$ 433,024</u>	<u>\$ 439,101</u>
Financial liabilities:				
Deposits	\$ 413,152	\$ 412,674	\$ 371,097	\$ 371,434
Borrowings	36,210	36,669	36,210	36,846
Directors deferred compensation	869	869	912	912
Accrued interest payable	385	385	488	488
Total financial liabilities	<u>\$ 450,616</u>	<u>\$ 450,597</u>	<u>\$ 408,707</u>	<u>\$ 409,680</u>

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

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

- Level 1:** In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access.
- Level 2:** Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3:** Level 3 inputs are unobservable inputs, including inputs available in situations where there is little, if any, market activity for the related asset or liability.

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

**9. FAIR VALUE MEASUREMENTS** (Continued)

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

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

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

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2009
<b>Assets</b>				
Investment securities - available for sale	\$ -	\$ 95,620	\$ -	\$ 95,620
<b>Liabilities</b>				
None				

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

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

**Assets Measured at Fair Value on a Nonrecurring Basis**

(dollars in thousands)

	Balance at June 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Three Months Ended June 30, 2009	Total Losses for Six Months Ended June 30, 2009
<b>Assets</b>						
Impaired loans accounted for under FAS 114	\$ -	\$ -	\$ -	\$ 1,142	\$ 43	\$ 80
					<u>\$ 43</u>	<u>\$ 80</u>

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

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

**10. SHAREHOLDERS' EQUITY**

***Participation in the TARP Capital Purchase Program***

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

**10. SHAREHOLDERS' EQUITY** (Continued)

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

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

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

The Corporation has the right to redeem the Series A Preferred Shares at any time after consulting with its primary regulator, in which case the executive compensation standards would no longer apply to the Corporation.

This capital will be used to increase the strong capital position of the Bank. The Bank will use the capital to grow loans. In addition, the capital will allow the Corporation to consider acquisitions of deposit franchisees that would enhance our funding mix.

**11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK**

***Financial Instruments With Off-Balance-Sheet Risk***

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

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

**11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK** (Continued)

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

	<b>June 30, 2009</b>	December 31, 2,008	June 30, 2008
Commitments to extend credit:			
Variable rate	\$ 31,337	\$ 40,036	\$ 40,215
Fixed rate	7,005	4,487	8,601
Standby letters of credit - Variable rate	1,742	1,838	6,693
Credit card commitments - Fixed rate	2,528	2,438	2,521
	<b>\$ 42,612</b>	<b>\$ 48,799</b>	<b>\$ 58,030</b>

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

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

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

**Contingencies**

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

**Concentration of Credit Risk**

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan. The Bank's most prominent concentration in the loan portfolio relates to commercial real estate loans to operators of nonresidential buildings. This concentration at June 30, 2009 represents \$44.087 million, or 14.87%, compared to \$41.778 million, or 15.85%, of the commercial loan portfolio on June 30, 2008. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gaming, petroleum, forestry, agriculture and construction. Due to the diversity of the Bank's locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic sector.

MACKINAC FINANCIAL CORPORATION  
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**12. SUBSEQUENT EVENTS**

On May 19, 2009, mBank, the banking subsidiary of the Corporation entered into a definitive Purchase and Assumption Agreement with The Miners State Bank of Iron River, Michigan, for the sale of two of their Northwest Upper Peninsula branch offices.

The Asset Purchase and Assumption Agreements call for The Miners State Bank of Iron River, Michigan to purchase the branch buildings and assume approximately \$30 million of deposits associated with both branches. These transactions are expected to close in the third quarter of 2009 and will result in a gain for the Corporation.

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

**FORWARD LOOKING STATEMENTS**

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

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

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

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

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

FINANCIAL OVERVIEW

The Corporation recorded second quarter 2009 income of \$.461 million or \$ .13 per share compared to net income of \$1.769 million, or \$.52 per share for the second quarter of 2008. Net income for the first six months of 2009 totaled \$ .551 million, or \$.16 per share, compared to \$1.908 million, or \$.56 per share, for the same period in 2008.

The quarter and six month results for 2009 includes the FDIC special assessment which was charged to all banking organizations based upon asset size, and amounted to \$.215 million for mBank. The quarter and six month results for 2008 include the positive effect, \$3.475 million, of a lawsuit settlement and the negative effect, \$.425 million, of a severance agreement. Operating results for the six month period in 2009 includes a \$.700 million provision compared to \$.750 million in the same period in 2008.

Weighted average shares totaled 3,419,736 year to date and for the second quarter in 2009 compared to 3,424,314 for the six month period and 3,419,935 at the second quarter of 2008.

Total assets of the Corporation at June 30, 2009 were \$506.304 million, up \$68.977 million, or 15.77% from the \$437.327 million in total assets reported at June 30, 2008 and up \$54.873 million, or 12.16%, from total assets of \$451.431 million at year-end 2008. Asset totals at June 30, 2009 reflect increased balances of investment securities of approximately \$48 million. The loan portfolio increased \$1.724 million in the first six months of 2009, from December 31, 2008 balances of \$370.280 million. Deposits totaled \$413.152 million at June 30, 2009, an increase from the \$371.097 million at December 31, 2008.

FINANCIAL CONDITION

**Cash and Cash Equivalents**

Cash and cash equivalents increased \$2.077 million in 2009. See further discussion of the change in cash and cash equivalents in the Liquidity section.

**Investment Securities**

Securities available-for-sale increased \$48.130 million, or 101.35%, from December 31, 2008 to June 30, 2009, with the balance on June 30, 2009, totaling \$95.620 million. Investment securities are utilized in an effort to manage interest rate risk and liquidity. In the second quarter of 2009, the Corporation increased its investment portfolio in combination with the funding received, \$11.000 million, from the issuance of preferred stock. The Corporation expects to reduce the current level of investment securities as loan funding increases later in 2009. As of June 30, 2009, investment securities with an estimated fair value of \$18.730 million were pledged.

**Loans**

Through the first half of 2009, loan balances increased by \$1.724 million, or .47%, from December 31, 2008 balances of \$370.280 million. During the first six months of 2009, the Bank had total loan production of \$27.436 million. This loan production, however, was significantly offset by normal principal runoff and amortization, \$11.785 million, and large paydowns and refinancing, which totaled \$7.520 million. Management continues to actively manage the loan portfolio, seeking to identify and resolve problem assets at an early stage. Management believes a properly positioned loan portfolio provides the most attractive earning asset yield available to the Corporation and, with changes to the loan approval process and exception reporting, management can effectively manage the risk in the loan portfolio. Management intends to continue loan growth within its markets for mortgage,

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

consumer, and commercial loan products while concentrating on loan quality, industry concentration issues, and competitive pricing.

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

	<b>June 30, 2009</b>	<b>Percent of Total</b>	December 31, 2008	Percent of Total	June 30, 2008	Percent of Total
Commercial real estate	<b>\$ 196,895</b>	<b>52.93</b> %	\$ 185,241	50.03	\$ 186,108	51.39
Commercial, financial, and agricultural	<b>73,372</b>	<b>19.72</b>	79,734	21.53	77,473	21.39
One to four family residential real estate	<b>65,564</b>	<b>17.63</b>	65,595	17.71	60,882	16.81
Consumer	<b>3,835</b>	<b>1.03</b>	3,745	1.01	3,608	1.00
Construction:						
Commercial	<b>26,125</b>	<b>7.02</b>	31,113	8.40	29,064	8.03
Consumer	<b>6,213</b>	<b>1.67</b>	4,852	1.31	4,987	1.38
Total loans	<b><u>\$ 372,004</u></b>	<b><u>100.00</u></b> %	<b><u>\$ 370,280</u></b>	<b><u>100.00</u></b> %	<b><u>\$ 362,122</u></b>	<b><u>100.00</u></b> %

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

	<b>Outstanding Balance</b>	<b>Percent of Commercial Loans</b>	<b>Percent of Shareholders' Equity</b>	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity
R/E - oper. of nonresidential bldgs.	\$ 44,087	14.87	81.74	\$ 41,299	13.95	105.79	\$ 41,778	15.85	101.96
Hospitality and tourism	35,033	11.82	64.95	35,086	11.85	95.63	35,053	13.30	85.55
Real estate agents and managers	24,614	8.30	45.63	29,292	9.89	75.20	27,495	10.43	67.10
Commercial construction	26,125	8.81	48.43	31,113	10.51	99.06	10,716	4.07	26.15
Other	166,533	56.20	308.74	159,298	53.80	358.88	148,539	56.35	362.51
Total Commercial Loans	<b><u>\$ 296,392</u></b>	<b><u>100.00</u></b> %		<b><u>\$ 296,088</u></b>	<b><u>100.00</u></b> %		<b><u>\$ 263,581</u></b>	<b><u>100.00</u></b> %	

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

### Credit Quality

Management analyzes the allowance for loan losses in detail on a monthly basis to determine whether the losses inherent in the portfolio are properly reserved for. Net charge-offs for the first half of 2009 amounted to \$.858 million, or .23% of average loans outstanding, compared to \$1.311 million, .36% of average loans outstanding, for the first half of 2008. The current reserve balance is representative of the relevant risk inherent within the Corporation's loan portfolio. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity. The \$7.749 million increase in nonperforming assets from 2008 year end balances of \$7.076 million includes two large credit relationships in Southeast Michigan that account for \$5.7 million of the June 30, 2009 nonperforming asset balances.

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The table below shows period end balances of nonperforming assets (dollars in thousands):

	<u>June 30,</u> <u>2009</u>	December 31, <u>2008</u>	June 30, <u>2008</u>
<b>Nonperforming Assets:</b>			
Nonaccrual Loans	<b>\$ 9,283</b>	\$ 4,887	\$ 4,613
Loans past due 90 days or more	-	-	-
Restructured loans	<b>592</b>	-	-
Total nonperforming loans	<b>9,875</b>	4,887	4,613
Other real estate owned	<b>4,950</b>	2,189	3,395
Total nonperforming assets	<b>\$ 14,825</b>	<b>\$ 7,076</b>	<b>\$ 8,008</b>
Nonperforming loans as a % of loans	<b>2.66</b> %	1.32 %	1.27 %
Nonperforming assets as a % of assets	<b>2.93</b> %	1.57 %	1.83 %
<b>Reserve for Loan Losses:</b>			
At period end	<b>\$ 4,119</b>	\$ 4,227	\$ 3,585
As a % of loans	<b>1.11</b> %	1.16 %	0.99 %
As a % of nonperforming loans	<b>41.71</b> %	87.52 %	77.72 %
As a % of nonaccrual loans	<b>44.37</b> %	87.52 %	77.72 %

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

	<u>June 30,</u> <u>2009</u>	December 31, <u>2008</u>	June 30, <u>2008</u>
Total loans, at period end	<b>\$ 372,004</b>	\$ 370,280	\$ 362,122
Average loans for the year	<b>371,278</b>	361,324	360,176
Allowance for loan losses	<b>4,119</b>	4,277	3,585
Allowance to total loans at period end	<b>1.11</b> %	1.16 %	0.99 %
Net charge-offs during the period	<b>\$ 858</b>	\$ 2,169	\$ 1,311
Net charge-offs to average loans	<b>.23</b> %	.60 %	.36 %
Net charge-offs to beginning allowance balance	<b>20.06</b> %	52.32 %	31.62 %

Management continues to address market issues impacting its loan customer base. In conjunction with the Corporation's senior lending staff and the bank regulatory examinations, management reviews the Corporation's loans, related collateral evaluations, and the overall lending process. The Corporation also utilizes a loan review consultant to perform a review of the loan portfolio. The opinion of this consultant upon completion of the independent review in 2008 provided findings similar to management on the overall adequacy of the reserve. The Corporation has engaged this same consultant for loan review during 2009.

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

<u>Collateral Type</u>	<u>Balance</u>	<u>Most Recent Appraisal</u>	<u>Reserve Allocation</u>
<b><u>Nonaccrual Loans</u></b>			
Non-farm / non-residential (SEM)	\$ 4,742	\$ 5,200	\$ 520
Non-farm / non-residential (NLP)	1,405	1,675	25
Construction / development (SEM)	1,000	460	400
Cabins / land (NLP)	451	425	-
Land development (NLP)	443	N/A	350
Non-farm / non-residential & commercial unsecured (SEM)	371	450	15
Conv 5+ residential properties (UP)	311	100	160
Non-farm / non-residential (UP)	172	314	-
Commercial general (UP)	129	50	71
Commercial general (SEM)	114	N/A	-
1-4 family (NLP)	68	163	-
Land (NLP)	40	130	-
Business equipment (UP)	32	25	15
Recreational (UP)	5	N/A	-
Total nonaccrual loans	<u>9,283</u>	<u>8,992</u>	<u>1,556</u>
<b><u>Restructured Loans</u></b>			
Non-farm / non-residential (UP)	<u>592</u>	<u>920</u>	<u>5</u>
<b><u>Other Real Estate</u></b>			
Land development (SEM)	2,133	2,370	-
Land development / condo (NLP)	630	700	-
Land development (NLP)	511	645	-
Non-farm / non-residential (SEM)	508	620	-
Construction/development (NLP)	448	485	7
1-4 family (UP)	400	490	-
Non-farm / non-residential (UP)	215	248	-
Downtown store frontage / 2 / 1-4 family (UP)	77	85	-
1-4 family (NLP)	28	35	-
Total other real estate owned	<u>4,950</u>	<u>5,678</u>	<u>7</u>
Total nonperforming assets	<u>\$ 14,825</u>	<u>\$ 15,590</u>	<u>\$ 1,568</u>
<b><u>REGIONAL BREAKOUT OF NONPERFORMING ASSETS</u></b>			
NLP - NORTHERN LOWER PENINSULA	\$ 4,024	\$ 4,258	\$ 382
UP - UPPER PENINSULA	1,933	2,232	251
SEM - SOUTHEAST MICHIGAN	<u>8,868</u>	<u>9,100</u>	<u>935</u>
<b>TOTAL</b>	<u>\$ 14,825</u>	<u>\$ 15,590</u>	<u>\$ 1,568</u>

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

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

	<u>June 30, 2009</u>	<u>December 31, 2008</u>	<u>June 30, 2008</u>
Commercial, financial and agricultural loans	\$ 3,769	\$ 3,819	\$ 3,276
One to four family residential real estate loans	5	27	27
Consumer loans	5	40	15
Unallocated and general reserves	<u>340</u>	<u>391</u>	<u>267</u>
Totals	<u>\$ 4,119</u>	<u>\$ 4,277</u>	<u>\$ 3,585</u>

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As of June 30, 2009, the allowance for loan losses represented 1.11% of total loans. In management's opinion, the allowance for loan losses is adequate to cover probable losses related to specifically identified loans, as well as probable losses inherent in the balance of the loan portfolio.

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

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

	<u>Six Months Ended</u> <u>June 30, 2009</u>	<u>Year Ended</u> <u>December 31, 2008</u>	<u>Six Months Ended</u> <u>June 30, 2008</u>
Balance at beginning of period	\$ 2,189	\$ 1,226	\$ 1,226
Other real estate transferred from loans due to foreclosure	3,276	2,849	2,439
Reclassification of redemption OREO	(475)	-	-
Other real estate sold/written down	(37)	(1,886)	(270)
Loss on sale of other real estate	(3)		
	<u>\$ 4,950</u>	<u>\$ 2,189</u>	<u>\$ 3,395</u>

During the first six months of 2009, the Corporation received real estate in lieu of loan payments of \$3.276 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balance. Any additional reduction in the fair value results in a write-down of other real estate.

### Deposits

The Corporation had an increase in deposits in the first six months of 2009. Total deposits increased by \$42.055 million, or 11.33%, in the first six months of 2009. The increase in deposits for the first six months of 2009 is composed of an increase in noncore deposits of \$34.328 million and an increase in core deposits of \$7.727 million. The core deposit balance increases are primarily in transactional account deposits, our lowest cost of funds. Management continues to monitor existing deposit products in order to stay competitive as to both terms and pricing. It is the intent of management to be aggressive in its markets to grow core deposits with an emphasis placed on transactional deposits.

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

	<u>June 30,</u> <u>2009</u>	<u>% of Total</u>		<u>December 31,</u> <u>2008</u>	<u>% of Total</u>		<u>June 30,</u> <u>2008</u>	<u>% of Total</u>
Non-interest-bearing	\$ 33,368	8.08 %	\$	30,099	8.11 %	\$	27,741	7.77 %
NOW, money market, checking	75,974	18.39		70,584	19.02		78,703	22.05
Savings	21,411	5.18		20,730	5.59		15,171	4.25
Certificates of Deposit <\$100,000	72,139	17.46		73,752	19.87		78,678	22.04
Total core deposits	<u>202,892</u>	<u>49.11</u>		195,165	52.59		200,293	56.11
Certificates of Deposit >\$100,000	25,455	6.16		25,044	6.75		28,252	7.92
Brokered CDs	184,805	44.73		150,888	40.66		128,431	35.98
Total non-core deposits	<u>210,260</u>	<u>50.89</u>		175,932	47.41		156,683	43.89
Total deposits	<u>\$ 413,152</u>	<u>100.00 %</u>	\$	<u>371,097</u>	<u>100.00 %</u>	\$	<u>356,976</u>	<u>100.00 %</u>

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**Borrowings**

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

**Shareholders' Equity**

Total shareholders' equity increased \$12.387 million from December 31, 2008 to June 30, 2009. This increase includes the increase from the Preferred Stock issue, \$10.382 million, along with the issuance of common stock warrants, \$.618 million. Also contributing to the increase in shareholders' equity was net income of \$.551 million, contributed capital of \$35,000, in recognition of stock option expense, an increase in the market value of securities of \$.766 million and the accretion of the discount on preferred stock of \$36,000.

RESULTS OF OPERATIONS

**Summary**

The Corporation reported income of \$.551 million for the first half of 2009, \$.16 per share, compared to net income of \$1.908 million, \$.56 per share, in the first half of 2008. In the second quarter of 2009, net income was \$.461, \$.13 per share, compared to \$1.769 million, \$.52 per share, in the second quarter of 2008.

**Net Interest Income**

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

Net interest margin increased to \$4.051 million, 3.58% of average earning assets, in the second quarter of 2009, compared to \$3.118 million, 3.19% of average earning assets, in the second quarter of 2008. In the first six months of 2009, net interest margin increased to \$7.546 million, 3.47% of average earning assets, compared to \$6.163 million, 3.16% of average earning assets, for the same period in 2008. Margin improvement in 2009 was primarily due to a reduction in funding costs between periods as average interest rates on brokered deposits declined more than rates on earning assets.

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

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

	Three Months Ended										
	Average Balances			Average Rates		Interest		2009-2008			
	June 30,		Increase/ (Decrease)	June 30,		June 30,		Income/ Expense Variance	Volume Variance	Rate Variance	Rate/ Volume Variance
	2009	2008		2009	2008	2009	2008				
(dollars in thousands)											
Loans (1,2,3)	\$ 371,609	\$ 362,574	\$ 9,035	5.65 %	6.39 %	\$ 5,231	\$ 5,759	\$ (528)	\$ 144	\$ (671)	(1)
Taxable securities	76,092	23,960	52,132	3.56	4.58	675	273	402	596	(61)	(133)
Nontaxable securities (2)	1,939	69	1,870	0.41	5.83	2	1	1	27	(1)	(25)
Federal funds sold	-	1,923	(1,923)	-	2.09	-	10	(10)	(10)	(10)	10
Other interest-earning assets	4,399	4,183	216	1.28	6.73	14	70	(56)	4	(57)	(3)
Total earning assets	454,039	392,709	61,330	5.23	6.26	5,922	6,113	(191)	761	(800)	(152)
Reserve for loan losses	(4,847)	(3,886)	(961)								
Cash and due from banks	17,708	6,053	11,655								
Intangible assets	16	94	(78)								
Other assets	24,289	23,276	1,013								
Total assets	\$ 491,205	\$ 418,246	\$ 72,959								
NOW and money market deposits	\$ 69,098	\$ 80,379	\$ (11,281)	.81	1.53	140	306	(166)	(43)	(144)	21
Interest checking	5,884	-	5,884	1.91	-	28	-	28	-	-	28
Savings deposits	21,363	13,310	8,053	.66	.94	35	31	4	19	(9)	(6)
CDs <\$100,000	71,608	81,746	(10,138)	2.85	4.25	508	863	(355)	(107)	(285)	37
CDs >\$100,000	25,939	26,773	(834)	2.35	3.97	152	264	(112)	(8)	(108)	4
Brokered deposits	176,940	104,187	72,753	1.59	4.20	703	1,087	(384)	761	(676)	(469)
Borrowings	36,376	42,430	(6,054)	2.88	3.71	261	391	(130)	(56)	(88)	14
Total interest-bearing liabilities	407,208	348,825	58,383	1.80	3.39	1,827	2,942	(1,115)	566	(1,310)	(371)
Demand deposits	30,678	26,331	4,347								
Other liabilities	3,464	2,691	773								
Shareholders' equity	49,855	40,399	9,456								
Total liabilities and shareholders' equity	\$ 491,205	\$ 418,246	\$ 72,959								
Rate spread				3.43 %	2.87 %						
Net interest margin/revenue				3.62 %	3.25 %	\$ 4,095	\$ 3,171	\$ 924	\$ 195	\$ 510	\$ 219

- (1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.  
(2) The amount of interest income on loans and nontaxable securities has been adjusted to a tax equivalent basis, using a 34% tax rate  
(3) Interest income on loans includes fees

	Six Months Ended										
	Average Balances			Average Rates		Interest		2009-2008			
	June 30,		Increase/ (Decrease)	June 30,		June 30,		Income/ Expense Variance	Volume Variance	Rate Variance	Rate/ Volume Variance
	2009	2008		2009	2008	2009	2008				
(dollars in thousands)											
Loans (1,2,3)	\$ 371,278	\$ 360,176	\$ 11,102	5.63 %	6.71 %	\$ 10,370	\$ 12,022	\$ (1,652)	\$ 370	\$ (1,929)	(93)
Taxable securities	61,906	23,930	37,976	3.69	4.51	1,132	537	595	850	(98)	(157)
Nontaxable securities (2)	975	70	905	1.24	11.49	6	4	2	52	(4)	(46)
Federal funds sold	-	3,641	(3,641)	-	2.93	-	53	(53)	(53)	(53)	53
Other interest-earning assets	4,383	4,436	(53)	.74	5.30	16	117	(101)	(1)	(100)	-
Total earning assets	438,542	392,253	46,289	5.30	6.53	11,524	12,733	(1,209)	1,218	(2,184)	(243)
Reserve for loan losses	(4,627)	(3,982)	(645)								
Cash and due from banks	15,539	6,127	9,412								
Intangible assets	26	104	(78)								
Other assets	23,594	23,462	132								
Total assets	\$ 473,074	\$ 417,964	\$ 55,110								
NOW and money market deposits	\$ 68,677	\$ 81,107	\$ (12,430)	.79	1.85	270	748	(478)	(114)	(427)	63
Interest checking	5,124	-	5,124	1.97	-	50	-	50	-	-	50
Savings deposits	20,545	12,668	7,877	.74	.89	75	56	19	35	(10)	(6)
CDs <\$100,000	71,642	82,146	(10,504)	2.99	4.44	1,061	1,813	(752)	(231)	(591)	70
CDs >\$100,000	25,846	24,962	884	2.57	4.25	329	527	(198)	19	(208)	(9)
Brokered deposits	164,517	107,105	57,412	1.91	4.64	1,559	2,471	(912)	1,321	(1,449)	(784)
Borrowings	36,511	40,906	(4,395)	2.99	4.15	542	845	(303)	(91)	(235)	23
Total interest-bearing liabilities	392,862	348,894	43,968	1.99	3.72	3,886	6,460	(2,574)	939	(2,920)	(593)
Demand deposits	30,819	26,383	4,436								
Other liabilities	3,537	2,742	795								
Shareholders' equity	45,856	39,945	5,911								
Total liabilities and shareholders' equity	\$ 473,074	\$ 417,964	\$ 55,110								
Rate spread				3.31 %	2.81 %						
Net interest margin/revenue				3.51 %	3.22 %	\$ 7,638	\$ 6,273	\$ 1,365	\$ 279	\$ 736	\$ 350

- (1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.  
(2) The amount of interest income on loans and nontaxable securities has been adjusted to a tax equivalent basis, using a 34% tax rate  
(3) Interest income on loans includes fees

Approximately 65% of the Corporation's loan portfolio repriced downward with prime rate reductions that occurred in 2008. The reduced rates of the Corporation's loan portfolio are reflected in the overall decrease in rates on earning assets from 6.53% in the first six months of 2008 to 5.30% in the first six months of 2009. In the three month comparative periods, rates declined on earning assets from 6.26% in 2008 to 5.23% in 2009. During the period of prime rate reductions, the Corporation reduced bank deposit rates in order to mitigate the impact on earnings. The Corporation is somewhat reliant on wholesale funding sources, specifically brokered deposits. The

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Corporation had average balances of \$164.517 million in the first six months of 2009 with an average cost of 1.91% compared to \$107.105 million at 4.64% in the first six months of 2008. The Corporation had average balances of \$176.940 million in the second quarter of 2009 with an average cost of 1.59% compared to \$104.187 million at 4.20% in the second quarter of 2008.

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

**Provision for Loan Losses**

The Corporation records a provision for loan losses when it believes it is necessary to adjust the allowance for loan losses to maintain an adequate level after considering factors such as loan charge-offs and recoveries, changes in identified levels of risk in the loan portfolio, changes in the mix of loans in the portfolio, loan growth, and other economic factors. During the first six months of 2009, the Corporation recorded a \$.700 million provision for loan loss. During the first six months of 2008, the Corporation recorded a \$.750 million provision for loan loss. In future periods, loan loss provisions will be required if there is further market deterioration that impacts the credit quality on the existing portfolio.

**Noninterest Income**

Other income decreased by \$3.227 million for the six months ended June 30, 2009, compared to the six months ended June 30, 2008. The Corporation recognized a benefit from the settlement of a shareholder lawsuit in the first half of 2008, which amounted to \$3.475 million. Service fees increased \$.146 million in the first six months of 2009, while other noninterest income decreased \$.122 million. Revenue due to loans produced and sold in the secondary market amounted to \$.142 million compared to \$.097 million a year ago. We expect to continue to benefit from secondary market activity in future periods as the refinancing boom continues. The Corporation is also expecting to increase other income from sources such as fees from the sale of SBA guaranteed loans.

During the second quarter of 2009, the Corporation recognized \$.439 million in noninterest income, compared to \$3.747 million for the second quarter of 2008. The second quarter 2008 noninterest income includes the \$3.475 million lawsuit settlement. Service fees increased for the second quarter of 2009 by \$77,000 to \$.271 million when compared to \$.194 million in the second quarter of 2008. Management continues to evaluate deposit products and services for ways to better serve its customer base and also enhance service fee income through a broad array of products that price services based on income contribution and cost attributes.

The following table details noninterest income for the three and six months ended June 30, 2008 and 2007 (dollars in thousands):

	Three Months Ended		% Increase (Decrease) 2009-2008	Six Months Ended		% Increase (Decrease) 2009-2008
	June 30,			June 30,		
	2009	2008		2009	2008	
Service fees	\$ 271	\$ 194	39.69	\$ 514	\$ 368	39.67
Net gains on sale of secondary market loans	84	49	71.43	142	97	46.39
Proceeds from lawsuit settlements	-	3,475	(100.00)	-	3,475	(100.00)
Other noninterest income	84	29	189.66	174	52	234.62
Subtotal	439	3,747	(88.28)	830	3,992	(79.22)
Net security gain (loss)	-	-	0.00	-	65	(100.00)
Total noninterest income	\$ 439	\$ 3,747	(88.28)	\$ 830	\$ 4,057	(79.54)

**Noninterest Expense**

Other expenses increased \$47,000 for the six months ended June 30, 2009, compared to the same period in 2008. Salaries and employee benefits decreased \$.724 million, during the first six months and \$.514 million for the second quarter of 2009, when compared to the same periods in 2008. The 2008 six month and second quarter salary and benefit expenses include a \$.425 million severance expense. The most significant increase in noninterest expense was in the loan and deposit expense category, primarily from increases in FDIC insurance premiums. In the second

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

quarter of 2009, the Corporation recorded a \$.215 million FDIC special assessment. Other increases in loan and deposit expense resulted from costs associated with higher levels of nonperforming assets. In the second quarter of

2008, the Corporation settled a long standing derivative shareholder lawsuit. As a part of this settlement, the Corporation received funds amounting to \$3.475 million,

recorded as other income, and a dismissal of unpaid legal fees, totaling \$95,000, related to the defense of prior directors of the Corporation. Management continually reviews all areas of noninterest expense for cost reduction opportunities that will not impact service quality and employee morale.

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

	Three Months Ended		% Increase (Decrease) 2009-2008%	Six Months Ended		% Increase (Decrease) 2009-2008%
	2009	June 30, 2008		2009	June 30, 2008	
Salaries and employee benefits	\$ 1,561	\$ 2,075	(24.77)	\$ 3,158	\$ 3,882	(18.65)
Occupancy	355	348	2.01	733	703	4.27
Furniture and equipment	222	190	16.84	411	368	11.68
Data processing	224	216	3.70	444	437	1.60
Professional service fees	144	79	82.28	297	232	28.02
Loan and deposit:						
FDIC insurance premiums	340	9	N/M	465	18	N/M
Other loan and deposit	172	135	27.41	308	254	21.26
Telephone	46	39	17.95	89	84	5.95
Advertising	80	60	33.33	158	120	31.67
Other	326	320	1.88	646	564	14.54
Total noninterest expense	<u>\$ 3,470</u>	<u>\$ 3,471</u>	<u>(.03)</u>	<u>\$ 6,709</u>	<u>\$ 6,662</u>	<u>.71</u>

### Federal Income Taxes

#### *Current Federal Tax Provision*

The Corporation recorded a current period federal tax provision of \$.278 million in the first half of 2009, compared to a \$.900 million provision for the same period in 2008.

#### *Deferred Tax Benefit*

The Corporation recognized a federal deferred tax benefit of \$7.500 million in the third quarter of 2007. The recognition of this deferred tax benefit relates to the generally accepted accounting principles applicable to the probability of utilizing the NOL and tax credit carryforwards of the Corporation. The Corporation, based upon current profitability trends largely supported by expansion of the net interest margin and controlled expenses, determined that the utilization of the NOL carryforward was probable. This tax benefit was recorded by reducing the valuation allowance that was recorded against the deferred tax assets of the Corporation. In 2006, the Corporation recognized a portion of this benefit, \$.500 million, based upon the then current probabilities. The \$7.500 million recognition is based upon assumptions of a sustained level of taxable income within the NOL carryforward period and takes into account Section 382, establishing annual limitations. A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized. As of June 30, 2009, the Corporation had an NOL carryforward of approximately \$32.1 million along with various credit carryforwards of \$2.1 million. This NOL and credit carryforward benefit is dependent upon the future profitability of the Corporation. A portion of the NOL, approximately \$22 million, and all of the tax credit carryforwards are also subject to the use limitations of Section 382 of the Internal Revenue Code since they originated prior to the December 2004 recapitalization of the Corporation. The Corporation intends to further evaluate the utilization of the NOL and credit carryforwards in subsequent periods to determine if any further adjustment to the valuation allowance is necessary. The determination criteria for recognition of deferred tax benefits will include the assumption of future period taxable income based upon the projected profitability of the Corporation.

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

LIQUIDITY

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

During the first half of 2009, the Corporation increased cash and cash equivalents by \$2.077 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was impacted by cash provided by financing activities, with a net increase in deposits of \$42.055 million, an increase of \$11.000 million from the issuance of preferred stock. Offsetting the increases provided by financing activities were uses in investing activities, most significantly increase of \$50.216 million in securities available for sale, along with an increase in loans of \$5.383 million. The increase in deposits was composed of an increase in brokered deposits of \$33.917 million combined with an increase in bank deposits of \$8.138 million. The management of bank liquidity for funding of loans and deposit maturities and withdrawals includes monitoring projected loan fundings and scheduled prepayments and deposit maturities within a 30 day period, a 30 to 90 day period and from 90 days until the end of the year. This funding forecast model is completed weekly.

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

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

Liquidity is managed by the Corporation through its Asset and Liability Committee ("ALCO"). The ALCO Committee meets monthly to discuss asset and liability management in order to address liquidity and funding needs to provide a process to seek the best alternatives for investments of assets, funding costs, and risk management. The liquidity position of the Bank is managed daily, thus enabling the Bank to adapt its position according to market fluctuations. Core deposits are important in maintaining a strong liquidity position as they represent a stable and relatively low cost source of funds. The Bank's liquidity is best illustrated by the mix in the Bank's core and non-core funding dependence ratio, which explain the degree of reliance on non-core liabilities to fund long-term assets. Core deposits are herein defined as demand deposits, NOW (negotiable order withdrawals), money markets, savings and certificates of deposit under \$100,000. Non-core funding consists of certificates of deposit greater than \$100,000, brokered deposits, and FHLB and Farmers' Home Administration borrowings. At June 30, 2009, the Bank's core deposits in relation to total funding were 45.15% compared to 50.93% at June 30, 2008. These ratios indicated at June 30, 2009, that the Bank increased its reliance on non-core deposits and borrowings to fund the Bank's long-term assets, namely loans and investments. The Bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also has correspondent lines of credit available to meet unanticipated short-term liquidity needs. As of June 30, 2009, the Bank had \$13.375 million of unsecured lines available and another \$10.100 million available if secured. As of June 30, 2009, the Bank had no borrowings against these available lines. The Bank believes that its liquidity position remains strong to meet both present and future financial obligations and commitments, events or uncertainties that have resulted or are reasonably likely to result in material changes with respect to the Bank's liquidity.

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

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

CAPITAL AND REGULATORY

As a bank holding company, the Corporation is required to maintain certain levels of capital under government regulation. There are several measurements of regulatory capital and the Corporation is required to meet minimum requirements under each measurement. The federal banking regulators have also established capital classifications beyond the minimum requirements in order to risk-rate deposit insurance premiums and to provide trigger points for prompt corrective action in the event an institution becomes financially troubled. As of June 30, 2008, the Corporation and Bank were well capitalized. The Corporation is currently exploring its alternatives for the possible issuance of equity or debt in order to provide a broader base to support future asset growth. During the first half of 2009, total capitalization increased by \$12.425 million.

On April 24, 2009, the Corporation issued \$11.000 million in perpetual preferred stock and 379,310 common stock warrants in the Capital Purchase Program ("CPP") under the Troubled Asset Relief Program. Mackinac Financial Corporation believes that participation in the CPP will provide a stronger base of capital for future growth. The June 30, 2009 capital ratios for the Corporation include the increased capital from the issuance of the preferred stock.

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

	<u>June 30,</u> <u>2009</u>	December 31, 2008	<u>June 30,</u> <u>2008</u>
<b>Capital Structure</b>			
Shareholders' equity	\$ 53,939	\$ 41,552	\$ 40,975
Total capitalization	<u>\$ 53,939</u>	<u>\$ 41,552</u>	<u>\$ 40,975</u>
Tangible capital	<u>\$ 53,932</u>	<u>\$ 41,507</u>	<u>\$ 40,890</u>
<b>Intangible Assets</b>			
Core deposit premium	\$ 7	\$ 46	\$ 85
Other identifiable intangibles	-	-	-
Total intangibles	<u>\$ 7</u>	<u>\$ 46</u>	<u>\$ 85</u>
<b>Regulatory capital</b>			
Tier 1 capital:			
Shareholders' equity	\$ 53,939	\$ 41,552	\$ 40,975
Net unrealized (gains) losses on available for sale securities	(1,211)	(445)	126
Less: disallowed deferred tax asset	(6,000)	(6,200)	(5,731)
Less: intangibles	(7)	(46)	(85)
Total Tier 1 capital	<u>\$ 46,721</u>	<u>\$ 34,861</u>	<u>\$ 35,285</u>
Tier 2 Capital:			
Allowable reserve for loan losses	\$ 4,119	\$ 4,277	\$ 3,585
Qualifying long-term debt	-	-	-
Total Tier 2 capital	<u>4,119</u>	<u>4,277</u>	<u>3,585</u>
Total capital	<u>\$ 50,840</u>	<u>\$ 39,138</u>	<u>\$ 38,870</u>
Risk-adjusted assets	<u>\$ 391,160</u>	<u>\$ 376,986</u>	<u>\$ 372,139</u>
Capital ratios:			
Tier 1 Capital to average assets	9.65 %	8.01 %	8.56 %
Tier 1 Capital to risk weighted assets	11.94 %	9.25 %	9.48 %
Total Capital to risk weighted assets	13.00 %	10.38 %	10.45 %

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

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

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

	Shareholders' Equity to Quarter-end Assets	Tangible Equity to Quarter-end Assets	Tier 1 Capital to Average Assets	Tier 1 Capital to Risk-Weighted Assets	Total Capital to Risk-Weighted Assets
Regulatory minimum for capital adequacy purposes	N/A	N/A	4.00%	4.00%	8.00%
Regulatory defined well capitalized guideline	N/A	N/A	5.00%	6.00%	10.00%
<b>The Corporation:</b>					
<b>June 30, 2009</b>	<b>10.65%</b>	<b>10.65%</b>	<b>9.65%</b>	<b>11.94%</b>	<b>13.00%</b>
June 30, 2008	9.37%	9.35%	8.56%	9.48%	10.45%
<b>The Bank:</b>					
<b>June 30, 2009</b>	<b>9.17%</b>	<b>9.17%</b>	<b>8.12%</b>	<b>10.03%</b>	<b>11.07%</b>
June 30, 2008	9.27%	9.26%	8.26%	9.13%	10.08%

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 \$95.620 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal. These cash flows are then reinvested into other earning assets at current market rates. The Corporation also has federal funds sold to correspondent banks as well as other interest-bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

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

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

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

The difference between repricing assets and liabilities for a specific period is referred to as the gap. An excess of 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 June 30, 2009 (dollars in thousands):

	<u>1-90</u> <u>Days</u>	<u>91 - 365</u> <u>Days</u>	<u>&gt;1-5</u> <u>Years</u>	<u>Over 5</u> <u>Years</u>	<u>Total</u>
Interest-earning assets:					
Loans	\$ 252,966	\$ 13,084	\$ 26,858	\$ 79,096	\$ 372,004
Securities	3,323	-	76,759	15,538	95,620
Other (1)	618	-	-	3,794	4,412
Total interest-earning assets	<u>256,907</u>	<u>13,084</u>	<u>103,617</u>	<u>98,428</u>	<u>472,036</u>
Interest-bearing obligations:					
NOW, money market, savings, interest checking	97,385	-	-	-	97,385
Time deposits	36,337	44,253	16,268	736	97,594
Brokered CDs	77,391	84,719	22,695	-	184,805
Borrowings	<u>20,000</u>	<u>-</u>	<u>15,000</u>	<u>1,210</u>	<u>36,210</u>
Total interest-bearing obligations	<u>231,113</u>	<u>128,972</u>	<u>53,963</u>	<u>1,946</u>	<u>415,994</u>
Gap	<u>\$ 25,794</u>	<u>\$ (115,888)</u>	<u>\$ 49,654</u>	<u>\$ 96,482</u>	<u>\$ 56,042</u>
Cumulative gap	<u>\$ 25,794</u>	<u>\$ (90,094)</u>	<u>\$ (40,440)</u>	<u>\$ 56,042</u>	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at June 30, 2009, the Corporation had a cumulative liability sensitivity gap position of \$90.094 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggests that if market interest rates continue to decline in the next twelve months, the Corporation has the potential to earn more net interest income. A limitation of the traditional gap analysis is that it does not consider the timing or magnitude of non-contractual repricing or expected prepayments. In addition, the gap analysis treats savings, NOW, and money market accounts as repricing within 90 days, while experience suggests that these categories of deposits are actually comparatively resistant to rate sensitivity. With the Corporation's current portfolio of variable rate loans, approximately 67%, or \$250 million, increasing interest rates will result in increased net interest income because repricing on the majority of deposits will lag asset repricing.

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

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

The borrowings in the gap analysis include \$15 million of the FHLB advances as fixed-rate advances. These advances give the FHLB the option to convert from a fixed-rate advance to an adjustable rate advance with quarterly repricing at three-month LIBOR Flat. The exercise of this conversion feature by the FHLB would impact the repricing dates currently assumed in the analysis. In 2006, the FHLB converted \$20 million of the \$25 million total FHLB borrowings from fixed to variable rate.

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

Evaluating the exposure to changes in interest rates includes assessing both the adequacy of the process used to control interest rate risk and the quantitative level of exposure. The Corporation's interest rate risk management process seeks to ensure that appropriate policies, procedures, management information systems, and internal

MACKINAC FINANCIAL CORPORATION

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

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. As of June 30, 2009, the Corporation had excess Canadian liabilities of \$56,000 (or \$63,000 in U.S. dollars). Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation.

OFF-BALANCE-SHEET RISK

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

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

IMPACT OF INFLATION AND CHANGING PRICES

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

MACKINAC FINANCIAL CORPORATION  
ITEM 4 CONTROLS AND PROCEDURES

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

There was no change in the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Corporation's fiscal quarter ended June 30, 2009 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. The litigation that is not routine and incidental to the business of banking is described below.

**Shareholder's Derivative Litigation**

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

**Item 4. Submission of Matters to a Vote of Security Holders**

The annual meeting of the Registrant's shareholders was held on May 27, 2009. The purpose of the meeting was to elect directors, as shown below, each for a three-year term expiring in 2012, and to approve, in a nonbinding advisory vote, the Corporation's executive compensation plan. The number of shares voted is presented in the table below.

<u>Proposal</u>	<u>For</u>	<u>Withheld</u>
Walter J. Aspatore	2,122,734	15,937
Robert H. Orley	2,122,619	16,052
Randolph C. Paschke	2,122,819	15,852
Executive Compensation Plan	1,774,184	341,313

MACKINAC FINANCIAL CORPORATION  
PART II. OTHER INFORMATION

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits:

- Exhibit 3.1 Articles of Incorporation and all amendments (most recent amendment filed December 14, 2004) incorporated herein by reference to exhibit 3.1 of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008
- Exhibit 3.2(a) Amended and Restated Bylaws as revised June 27, 2001 incorporated herein by reference to exhibit 3.2(a) of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008
- Exhibit 3.2(b) Amendment to the Amended and Restated Bylaws adopted August 9, 2004 incorporated herein by reference to exhibit 3.2(b) of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008
- Exhibit 3.2(c) Second Amendment to the Amended and Restated Bylaws adopted December 2007 incorporated herein by reference to exhibit 3.2(c) of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008
- 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

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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: August 13, 2009

By: /s/ Paul D. Tobias

PAUL D. TOBIAS,  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER  
(principal executive officer)

By: /s/ Ernie R. Krueger

ERNIE R. KRUEGER,  
EVP / CHIEF FINANCIAL OFFICER  
(principal accounting officer)

CERTIFICATION

Exhibit 31.1

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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) 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
  - (d) 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 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: August 13, 2009

/s/ Paul D. Tobias  
Paul D. Tobias  
Chairman and Chief Executive Officer  
(principal executive officer)

CERTIFICATION

Exhibit 31.2

I, Ernie R. Krueger, 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) 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
  - (d) 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 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: August 13, 2009

/s/ Ernie R. Krueger  
Ernie R. Krueger  
Executive Vice President/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 June 30, 2009, (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)

Date: August 13, 2009

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 June 30, 2009, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Ernie R. Krueger, 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.

/s/ Ernie R. Krueger  
Executive Vice President and Chief Financial Officer  
(principal financial officer)

Date: August 13, 2009