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

FORM 10-Q

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

For the quarterly period ended September 30, 2005

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from <> to <>

Commission file number: 0-20167

MACKINAC FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

MICHIGAN	38-2062816
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
130 SOUTH CEDAR STREET, MANISTIQUE, MI	49854
(Address of principal executive offices)	(Zip Code)

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

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

Yes__X___ No______

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

Yes_______ No___X____

As of October 31, 2005, there were outstanding 3,428,695 shares of the registrant's common stock, no par value.

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MACKINAC FINANCIAL CORPORATION

PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)

	September 30, 2005 (Unaudited)	December 31, 2004	September 30, 2004 (Unaudited)
ASSETS			
Cash and due from banks	$ 5,333	$ 4,230	$ 8,210
Federal funds sold	4,849	39,848	12,318
Cash and cash equivalents	10,182	44,078	20,528
Interest-bearing deposits in other financial institutions	1,282	18,535	6,126
Securities available for sale	35,506	57,075	67,502
Federal Home Loan Bank stock	4,855	4,754	4,704
Total loans	218,462	203,832	221,595
Allowance for loan losses	(6,589)	(6,966)	(10,720)
Net loans	211,873	196,866	210,875
Premises and equipment	11,268	10,739	10,927
Other real estate held for sale	1,948	1,730	4,650
Other assets	3,676	5,720	6,840
Total assets	$ 280,590	$ 339,497	$ 332,152
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities:			
Non-interest-bearing deposits	$ 19,690	$ 20,956	$ 23,036
Interest-bearing deposits	193,578	194,694	200,074
Total deposits	213,268	215,650	223,110
Borrowings	36,417	85,039	85,595
Subordinated debentures	-	-	12,450
Other liabilities	3,005	4,078	4,526
Total liabilities	252,690	304,767	325,681
Shareholders' equity:			
Preferred stock - No par value:			
Authorized - 500,000 shares, no shares outstanding	-	-	-
Common stock and additional paid in capital - No par value			
Authorized - 18,000 000 shares			
Issued and outstanding - 3,428,695,			
3,428,695, and 350,958, respectively	42,412	42,335	16,175
Accumulated deficit	(14,434)	(8,097)	(10,530)
Accumulated other comprehensive income (loss)	(78)	492	826
Total shareholders' equity	27,900	34,730	6,471
Total liabilities and shareholders' equity	$ 280,590	$ 339,497	$ 332,152

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Interest income:				
Interest and fees on loans:				
Taxable	$ 3,547	$ 3,341	$ 9,807	$ 11,206
Tax-exempt	222	276	694	919
Interest on securities:				
Taxable	282	612	1,178	1,884
Tax-exempt	42	42	126	128
Other interest	177	137	470	400
Total interest income	4,270	4,408	12,275	14,537
Interest expense:				
Deposits	1,338	1,246	3,666	4,289
Borrowings	425	1,184	1,509	3,554
Subordinated debentures	-	118	-	356
Total interest expense	1,763	2,548	5,175	8,199
Net interest income	2,507	1,860	7,100	6,338
Provision for loan losses	-	-	-	-
Net interest income after provision for loan losses	2,507	1,860	7,100	6,338
Other income:				
Service fees	137	225	470	805
Loan and lease fees	5	4	11	13
Net security gains (losses)	(1)	-	96	-
Net gains on sale of loans	17	11	37	31
Gain on sale of branches	-	458	-	204
Other	96	169	194	540
Total other income	254	867	808	1,593
Other expense:				
Salaries and employee benefits	1,555	1,302	4,665	4,155
Furniture and equipment	133	247	430	819
Occupancy	275	193	748	740
Data processing	234	282	726	985
Accounting, legal, and consulting fees	204	419	750	1,397
Loan and deposit	153	296	696	1,389
Telephone	66	83	203	315
Advertising	314	9	696	52
Penalty on prepayment of FHLB borrowings	-	-	4,320	-
Other	345	657	1,010	2,107
Total other expense	3,279	3,488	14,244	11,959
Loss before provision for income taxes	(518)	(761)	(6,336)	(4,028)
Provision for income taxes	-	-	0	-
Net loss	$ (518)	$ (761)	$ (6,336)	$ (4,028)
Loss per common share:				
Basic	$ (.15)	$ (2.17)	$ (1.85)	$ (11.48)
Diluted	$ (.15)	$ (2.17)	$ (1.85)	$ (11.48)

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 September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Balance, beginning of period	$ 28,517	$ 5,885	$ 34,730	$ 10,700
Net loss for period	(518)	(761)	(6,336)	(4,028)
Change in minority interest of consolidated subsidiary	-	-	76	-
Net unrealized gain (loss) on securities available for sale	(99)	1,347	(570)	(201)
Total comprehensive income (loss)	(617)	586	(6,830)	(4,229)
Balance, end of period	$ 27,900	$ 6,471	$ 27,900	$ 6,471

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Net loss	$ (6,336)	$ (4,028)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	707	1,295
Provision for impairment of other real estate held for sale	-	92
Gain on sales of securities	(96)	-
Gain on sales of premises, equipment, and other real estate	(64)	98
FHLB stock dividend	(101)	(160)
Change in other assets	1,950	3,109
Change in other liabilities	(1,073)	(2,043)
Net cash used in operating activities	(5,013)	(1,637)
Cash flows from investing activities:		
Net (increase) decrease in interest-bearing deposits in other financial institutions	17,253	(78)
Purchase of securities available for sale	(16,009)	(21,910)
Proceeds from sales of securities available for sale	30,811	27,997
Proceeds from maturities, calls, or paydowns of securities available for sale	6,218	10,771
Net decrease (increase) in loans	(15,563)	59,813
Purchase of premises and equipment	(1,088)	(87)
Proceeds from sales of premises, equipment, and other real estate	423	6,741
Purchase of minority interest in subsidiary of bank	76	-
Net cash provided by investing activities	22,121	83,247
Cash flows from financing activities:		
Net decrease in deposits	(2,382)	(82,684)
Proceeds from issuance of debt	1,651	125
Principal payments on borrowings	(50,273)	(1,556)
Net cash used in financing activities	(51,004)	(84,115)
Net change in cash and cash equivalents	(33,896)	(2,505)
Cash and cash equivalents at beginning of period	44,078	23,033
Cash and cash equivalents at end of period	10,182	$ 20,528
Supplemental cash flow information:		
Cash paid for:		
Interest	$ 5,338	$ 8,405
Income taxes	-	-
Transfers of foreclosures from loans to other real estate held for sale	556	5,153

See accompanying notes to condensed consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited condensed consolidated financial statements of Mackinac Financial Corporation (the "Corporation") have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine month period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. The unaudited consolidated financial statements and footnotes thereto should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2004.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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 December 2004 the Corporation effected a 1:20 reverse stock split. All historical per share data has been restated to reflect the decrease in shares outstanding as a result of this split.

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 recently completed stock offering and recapitalization. The amendment, approved by shareholders, increased the shares available under this plan by 428,587 shares from the original 25,000 (adjusted for the 1:20 reverse stock split), to a total authorized share balance of 453,587. The other two plans, one for officers and employees and the other for nonemployee directors, were approved in 1997. A total of 30,000 shares (adjusted for the 1:20 reverse stock split), were made available for grant under these plans. Options under all of the plans are granted at the

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

The fair value of each option granted is estimated on the grant date using the Black-Scholes methodology. The following assumptions were made in estimating fair value for options granted for the nine months ended September 30, 2005. The weighted average fair value of options granted in 2005 as of their grant date, along with the assumptions used for each grant, is shown below.

	Grant Date	
	June 10, 2005	September 28, 2005
Shares granted	60,000	40,000
Exercise price	$ 12.00	$ 11.50
Dividend yield	0.0 %	0.0 %
Risk-free interest rate	3.80 %	4.10 %
Weighted average expected life (years)	4.0	4.0
Expected volatility	30.00 %	30.00 %
Fair value per share	$ 3.55	$ 3.46

The Corporation accounts for stock options using the intrinsic value method. For all options granted, the intrinsic value was zero; therefore, no compensation cost has been recognized for the plans. Had compensation cost been determined on the basis of fair value, net income and earnings per share would have been reduced for the nine months ended September 30, 2005 and 2004 as follows (dollars in thousands, except per share data):

	Nine Months Ended	
	September 30, 2005	September 30, 2004
Net Loss:		
As reported	$ (6,336)	$ (4,028)
Total stock-based compensation expense determined under fair value-based method	70	-
Pro forma	$ (6,406)	$ (4,028)
Loss per share - Basic:		
As reported	$ (1.85)	$ (11.48)
Pro forma	$ (1.87)	$ (11.48)
Loss per share - Diluted:		
As reported	$ (1.85)	$ (11.48)
Pro forma	$ (1.87)	$ (11.48)
Weighted average shares outstanding	3,428,695	350,958

Reclassification

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

2. RECENT ACCOUNTING PRONOUNCEMENT

In December 2004, the FASB re-issued SFAS No. 123 "Accounting for Stock-Based Compensation" which becomes effective for interim periods beginning after June 15, 2005. (Note: This date has now been extended to December 31, 2005). This Statement supersedes APB Opinion No. 25 "Accounting for Stock Issued to Employees" and its related implementation guidance. Under Opinion No. 25, issuing stock options to employees generally resulted in recognition of no compensation cost. This Statement requires entities to recognize the cost of employee services received in exchange for these stock options. This Statement applies to all unvested awards outstanding as of the effective date. The Corporation plans to adopt SFAS No. 123 for the period beginning after December 31, 2005 and does not expect a material impact on the Corporation's Consolidated Financial Statements.

3. EARNINGS (LOSS) PER SHARE

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

The following shows the computation of basic and diluted earnings (loss) per share for the three and nine months ended September 30, 2005 and 2004 (dollars in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Basic loss per common share:				
Net loss	$ (518)	$ (761)	$ (6,336)	$ (4,028)
Weighted average common shares outstanding	3,429	351	3,429	351
Basic loss per common share	$ (.15)	$ (2.17)	$ (1.85)	$ (11.48)
Diluted loss per common share:				
Net loss	$ (518)	$ (761)	$ (6,336)	$ (4,028)
Weighted average common shares outstanding for basic loss per common share	3,428,695	350,958	3,428,695	350,958
Add: Dilutive effect of assumed exercise of stock options	-	-	-	-
Average shares and dilutive potential common shares	3,429	351	3,429	351
Diluted loss per common share	$ (.15)	$ (2.17)	$ (1.85)	$ (11.48)

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

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2005, December 31, 2004 and September 30, 2004 are as follows (dollars in thousands):

	September 30, 2005		December 31, 2004		September 30, 2004	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
US Agencies	$ 31,990	$ 31,568	$ 21,980	$ 21,843	$ 29,953	$ 29,942
Obligations of states and political subdivisions	3,594	3,938	3,711	4,029	3,711	4,053
Corporate securities	-	-	667	681	667	689
Mortgage-related securities	-	-	30,225	30,522	32,345	32,818
total securities available for sale	$ 35,584	$ 35,506	$ 56,583	$ 57,075	$ 66,676	$ 67,502

The amortized cost and estimated fair value of investment securities pledged to treasury deposits and borrowings were $21.410 million and $21.085 million, respectively, at September 30, 2005.

5. LOANS

The composition of loans at September 30, 2005, December 31, 2004 and September 30, 2004 is as follows (dollars in thousands):

	September 30, 2005	December 31, 2004	September 30, 2004
Commercial real estate	$ 123,429	$ 105,619	$ 114,929
Commercial, financial, and agricultural	36,297	47,446	59,206
One to four family residential real estate	42,490	45,292	44,365
Consumer	2,108	2,379	2,646
Construction	14,138	3,096	449
Total loans	$ 218,462	$ 203,832	$ 221,595

LOANS – Allowance for loan losses

An analysis of the allowance for loan losses for the nine months ended September 30, 2005, the year ended December 31, 2004, and the nine months ended September 30, 2004 is as follows: (dollars in thousands):

	September 30, 2005	December 31, 2004	September 30, 2004
Balance, beginning of period	$ 6,966	$ 22,005	$ 22,005
Recoveries on loans	107	719	633
Loans charged off	(484)	(15,758)	(11,918)
Provision for loan losses	-	-	-
Balance, end of period	$ 6,589	$ 6,966	$ 10,720

5. LOANS (Continued)

In the first nine months of 2005, net charge-off activity was minimal at $.377 million, or .19% of average loans outstanding. The allowance for loan losses was significantly impacted by loan charge-offs in the first nine months of 2004. The Corporation completed the sale of $25.2 million of loans, primarily nonperforming, during the first quarter of 2004 which resulted in a previously allocated specific reserve on these loans being recognized as a charge-off. This specific reserve charge-off amounted to $7.4 million.

The aggregate amount of nonperforming residential and consumer loans was approximately $391,000, $888,000, and $469,000 at September 30, 2005, December 31, 2004 and September 30, 2004, respectively. Nonperforming loans are those which are contractually past due 90 days or more as to interest or principal payments, on nonaccrual status, or loans, the terms of which have been renegotiated to provide a reduction or deferral of interest or principal. The interest income recorded and that which would have been recorded had residential and consumer nonaccrual and renegotiated loans been current, or not troubled, are not material to the consolidated financial statements for the nine months ended September 30, 2005 and 2004. The nonperforming commercial loans are reflected in the information regarding impaired loans.

LOANS – Impaired loans

Information regarding impaired loans as of September 30, 2005, December 31, 2004 and September 30, 2004 is as follows (dollars in thousands):

				Valuation Reserve		
	September 30, 2005	December 31, 2004	September 30, 2004	September 30, 2005	December 31, 2004	September 30, 2004
Balances, period end						
Impaired loans with specific valuation reserve	$ 1,071	$ 608	$ 3,845	$ 321	$ 136	$ 2,230
Impaired loans with no specific valuation reserve	886	3,699	6,160	-	-	-
Total impaired loans	$ 1,957	$ 4,307	$ 10,005	$ 321	$ 136	$ 2,230
Impaired loans on nonaccural basis	$ 1,957	$ 4,307	$ 6,862	$ 321	$ 136	$ 377
Impaired loans on accrual basis	-	-	3,143	-	-	1,853
Total impaired loans	$ 1,957	$ 4,307	$ 10,005	$ 321	$ 136	$ 2,230
Average investment in impaired loans	2,374	17,036	12,907			
Interest income recognized during impairment	76	1,053	961			
Interest income that would have been recognized on an accrual basis	132	803	646			
Cash-basis interest income recognized	76	863	771			

The average investment in impaired loans was approximately $2.374 million for the nine months ended September 30, 2005, $17.036 million for the year ended December 31, 2004, and $12.907 million for the nine months ended September 30, 2004, respectively. The $10.533 million reduction in average balance of impaired loan balances from September 30, 2004 to September 30, 2005 was due to sales of $25.2 million of impaired loans in the first quarter of 2004 and the sale of $14.1 million of loans in December 2004.

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):

	September 30, 2005	December 31, 2004	September 30, 2004
Loans outstanding, beginning of period	$ 63	$ 6,514	$ 6,514
New loans	52	365	330
Net activity on revolving lines of credit	514	-	-
Repayment	(115)	(765)	(465)
Decrease related to retired executive officers and directors	-	(6,051)	(5,621)
Loans outstanding, end of period	$ 514	$ 63	$ 758

There were no loans to related-parties classified at September 30, 2005, December 31, 2004 or September 30, 2004, respectively. In addition to the outstanding balances as shown above, there were unused commitments to related parties of approximately $340,000.

6. BORROWINGS

Borrowings consist of the following at September 30, 2005, December 31, 2004 and September 30, 2004 (dollars in thousands):

	September 30, 2005	December 31, 2004	September 30, 2004
Federal Home Loan Bank advances at rates ranging from 4.35% to 5.16 %, maturing in 2010 and 2011	$ 35,000	$ 83,555	$ 83,986
Farmers Home Administration, fixed-rate notes payable, maturing August 24, 2024, interest payable at 1%	1,417	1,484	1,484
Notes payable to directors	-	-	125
Borrowings outstanding	$ 36,417	$ 85,039	$ 85,595

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

The Federal Home Loan Bank borrowings are collateralized at September 30, 2005, by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately $25,920,000; U.S. government agency securities with an amortized cost and estimated fair value of $20,408,000 and $20,085,000, respectively; and Federal Home Loan Bank stock owned by the Bank totaling $4,855,000. Prepayment of the remaining advances is subject to the provisions and conditions of the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of September 30, 2005.

6. BORROWINGS (Continued)

The U.S.D.A. Rural Development borrowing is collateralized by loans totaling $.719 million originated and held by the Corporation's wholly owned subsidiary, First Rural Relending, an assignment of a demand deposit account in the amount of $.829 million, and guaranteed by the Corporation.

7. STOCK OPTION PLANS

A summary of stock option transactions for the nine months ended September 30, 2005 and 2004, and the year ended December 31, 2004, is as follows: (Historical stock option information has been adjusted for the 1:20 reverse stock split which occurred in December 2004.

	September 30, 2005	December 31, 2004	September 30, 2004
Outstanding shares, beginning of year	282,999	27,483	27,483
Granted during the period	100,000	257,152	-
Expired during the period	(19,442)	(1,636)	(700)
Outstanding shares, end of period	363,557	282,999	26,783
Weighted average exercise price per share, end of period	$ 14.73	$ 34.55	$ 280.40
Shares available for grant, end of period	108,974	189,532	18,612

Options granted in 2005 were granted at a price of $12.00 per share in the second quarter, and $11.50 per share for options granted in the third quarter, the fair market value at date of grant. Under these plans, options expire ten years after the date of grant.

Following is a summary of the options outstanding and exercisable at September 30, 2005:

Exercise Price Range	Number Outstanding	Number Exercisable	Remaining Contractual Life-Years	Average Exercise Price
$9.75	257,152	120,861	9.2	$ 9.75
$11.50	40,000	8,000	10.0	11.50
$12.00	60,000	12,000	9.7	12.00
$156.00 - $240.00	3,945	3,945	5.0	183.63
$300.00 - $406.60	2,460	2,460	3.5	382.93
	363,557	147,266	9.3	$ 14.73

8. SUBORDINATED DEBENTURES

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

9. CAPITAL

On December 16, 2004, the Corporation consummated a recapitalization through the issuance of $30 million of common stock in a private placement. The net proceeds of this offering amounted to $26.2 million. This recapitalization provided the funding to enable the Corporation to recapitalize the Bank with a $15.5 million capital infusion. This capital infusion provided the Bank with enough capital to be deemed a "well capitalized" institution by regulatory standards.

10. COMMITMENTS, CONTINGENCIES AND CREDIT RISK

Financial Instruments With Off-Balance-Sheet Risk

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

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

	September 30, 2005	December 31, 2004	September 30, 2004
Commitments to extend credit			
Fixed rate	$ 1,709	$ 638	$ 488
Variable rate	27,827	10,889	8,685
Standby letters of credit - Variable rate	10,933	17,970	17,849
Credit card commitments - Fixed rate	3,145	2,995	3,047
	$ 43,614	$ 32,492	$ 30,069

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.

10. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

Contingencies

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

Concentration of Credit Risk

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan. The Bank's most prominent concentration in the loan portfolio relates to commercial loans to entities within the hospitality and tourism industry. This concentration represents $40.4 million, or 25.3%, of the commercial loan portfolio at September 30, 2005. The remainder of the commercial loan portfolio is diversified in such categories as gaming, petroleum, forestry, and agriculture. Due to the diversity of the Bank's locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic locality.

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

FORWARD-LOOKING STATEMENTS

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

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

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

The following discussion will cover results of operations, asset quality, financial position, liquidity, interest rate sensitivity, and capital resources for the periods indicated. The information included in this discussion is intended to assist readers in their analysis of, and should be read in conjunction with, the consolidated financial statements and related notes and other supplemental information presented elsewhere in this report. This discussion should be read in conjunction with the consolidated financial statements and footnotes contained in the Corporation's Annual Report and Form 10-K for the year-ended December 31, 2004. Throughout this discussion, the term "Bank" refers to mBank, formerly known as North Country Bank and Trust, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

Year-to-date consolidated net loss was $6.336 million through September 30, 2005, compared to a net loss of $4.028 million for the same period in 2004. Basic loss per share was $1.85 for the nine months ended September 30, 2005, compared to a loss of $11.48 for the same period in 2004. The loss for the three months ended September 30, 2005 amounted to $.518 million, or $.15 per share, compared to $.761 million, or $2.17 per share for the same period in 2004. Impacting the per share earnings between periods was the increase in weighted average shares outstanding. In 2005, weighted average shares outstanding totaled 3,428,695, compared to 350,958 in 2004. There was no provision for loan losses recorded during the three and nine month periods for 2005 and 2004. Total assets declined $58.907 million from December 31, 2004 to September 30, 2005. The loan portfolio increased $14.630 million in the first nine months of 2005, from December 31, 2004 balances of $203.832 million. Deposits totaled $213.268 million at September 30, 2005, a decline of $2.382 million from the $215.650 million at December 31, 2004.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents decreased $33.896 million in 2005. This was due to the utilization of the excess liquidity, which existed at December 31, 2004, to prepay FHLB borrowings in the first quarter of 2005. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Available-for-sale securities decreased $21.569 million, or 37.79%, from December 31, 2004 to September 30, 2005, with the balance on September 30, 2005, totaling $35.506 million. The decrease during the first nine months of 2005 was due to a combination of maturities, calls, and paydowns of agencies and mortgage related securities. In the second quarter of 2005, the Corporation sold $18.7 million of callable mortgage backed securities and reinvested the proceeds in shorter term US agencies. This repositioning was done with lower interest rate and principal risk in anticipation of future rate increases. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of September 30, 2005, investment securities with an estimated fair value of $21.085 million were pledged.

Loans

Through the third quarter of 2005, loan balances increased by $14.630 or 7.18% from December 31, 2004 balances of $203.832 million. During the first nine months of 2005, the Bank experienced a high level, $36.9 million, of loan payoffs along with normal principal reduction of $20.4 million. These loan payoffs, which included approximately $2.3 million of nonaccrual loans, were higher than anticipated and are not expected to continue at this level for the remainder of 2005. New loan production in the 2005 third quarter and nine month period totaled $24.0 and $71.9 million, respectively. The Bank added additional commercial lending staff during the second quarter of 2005 and added three mortgage lenders in the third quarter. It is anticipated that with the addition of lending staff, along with the extensive marketing campaign and introduction of new and more competitive loan products, future periods will benefit from increased loan production. The Bank sold $39.3 million of loans in 2004. These sales, composed of a $25.2 million sale in the first quarter and $14.1 million in December, were composed of primarily non-performing loans and resulted in a reduction in non-accrual loans of $22.9 million. This loan sale also reduced concentration exposure in the hotel and tourism industry. Enhancements to the loan approval process and exception reporting further provide for a more effective management of risk in the loan portfolio. Management continues to actively manage the loan portfolio, seeking to identify and resolve problem assets at an early stage. Management believes a properly positioned loan portfolio provides the most attractive earning asset yield available to the Corporation and, with changes to the loan approval process and exception reporting, management can effectively manage the risk in the loan portfolio. As shown in the table below, commercial real estate and construction loans increased significantly in the first nine months of 2005. Management intends to increase lending activities in its market for mortgage, consumer, and commercial loan products while concentrating on loan quality, industry concentration issues, and competitive pricing.

Following is a summary of the loan portfolio at September 30, 2005, December 31, 2004 and September 30, 2004 (dollars in thousands):

	September 30, 2005	Percent of Total	December 31, 2004	Percent of Total	September 30, 2004	Percent of Total
Commercial real estate	$ 123,429	56.51 %	$ 105,619	51.81 %	$ 114,929	51.87 %
Commercial, financial, and agricultural	36,297	16.61	47,446	23.28	59,206	26.72
One to four family residential real estate	42,490	19.45	45,292	22.22	44,365	20.02
Consumer	2,108	.96	2,379	1.17	2,646	1.19
Construction	14,138	6.47	3,096	1.52	449	.20
Total loans	$ 218,462	100.00 %	$ 203,832	100.00 %	$ 221,595	100.00 %

Following is a table showing the significant industry types in the commercial loan portfolio as of September 30 2005, December 31, 2004 and September 30, 2004 (dollars in thousands):

	September 30, 2005			December 31, 2004			September 30, 2004		
	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity
Hospitality and tourism	$ 40,424	25.31 %	144.89 %	$ 52,659	34.40 %	151.62 %	$ 54,780	31.46 %	846.55 %
Gaming	9,331	5.84	33.44	14,310	9.35	41.20	14,932	8.58	230.75
Petroleum	6,971	4.36	24.99	7,718	5.04	22.22	8,308	4.77	128.39
Forestry	5,564	3.48	19.94	2,245	1.47	6.46	2,511	1.44	38.80
Other	97,436	61.00	349.23	76,133	49.74	219.21	93,604	53.75	1,446.52 %
Total commercial loans	$ 159,726	100.00 %		$ 153,065	100.00 %		$ 174,135	100.00 %	

The Bank has a high concentration of hospitality and tourism loans. This economic segment of our loan portfolio represents the importance of tourism in the markets we serve. Management expects that the concentrations of hospitality and tourism loans will be reduced in future periods through a combination of new loans in other industries and paydowns and maturities of current portfolio loans in this sector.

Credit Quality

The allowance for loan losses is maintained by management at a level considered to be adequate to cover probable losses related to specifically identified loans, as well as losses inherent in the balance of the loan portfolio. At September 30, 2005, the allowance for loan losses was 3.02% of total loans outstanding compared to 3.42% at December 31, 2004 and 4.84% at September 30, 2004.

Management analyzes the allowance for loan losses in detail on a monthly basis to determine whether the losses inherent in the portfolio are properly reserved for. Net charge-offs to average loans outstanding amounted to .19% and 4.45% for the nine months ended September 30, 2005 and 2004, respectively. Net charge-offs for the nine-month period ended September 30, 2005, were $.377 million compared to $11.285 million for the same period in 2004. Charge-offs during the first nine months of 2004 include $7.4 million of charge-offs incurred as a result of the sale of $25.2 million of primarily non-performing loans. The sale of these non-performing loans did not result in any gain or loss since the total reduced carrying value was previously recognized as a specific reserve allocation. The Corporation did not recognize a provision for loan losses for the nine months ended September 30, 2005, and September 30, 2004 since the reserve was considered adequate at the end of both periods. In the third quarter, the Corporation placed two commercial loans, from the same borrower, totaling approximately $1.071 million in nonaccrual.

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

	Nine Months Ended September 30, 2005	Year Ended December 31, 2004	Nine Months Ended September 30, 2004
Nonperforming Assets:			
Nonaccrual loans	$ 1,957	$ 4,307	$ 6,862
Loans past due 90 days or more	-	-	143
Restructured loans	-	-	-
Total nonperforming loans	1,957	4,307	7,005
Other real estate owned	1,948	1,730	4,650
Total nonperforming assets	$ 3,905	$ 6,037	$ 11,655
Nonperforming loans as a % of loans	.90 %	2.11 %	3.16 %
Nonperforming assets as a % of assets	1.39 %	1.78 %	3.51 %
Reserve for Loan Losses:			
At period end	$ 6,589	$ 6,966	$ 10,720
As a % of loans	3.02 %	3.42 %	4.84 %
As a % of nonperforming loans	336.69 %	161.74 %	153.03 %

Following is the allocation of the allowance for loan losses as of September 30, 2005, December 31, 2004, and September 30, 2004 (dollars in thousands):

	September 30, 2005	December 31, 2004	September 30, 2004
Commercial, financial, and agricultural loans	$ 1,716	$ 1,419	$ 4,228
One to four family residential real estate loans	80	97	105
Consumer loans	-	-	-
Unallocated and general reserves	4,793	5,450	6,387
Totals	$ 6,589	$ 6,966	$ 10,720

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

	Nine Months Ended September 30, 2005	Twelve Months Ended December 31, 2004	Nine Months Ended September 30, 2004
Allowance to total loans, at period end	3.02 %	3.42 %	4.84 %
Average loans outstanding for the peiods indicated	$ 202,381	$ 244,730	$ 253,414
Net charge-off to average outstanding loans	.19 %	6.15 %	4.45 %
Nonperforming loans to gross loans, at period end	1.79 %	2.11 %	3.16 %

Total nonperforming loans decreased $2.350 million since December 31, 2004. The reduction in nonperforming loans during the nine months of 2005 is primarily due to the payoff of one major commercial loan that was in nonaccrual status. During 2004, nonperforming loans were reduced through a combination of loan sales, charge-offs, and external refinancing. In 2004 the Bank sold $39.3 million of primarily nonperforming loans of which $22.9million were in a nonaccrual status. Management continues to address market issues impacting its loan customer base. In conjunction with the Corporation's senior lending staff and the bank regulatory examinations, management intensified the review of the Corporation's loans, related collateral evaluations, and the overall lending process during 2004. The Corporation also utilized a loan review consultant in 2004, to perform a review of the loan portfolio. The opinion of this consultant upon completion of the independent review provided findings similar to management on the overall adequacy of the reserve. The Corporation has engaged this same consultant for loan review during 2005.

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

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

	Nine Months Ended September 30, 2005	Year Ended December 31, 2004	Nine Months Ended September 30, 2004
Balance at beginning of period	$ 1,730	$ 4,356	$ 4,356
Other real estate transferred from loans	556	4,762	5,153
Other real estate sold/written down	(338)	(7,388)	(4,859)
Balance at end of period	$ 1,948	$ 1,730	$ 4,650

During the first nine months of 2005, the Corporation received real estate in lieu of loan payments of $.556 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balance. Any additional reduction in the fair value results in a write-down of other real estate. Write-downs on other real estate may be recorded based on subsequent evaluations of current realizable fair values.

Deposits

The Corporation had a decrease in deposits in the first nine months of 2005. Total deposits decreased by $2.382 million, or 1.10%, in the first nine months of 2005. Non-core deposits decreased by $11.591 million during the first nine months of 2005, while core deposits showed an increase of $9.209 million during this same period. The Corporation initiated an aggressive marketing campaign in the second quarter of 2005 to introduce new products and offer more competitive deposit pricing in an attempt to gather in market deposits. This campaign, along with continued competitive pricing and products, is expected to help generate core deposits in future periods.

	September 30, 2005	December 31, 2004	September 30, 2004
Demand deposit accounts	$ 19,690	$ 20,956	$ 23,036
NOW and money market	61,093	53,468	52,521
Savings and IRAs	23,670	25,570	25,866
Certificates of Deposit <$100,000	57,850	53,100	52,355
Total core deposits	162,303	153,094	153,778
Certificates of Deposit >$100,000	12,300	10,726	9,892
Internet CDs <$100,000	33,461	46,227	53,538
Internet CDs >$100,000	5,204	5,603	5,902
Total non-core deposits	50,965	62,556	69,332
Total deposits	$ 213,268	$ 215,650	$ 223,110

Borrowings

The Corporation has used alternative funding sources to provide long-term, stable sources of funds. Total borrowings of the Corporation decreased by $48.622 million from 2004 year-end. In the first quarter of 2005 the Corporation prepaid $48.555 million of the FHLB borrowings in order to reduce interest rate risk and to better match earning assets and funding sources. The remaining FHLB borrowings carry fixed interest rates and mature in 2010 and 2011. The remaining FHLB borrowings are callable quarterly at the option of the FHLB and can also be converted to variable rates, at the option of the FHLB, should rates rise above certain index levels. These borrowings are secured by a blanket collateral agreement on the Bank’s residential mortgage loans and specific assignment of other assets. Management may increase FHLB borrowings in the future as a source for funding future loan production. In the first quarter of 2005, the Bank borrowed $2 million in Canadian dollars from a correspondent bank in order to reduce the risk of an asset sensitive foreign exchange position. This borrowing was repaid in the second quarter.

Subordinated Debentures

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

Shareholders’ Equity

Total shareholders’ equity decreased $6.830 million from December 31, 2004 to September 30, 2005. The decrease is comprised of a net loss of $6.336 million and a decrease in the net unrealized gain on securities of $.570 million and an adjustment to record the purchase of the minority interests of bank subsidiaries. The Board of Directors does not anticipate declaring any dividends in the near future. The declaration of dividends is contingent on a variety of factors including regulatory and state statutes, and the Corporation’s return to profitability.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income before provision for loan losses for the quarter ended September 30, 2005, increased by $.647 million, or 34.785% compared to the same period one year ago. For the nine month period ended September 30, 2005, net interest income amounted to $7.100 million, an increase of $.762 million, 12.023% from the amount recorded in the same period in 2004. This increase in net interest income resulted despite significant declines in average earning assets. The prepayment of $48.555 million of the FHLB borrowings at a weighted average rate of 6.04% contributed to the reduction in cost of funds and benefited the interest margin in the first nine months of 2005. The Corporation also benefited from significant declines in nonperforming loans, $5.048 million, from September 30, 2004 to September 30, 2005. The Corporation also benefited from the increases in the prime rate of 2.00%, in the last twelve months, since it is asset sensitive, with approximately 75% of the loan portfolio repricing with changes in various indices. The Corporation expects to see continued growth in net interest income with growth in the loan portfolio; however, expects to see pressure on the net interest margin as a percent of average earnings assets due to increased cost of funds.

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										
								2005-2004			
	Average Balances			**Average Rates**		**Interest**		Income/			Rate/
	September 30,		Increase/	September 30,		September 30,		Expense	Volume	Rate	Volume
(dollars in thousands)	2005	2004	(Decrease)	2005	2004	2005	2004	Variance	Variance	Variance	Variance
Loans	$ 209,785	$ 226,951	$ (17,166)	7.13 %	6.32 %	$ 3,769	$ 3,617	$ 152	$ (273)	$ 463	(37)
Taxable securities	32,087	68,846	(36,759)	3.49	3.52	282	612	(330)	(326)	(5)	2
Nontaxable securities	3,613	3,711	(98)	4.61	4.60	42	42	-	(1)	-	1
Federal funds sold	12,062	12,383	(321)	3.39	1.42	103	44	59	(1)	61	(2)
Other interest-earning assets	4,855	16,672	(11,817)	5.97	2.21	74	93	(19)	(66)	158	(112)
Total earning assets	262,402	328,563	(66,161)	6.46	5.32	4,270	4,408	(138)	(668)	678	(148)
Reserve for loan losses	(6,632)	(10,942)	4,310								
Cash and due from banks	5,958	5,352	606								
Fixed assets	10,701	12,070	(1,369)								
Other assets	8,077	11,035	(2,958)								
Total assets	$ 280,506	$ 346,078	$ (65,572)								
NOW and money market deposits	$ 57,534	$ 59,723	$ (2,189)	2.09	1.44	302	217	85	(8)	98	(5)
Savings deposits	17,489	18,903	(1,414)	1.36	.96	60	46	14	(8)	19	(1)
Time deposits	114,945	135,040	(20,095)	3.37	2.89	976	983	(7)	(146)	163	(24)
Borrowings	36,436	85,643	(49,207)	4.62	5.48	425	1,184	(759)	(680)	(186)	106
Subordinated debentures	-	12,450	(12,450)	-	3.76	-	118	(118)	(118)	-	-
Total interest-bearing liabilities	226,404	311,759	(85,355)	3.09	3.24	1,763	2,548	(785)	(955)	(23)	192
Demand deposits	21,229	22,752	(1,523)								
Other liabilities	4,761	3,128	1,633								
Shareholders' equity	28,112	8,439	19,673								
Total liabilities and shareholders' equity	$ 280,506	$ 346,078	$ (65,572)								
Rate spread				3.37 %	2.08 %						
Net interest margin/revenue				3.79 %	2.25 %	$ 2,507	$ 1,860	$ 647	$ 288	$ 701	(340)

	Nine Months Ended										
								2005-2004			
	Average Balances			**Average Rates**		**Interest**		Income/			Rate/
	September 30,		Increase/	September 30,		September 30,		Expense	Volume	Rate	Volume
(dollars in thousands)	2005	2004	(Decrease)	2005	2004	2005	2004	Variance	Variance	Variance	Variance
Loans	$ 202,381	$ 253,414	$ (51,033)	6.94 %	6.38 %	$ 10,501	$ 12,124	$ (1,624)	$ (2,444)	$ 1,065	(246)
Taxable securities	43,304	70,255	(26,951)	3.64	3.57	1,178	1,884	(706)	(722)	37	(20)
Nontaxable securities	3,674	3,735	(61)	4.59	4.57	126	128	(2)	(2)	1	-
Federal funds sold	11,905	17,617	(5,712)	2.86	1.10	254	145	109	(47)	233	(76)
Other interest-earning assets	6,789	15,829	(9,040)	4.24	2.15	216	256	(39)	(146)	248	(142)
Total earning assets	268,053	360,850	(92,797)	6.12	5.37	12,275	14,537	(2,262)	(3,362)	1,584	(484)
Reserve for loan losses	(6,773)	(14,876)	8,103								
Cash and due from banks	5,392	5,970	(578)								
Fixed assets	10,648	12,826	(2,178)								
Other assets	7,658	12,885	(5,227)								
Total assets	$ 284,978	$ 377,655	$ (92,677)								
NOW and money market deposits	$ 54,537	$ 64,192	$ (9,655)	1.78	1.44	725	675	50	(101)	183	(32)
Savings deposits	18,054	19,915	(1,861)	1.19	.93	161	139	22	(1,299)	9	(4)
Time deposits	115,854	156,976	(41,122)	3.21	2.95	2,780	3,475	(695)	(911)	306	(90)
Borrowings	42,038	86,508	(44,470)	4.80	5.47	1,509	3,554	(2,045)	(1,826)	(435)	216
Subordinated debentures	-	12,450	(12,450)	-	3.81	-	356	(356)	(356)	-	-
Total interest-bearing liabilities	230,483	340,041	(109,558)	3.00	3.21	5,175	8,199	(3,024)	(264,002)	(53,605)	152
Demand deposits	20,598	23,509	(2,911)								
Other liabilities	4,679	6,323	(1,644)								
Shareholders' equity	29,218	7,782	21,436								
Total liabilities and shareholders' equity	$ 284,978	$ 377,655	$ (92,677)								
Rate spread				3.12 %	2.16 %						
Net interest margin/revenue				3.54 %	2.34 %	$ 7,100	$ 6,338	$ 762	$ 260,640	$ 55,189	(636)

Provision for Loan Losses

The Corporation records a provision for loan losses at a level it believes is necessary to maintain the allowance at an adequate level after considering factors such as loan charge-offs and recoveries, changes in the mix of loans in the portfolio, loan growth, and other economic factors. There was no provision for loan losses for the quarter or nine months ended September 30, 2005, and 2004. Management continues to monitor the loan portfolio for changes which may impact the required allowance for loan losses. A provision for loan losses may be required for future periods if credit quality should deteriorate or loan growth is such that the general reserve is no longer deemed adequate.

Other Income

Other income decreased by $.785 million for the nine months ended September 30, 2005, compared to the nine months ended September 30, 2004. Service fees decreased $.335 million while loan and lease income decreased $2,000. The decline in service fees is primarily due to the significant decline in deposits from September 30, 2004 to September 30, 2005. Other non-interest income was positively impacted in the first nine months of 2004 from a gain of $258,000 on the sale of a limited partnership interest. The Corporation realized security gains of $98,000 in the second quarter of 2005 from the sale of approximately $12 million of mortgage-backed securities. The sale of these securities was done to provide funding for future loan growth. In the first nine months of 2004, the Corporation sold five branch offices at a net gain of $204,000.

The following table details noninterest income for the three and nine months ended September 30, 2005 and September 30, 2004 (dollars in thousands):

	Three Months Ended September 30,		% Increase (Decrease)	Nine Months Ended September 30,		% Increase (Decrease)
	2005	2004	2005-2004	2005	2004	2005-2004
Service fees	$ 137	$ 225	(39.1)	$ 470	$ 805	(41.6)
Loan and lease fees	5	4	25.0	11	13	(15.4)
Net gains on sale of loans	17	11	54.5	37	31	19.4
Gain on sale of branches	-	458	-	-	204	-
Other	96	169	(43.2)	194	540	(64.1)
Subtotal	255	867	(70.6)	712	1,593	(55.3)
Net securities gains	(1)	-	(100.0)	96	-	100.0
Total other income	$ 254	$ 867	(70.6)	$ 808	$ 1,593	(49.3)

Other Expenses

Other expenses increased $2.285 million for the nine months ended September 30, 2005, compared to the same period in 2004. The prepayment penalty on FHLB borrowings incurred by the Corporation in the first nine months of 2005 amounted to $4.320 million and was the primary reason for the increase. Salaries and employee benefits increased by $.510 million, during the first nine months of 2005 compared to the first nine months of 2004. During the first nine months of 2004, the Corporation recognized the $452,000 cost of closing five branch offices which is included in other operating expenses. Areas of noninterest expense such as furniture and equipment, occupancy, data processing, and telephone expense declined between periods due to these branch closures and branch sales that occurred in 2004. Advertising expense at $.696 million in the first nine months of 2005 increased due to the Corporation's efforts to regain market share by advertising new products and services. The Corporation engaged a marketing agency to develop an extensive marketing program to launch the Bank's new name, from North Country Bank and Trust to mBank, and create an advertising program to announce new products and services. It is anticipated that the advertising expenses for the remainder of 2005 will decrease since the development of this marketing program is complete.

The following table details noninterest expense for the three and nine months ended September 30, 2005 and 2004 (dollars in thousands):

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	% Increase (Decrease) 2005-2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	% Increase (Decrease) 2005-2004
Salaries and employee benefits	$ 1,555	$ 1,302	19.4	$ 4,665	$ 4,155	12.3
Furniture and equipment	133	247	(46.2)	430	819	(47.5)
Occupancy	275	193	42.5	748	740	1.1
Data processing	234	282	(17.0)	726	985	(26.3)
Accounting, legal and consulting fees	204	419	(51.3)	750	1,397	(46.3)
Loan and deposit	153	296	(48.3)	696	1,389	(49.9)
Telephone	66	83	(20.5)	203	315	(35.6)
Advertising	314	9	3,388.9	696	52	1,238.5
Penalty on prepayment of FHLB borrowings	-	-	-	4,320	-	-
Other	345	657	(47.5)	1,010	2,107	(52.1)
Total other expense	$ 3,279	$ 3,488	(6.0)	$ 14,244	$ 11,959	19.1

Salaries and employee benefits amounted to $4.665 million for the nine months ended September 30, 2005 compared to $4.155 million in the same period in 2004, a 12.27% increase. Salaries and benefits increased $.253 million, 19.4%, when comparing the three month periods in 2005 and 2004. Late in 2004 and during the first nine months in 2005, the Corporation made staff additions in lending and senior management. The Corporation added senior management as a part of the recapitalization which occurred in December 2005, and also has made several additions to its lending staff, primarily in Lower Michigan. These employee additions will benefit the Corporation by providing additional management expertise and seasoned lending personnel to provide future loan growth. The Corporation signed an agreement with a new systems administrator in 2005 and is expecting to complete a total loan, deposit and general ledger system conversion prior to 2005 year-end. This system conversion is expected to significantly enhance the Corporation's management information systems and result in an overall reduction of data processing expenses beginning in 2006.

Federal Income Taxes

There was no federal tax provision for the third quarter or nine months ended 2005 and 2004. The Corporation has approximately $26.2 million of NOL carryforward along with tax benefit carryforwards of $2.2 million. The NOL and tax credit carryforward benefit is dependent upon the future profitability and generation of taxable income; therefore no future benefit of these deferred items has been recorded.

LIQUIDITY

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

During the first nine months of 2005, the Corporation decreased cash and cash equivalents by $33.896 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was primarily impacted from cash used in financing activities. The Corporation prepaid $48.555 million in FHLB borrowings in the first quarter of 2005. The Corporation utilized short term liquidity sources such as federal funds sold and time deposits in other financial institutions to fund the prepayment. In the first nine months of 2005, the Corporation funded the increase in loans, $15.6 million and reduction of deposits, $2.4 million, primarily through the balance sheet reductions of $21.569 million in securities available for sale. These asset reductions allowed the Corporation to maintain adequate liquidity at quarter end, which included $10.2 million of cash and cash equivalents.

It is anticipated that during the remainder of 2005, the Corporation will fund anticipated loan production with a combination of core deposit growth, and Internet deposits or FHLB or alternative borrowings, if needed. The Bank's liquidity plan for 2005 includes strategies to increase core deposits in the Corporation's local markets. The introduction of new products, through an extensive advertising campaign commenced in the first quarter of 2005. During the second quarter, the Bank began to see the positive results of its marketing campaign. The Bank's core deposits increased by $9.209 million in the first nine months of 2005. The Corporation's liquidity plan for 2005 calls for augmenting local deposit growth efforts with Internet CD funding, to the extent necessary. The Corporation has also reestablished borrowing lines at correspondent banks to provide additional sources of liquidity.

The Corporation's parent company is dependent upon its primary operating subsidiary, the Bank, for sources of cash to fund its operating needs. At September 30, 2005, the Corporation's parent had a balance of $1.252 million in cash and cash equivalents and does not anticipate the need for additional sources of funds in the near term.

CAPITAL AND REGULATORY

During the first nine months of 2005, capital decreased by $6.830 million, as a result of the net loss of $6.336 million, the decrease in the unrealized gain on securities available for sale of $.570 million, and a $.076 million increase from the purchase of the minority interests of bank subsidiaries. This compares to a decrease in capital during the same period in the previous year of $4.229 million, resulting primarily from a net loss of $4.028 million and a reduction in the unrealized gain on securities available for sale of $.201 million.

As a bank holding company, the Corporation is required to maintain certain levels of capital under government regulation. There are several measurements of regulatory capital and the Corporation is required to meet minimum requirements under each measurement. The federal banking regulators have also established capital classifications beyond the minimum requirements in order to risk-rate deposit insurance premiums and to provide trigger points for prompt corrective action in the event an institution becomes financially troubled. As of September 30, 2005 and December 31, 2004, the Corporation and the Bank, were well capitalized.

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

	September 30, 2005	December 31, 2004	September 30, 2004
Capital Structure			
Long-term debt	$ -	$ -	$ 12,450
Shareholders' equity	27,900	34,730	6,471
Total capitalization	27,900	34,730	18,921
Tangible capital	$ 27,538	$ 34,275	$ 17,900
Intangible Assets			
Core deposit premium	$ 362	$ 455	$ 517
Other identifiable intangibles	-	-	504
Total intangibles	$ 362	$ 455	$ 1,021
Risk-based capital			
Tier I Capital:			
Shareholders' equity	$ 27,900	$ 34,730	$ 6,471
Net unrealized (gains) losses on available for sale securities	78	(492)	(826)
Minority interest	-	78	1,641
Less: intangibles	(362)	(455)	(1,021)
Total Tier I Capital	$ 27,616	$ 33,861	$ 6,265
Tier II Capital:			
Allowable reserve for loan losses	$ 2,912	$ 2,918	$ 3,056
Qualifying long-term debt	-	-	3,209
Total Tier II capital	2,912	2,918	6,265
Total capital	$ 30,528	$ 36,779	$ 12,530
Risk-adjusted assets	$ 229,245	$ 229,355	$ 236,803
Average tangible assets	$ 280,144	$ 277,361	$ 346,067
Capital ratios:			
Tier I Capital to risk-weighted assets	12.05%	14.76%	2.65%
Total capital to risk-weighted assets	13.32%	16.04%	5.29%
Tier I Capital to average assets	9.86%	10.68%	1.82%

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

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

	Tier I Capital to Average Assets	Tier I Capital to Risk-Weighted Assets	Total Capital to Risk-Weighted Assets
Regulatory minimum for capital adequacy purposes	4.00 %	4.00 %	8.00 %
The Corporation:			
September 30, 2005	9.86 %	12.05 %	13.32 %
December 31, 2004	10.68	14.76	16.04
The Bank:			
September 30, 2005	9.39 %	11.47 %	12.74 %
December 31, 2004	9.89	13.96	15.23

History

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

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

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

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

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

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

On February 8, 2005, the Order was formally removed; however, the Bank entered into an informal agreement which requires the Bank to maintain a Tier 1 Capital ratio of at least 8%. The Bank is also required to have regulatory approval before paying dividends.

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 competitive interest rates. The loan products offered include those which reprice with indices such as the prime rate or rates paid on government issued securities. The Corporation's current loan portfolio is comprised of approximately 75% which is indexed and 25% fixed rate term loans, generally 3-5 years.

The Corporation also has $35.506 million of securities. These securities are available for sale and provide flexibility for the Corporation in managing interest rate risk. These cash flows are then reinvested into other earning assets at current market rates.

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

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

Beyond general efforts to shorten or extend 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 difference between repricing assets and liabilities for a specific period is referred to as the gap. An excess of repricable assets over liabilities is referred to as a positive gap. An excess of repricable liabilities over assets is referred to as a negative gap. The cumulative gap is the summation of the gap for all periods to the end of the period for which the cumulative gap is being measured.

Assets and liabilities scheduled to reprice are reported in the following time frames. Those instruments with a variable interest rate tied to an index and considered immediately repricable are reported in the 1- to 90-day time frame. The estimates of principal amortization and prepayments are assigned to the following time frames.

The following is the Corporation's repricing opportunities at September 30, 2005 (dollars in thousands):

	1-90 Days	91-365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets					
Loans	$ 157,371	$ 6,159	$ 34,957	$ 19,975	$ 218,462
Securities	1,000	71	30,898	3,537	35,506
Other (1)	9,704	-	-	-	9,704
Total interest-earning assets	168,075	6,230	65,855	23,512	263,672
Interest-bearing obligations:					
Savings deposits	77,853	-	-	-	77,853
Time deposits	35,356	55,260	24,348	761	115,725
Borrowings	68	-	1,349	35,000	36,417
Total interest-bearing obligations	113,277	55,260	25,697	35,761	229,995
Gap	$ 54,798	$ (49,030)	$ 40,158	$ (12,249)	$ 33,677
Cumulative gap	$ 54,798	$ 5,768	$ 45,926	$ 33,677	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at September 30, 2005, the Corporation had a cumulative asset sensitivity gap position of $5.8 million within the one-year time frame. The Corporation's cumulative asset sensitive gap suggests that if market interest rates increase in the next twelve months, the Corporation's net interest income could benefit. Conversely, if market interest rates decrease over the next twelve months, the above GAP position suggests the Corporation's net interest income would decline.

At December 31, 2004, the Corporation had a cumulative asset sensitivity gap position of $63.804 million within the one-year time frame. The Corporation's cumulative asset sensitive gap suggested that if market interest rates increased in the next twelve months, the Corporation had the potential to earn more net interest income. Conversely, if market interest rates continued to decrease over a twelve-month period, the December 31, 2004, gap position suggested the Corporation's net interest income would decrease. During the first nine months of 2005, the Corporation did benefit from its asset sensitivity gap position because of rising interest rates.

The decrease in the gap position from December 31, 2004 to September 30, 2005 resulted from the use of short term investments to fund the prepayment of long term liabilities. This was done in order to reduce interest rate risk and better match assets and liabilities. A limitation of the traditional gap analysis is that it does not consider the timing or magnitude of noncontractual repricing or expected prepayments. In addition, the gap analysis treats savings, NOW, and money market accounts as repricing within 90 days, while experience suggests that these categories of deposits are actually comparatively resistant to rate sensitivity.

The borrowings in the gap analysis include FHLB advances as fixed-rate advances. A significant portion of these advances give the FHLB the option to convert from a fixed-rate advance to an adjustable rate advance with quarterly repricing at three-month LIBOR Flat. The exercise of this conversion feature by the FHLB would impact the repricing dates currently assumed in the analysis.

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

Evaluating the exposure to changes in interest rates includes assessing both the adequacy of the process used to control interest rate risk and the quantitative level of exposure. The Corporation's interest rate risk management process seeks to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. In evaluating the quantitative level of interest rate risk, the Corporation assesses the existing and potential future effects of changes in interest rates on its financial condition, including capital adequacy, earnings, liquidity, and asset quality. In addition to changes in interest rates, the level of future net interest income is also dependent on a number of variables, including: the growth, composition and levels of loans, deposits, and other earning assets and interest-bearing obligations, and economic and competitive conditions; potential changes in lending, investing, and deposit strategies; customer preferences; and other factors.

FOREIGN EXCHANGE RISK

In addition to managing interest rate risk, management also actively manages risk associated with foreign exchange. The Corporation provides foreign exchange services, makes loans to, and accepts deposits from, Canadian customers primarily at its banking offices in Sault Ste. Marie, Michigan. To protect against foreign exchange risk, the Corporation monitors the volume of Canadian deposits it takes in and then invests these Canadian funds in Canadian commercial loans and securities. The Corporation entered into a term loan payable in Canadian dollars during the first quarter of 2005 in order to offset the foreign exchange exposure due to an asset sensitive position. This loan was repaid in the second quarter when the asset exposure was reduced. As of September 30, 2005, the Corporation had excess Canadian assets of $.310 million (or $.266 million in U.S. dollars). Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation.

OFF-BALANCE-SHEET RISK

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

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

IMPACT OF INFLATION AND CHANGING PRICES

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

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision of and with the participation of the Corporation's management, including the President and Chief Executive Officer, and the Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures (as such term is defined in Rules 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 President and Chief Executive Officer, have concluded that, as of the end of such period, the Corporation's disclosure controls and procedures were effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be disclosed by the Corporation in the reports that it files or submits under the Exchange Act.

There was no change in the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Corporation's fiscal quarter ended September 30, 2005 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation and its subsidiaries are subject to routine litigation incidental to the business of banking. In addition, the Corporation or the Bank is subject to an informal agreement with regulatory authorities and the litigation described below. Information regarding the informal agreement is contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the caption "History" in this report, and is incorporated here by reference. The litigation that is not routine and incidental to the business of banking is described below. The shareholders' derivative cases discussed below, were previously described in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2004, and in the Corporation's Quarterly Report for the period ended June 30, 2005.

Shareholder's Derivative Litigation

Damon Trust v. Bittner, et al.

In an action styled *Virginia M. Damon Trust v. North Country Financial Corporation, Nominal Defendant, and Dennis Bittner, Bernard A. Bouschor, Ronald G. Ford, Sherry L. Littlejohn, Stanley J. Gerou II, John D. Lindroth, Stephen Madigan, Spencer Shunk, Michael Henrickson, Glen Tolksdorf, and Wesley Hoffman,* filed in the U.S. District Court for the Western District of Michigan on July 1, 2003, a shareholder of the Corporation has brought a shareholder's derivative action under Section 27 of the Exchange Act against the Corporation and certain of its current and former directors and senior executive officers. The Complaint, which demands a jury trial, is brought on behalf of the Corporation against the individual defendants. It alleges that the individual defendants have caused loss and damage to the Corporation through breaches of their fiduciary duties of oversight and supervision by failing i) adequately to safeguard the assets of the Corporation, (ii) to ensure that adequate administrative, operating, and internal controls were in place and implemented, (iii) to ensure that the Corporation was operated in accordance with legally-prescribed procedures, and (iv) to oversee the audit process to ensure that the Corporation's assets were properly accounted for and preserved. The Complaint further alleges that the individual defendants violated Section 14(a) of the Exchange Act by making materially false and misleading statements in the proxy statement mailed to shareholders in connection with the annual meeting of the Corporation held May 29, 2000, and the adoption by the shareholders at that meeting of the Corporation's 2000 Stock Incentive Plan. The Complaint also alleges that Mr. Ford and Ms. Littlejohn, through a series of compensation arrangements, stock options, and employment agreements obtained by them through improper means resulting from the offices they held with the Corporation, received excessive compensation, to the injury of the Corporation. Among other things, the Complaint is based upon allegations of material misstatements or omissions in filings made by the Corporation with the SEC, and deficiencies in the Corporation's policies and procedures for safe and sound operation, including its directorate and management personnel and practices, credit underwriting, credit administration, and policies regarding asset/liability management, liquidity, funds management, and investments, and its compliance with all applicable laws and regulations, including Regulations O and U of the Board, FDIC Rules and Regulations, and the Michigan Banking Code of 1999. The Complaint seeks (i) rescission of the approval of the 2000 Stock Incentive Plan and return of all stock and options granted under the Plan, (ii) a declaration that the individual defendants breached their fiduciary duty to the Corporation, (iii) an order to the individual defendants to account to the Corporation for all losses and/or damages by reason of the acts and omissions alleged, (iv) an order to each of the individual defendants to remit to the Corporation all salaries and other compensation received for periods during which they breached their fiduciary duties, (v) compensatory damages in favor of the Corporation, (vi) injunctive relief, and (vii) interest, costs, and attorney's and expert's fees.

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

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

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

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

During the above described proceedings, on November 11, 2003, the Corporation filed a motion, as permitted by section 495 of the MBCA, M.C.L.§ 450.1495, requesting the Court to appoint a disinterested person to conduct a reasonable investigation of the claims made by the plaintiff and to make a good faith determination whether the maintenance of the derivative action is in the best interests of the Corporation. After additional written submissions to the Court by the defendants and the plaintiff concerning the issues presented by this motion, and after several conferences with the Court, on May 20, 2004, the Court entered an Order adopting the parties' written stipulations concerning the appointment of a disinterested person and the manner of conducting the investigation of the claims made by the plaintiff and making recommendations as to whether the maintenance of the derivative action is in the best interests of the Corporation.

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

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

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

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

In an Opinion and Order, each dated September 7, 2005, the Court granted the Corporation's motion and dismissed with prejudice (i) all the breach of fiduciary duty claims against defendants Bittner, Bouschor, Gerou, Lindroth, Madigan, Shunk, Hendrickson, and Tolksdorf, (ii) the breach of fiduciary duty claims against defendant Hoffman, except for one claim identified by the disinterested person in his report, and (iii) the excess compensation claims against defendants Ford and Littlejohn. The Court directed that the case proceed with the claim against defendant Hoffman with respect to his involvement in defendant Ford's December 21, 2001 employment agreement, and with respect to the breach of fiduciary duty claims against defendants Ford and Littlejohn, subject to the stay regarding proceedings against defendant Littlejohn.

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

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

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

If the case proceeds beyond November 15, 2005 mediation, the Corporation will incur legal fees and expenses in monitoring the plaintiff's prosecution of the case on behalf of the Corporation and in responding to the parties' requests for discovery directed to it. At this time the Corporation cannot accurately estimate the amount of any such future legal fees and expenses.

Damon Trust v. Wipfli

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

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

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

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

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

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

In an Order dated September 29, 2005, the Court realigned the Corporation as the plaintiff and made the Corporation exclusively responsible for prosecuting all further aspects of the case, including any settlement.. In the same Order, the Court stated that the Virginia M. Damon Trust would remain as a nominal plaintiff in the case, entitled to notice. The Corporation is currently evaluating its position with regard to the case, in advance of a scheduling conference with the Court, which is anticipated to occur during the fourth quarter of 2005.

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 3.1 Articles of Incorporation, as amended, incorporated herein by reference to exhibit 3.1 of the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 1999.

Exhibit 3.2 Amended and Restated Bylaws, incorporated herein by reference to exhibit 3.1 of the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001.

Exhibit 31.1 Rule 13a-14(a) Certification of Chief Executive Officer

Exhibit 31.2 Rule 13a-14(a) Certification of Chief Financial Officer

Exhibit 32.1 Section 1350 Certification of Chief Executive Officer

Exhibit 32.2 Section 1350 Certification of Chief Financial Officer

SIGNATURES

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

MACKINAC FINANCIAL CORPORATION
(Registrant)

Date: November 11, 2005

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

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

Exhibit 31.1
CERTIFICATION

I, Paul D. Tobias, Chairman of Mackinac Financial Corporation, certify that:

1. I have reviewed this report on Form 10-Q of Mackinac Financial Corporation (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 11, 2005

/s/ Paul D. Tobias
Chairman
(principal executive officer)

Exhibit 31.2

CERTIFICATION

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

1. I have reviewed this report on Form 10-Q of Mackinac Financial Corporation (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 11, 2005

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

Exhibit 32.1

CERTIFICATION PERSUANT 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 September 30, 2005, (the “Form 10-Q”) of Mackinac Financial Corporation (the “Issuer”).

I, Paul D. Tobias, Chairman 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
(chief executive officer)

Date: November 11, 2005

Exhibit 32.2

CERTIFICATION PERSUANT 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 September 30, 2005, (the "Form 10-Q") of Mackinac Financial Corporation (the "Issuer").

I, Eliot R. Stark, Executive Vice President and Chief Financial 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/ Eliot R. Stark
Executive Vice President and Chief Financial Officer
(chief financial officer)

Date: November 11, 2005