



March 30, 2007

Dear Shareholders:

This letter will provide you, our shareholders, with an update on the performance of Mackinac Financial Corporation through the end of 2006. We are pleased with our continued success in generating commercial loans, but have not yet generated the level of core deposit growth that we need to create profits that are more in line with shareholder expectations.

The chart below is a recap of various balances and book value per share as of the end of the last three years (dollars in thousands, except per share data).

	As of December 31,			2006/2005		2005/2004	
	2006	2005	2004	Dollars	Percentage	Dollars	Percentage
Loans	\$ 322,581	\$ 239,771	\$ 203,832	\$ 82,810	34.54 %	\$ 35,939	17.63 %
Assets	382,791	298,722	339,497	84,069	28.14	(40,775)	(12.01)
Deposits	312,421	232,632	215,650	79,789	34.30	16,982	7.87
Borrowings	38,307	36,417	85,039	1,890	5.19	(48,622)	(57.18)
Shareholders' equity	28,790	26,588	34,730	2,202	8.28	(8,142)	(23.44)
Book value per share	8.40	7.75	10.13	0.65	8.39	(2.38)	(23.49)

The main thrust of our initial Strategic Plan was to deploy relationship bankers with “big bank” lending skills in Oakland County, Michigan and other growing banking markets. We have been successful in the execution of this part of our Plan with loan production that has been in line with operational budgets. In 2006, the Corporation returned to profitability. The foundation has now been built to sustain this profitability in future periods. Our Strategic Plan also called for us to maximize the productivity and efficiency of our branch system to deliver the maximum amount of deposits at the lowest funding cost possible to compliment this loan growth. We must now demonstrate the ability to leverage our branch system to grow core deposits, which is the next critical factor to expand earnings. The following information will review our progress thus far and outline some of our future initiatives.

### 2006 Year-in-Review

- Loan growth of **\$82.810 million**
- Credit quality still strong with nonperforming assets to total assets of **.77%**
- Core deposit growth of **\$25.079 million**
- Net interest margin at **3.51%** for the year
- Net income of **\$1.716 million**, or **\$.50** per common share

### Loan Growth

We have been very successful in growing our loan base in the first two years following the recapitalization. In 2006, we grew total loans by \$82.810 million or 34.54%. The total loan growth for the two year period amounted to \$118.749 million, a 58% increase from our 2004 starting point of \$203.832 million.

**Loan Production**

The success of our loan growth is the result of placing highly skilled commercial lenders in the markets which offer the most potential for loan growth, which has resulted in loan production in our three geographical regions as shown below.

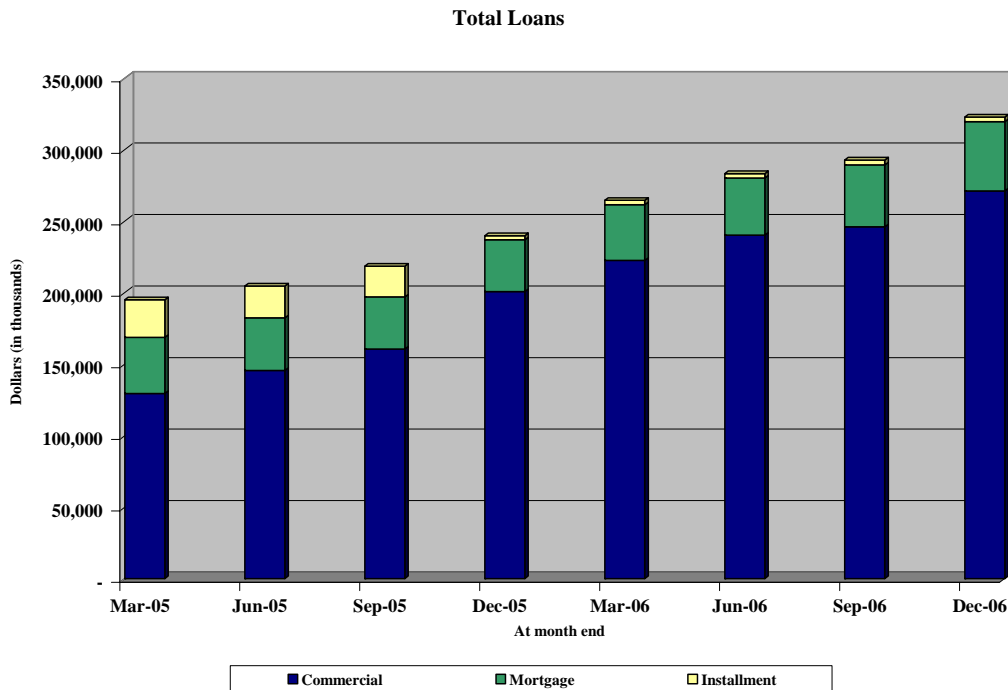
(dollars in thousands)		<b>2005</b>				
		First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD Total
<b><u>REGION</u></b>						
Upper Peninsula		\$ 6,861	\$ 9,099	\$ 9,090	\$ 19,263	\$ 44,313
Northern Lower Peninsula		686	12,449	9,698	13,786	36,619
Southeast Michigan		1,100	12,480	10,434	12,813	36,827
<b>TOTAL</b>		<b>\$ 8,647</b>	<b>\$ 34,028</b>	<b>\$ 29,222</b>	<b>\$ 45,862</b>	<b>\$ 117,759</b>

		<b>2006</b>				
		First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD Total
<b><u>REGION</u></b>						
Upper Peninsula		\$ 7,592	\$ 14,082	\$ 10,356	\$ 5,085	\$ 37,115
Northern Lower Peninsula		7,621	7,655	5,537	5,116	25,929
Southeast Michigan		14,884	10,320	5,501	41,434	72,139
<b>TOTAL</b>		<b>\$ 30,097</b>	<b>\$ 32,057</b>	<b>\$ 21,394</b>	<b>\$ 51,635</b>	<b>\$ 135,183</b>

As you can see, we have generated solid loan growth in all regions. We were especially pleased with the fourth quarter surge in loan production for Southeast Michigan. We will continue to evaluate loan growth potential and add loan staffing in markets where we can grow loans with good credit quality and acceptable loan pricing enhanced with fee income.

The chart below illustrates the portfolio mix as of each period end:



The loan production that we were able to generate in 2005 and 2006 did not translate to our projected growth in loan balances due to higher than anticipated levels of loan payoffs which totaled \$46.8 million in 2005 and \$27.9 million in 2006. These loan payoffs have generally resulted in improved loan portfolio mix and quality.

## Credit Quality

Loan quality has continued to be one of our strengths, which is a testament to our underwriting processes. Nonperforming loans amounted to \$4.307 million, 2.11% of loans, at December 31, 2004 to \$114,000 on December 31, 2005, and \$2.939 million, or .91% of loans, at 2006 year end. The increase in nonperforming loans, \$2.8 million, in 2006 was due primarily to commercial credits that were originated prior to the recapitalization and existing management. Measurement ratios pertaining to credit quality are well below peer group averages in all categories. An important aspect in the management of our loan portfolio is a program of continual credit monitoring which results in early detection of problem credits. We follow this detection process with a program that aggressively seeks an early resolution of problem loans to minimize principal loss and the expenses of problem credits.

## Deposit Growth

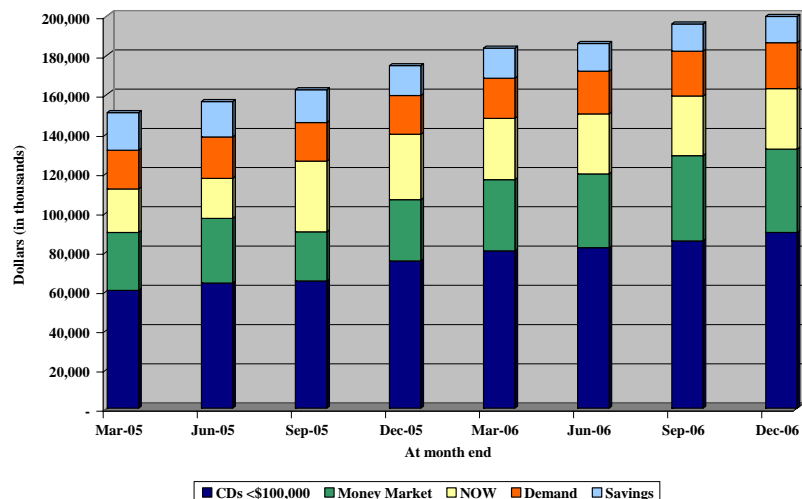
Core deposits, which we define as demand deposits, interest bearing checking accounts, money market savings accounts and certificates of deposit under \$100,000 started to grow in mid 2005. We renamed the bank, changed all of our signs, altered every deposit product to bring about market place competitiveness and developed new collateral material and newspaper ads for our local markets. We grew core deposits by 14.0% in 2005 and continued this success in 2006 by growing core deposits by \$25.079 million or 14.4%.

While we are gratified by our progress in changing our deposit gathering skills, we are not satisfied and we have a lot that we need to accomplish. We have introduced a remote deposit capture product which, when combined with our internet banking product and willingness to waive ATM fees, positions us to compete very effectively for the banking accounts of our commercial and consumer customers. We have also hired cash management specialists in each of our three core markets to allow us to pursue these accounts aggressively. In 2007, we plan on significant gains in the core deposit area.

### DEPOSIT GROWTH

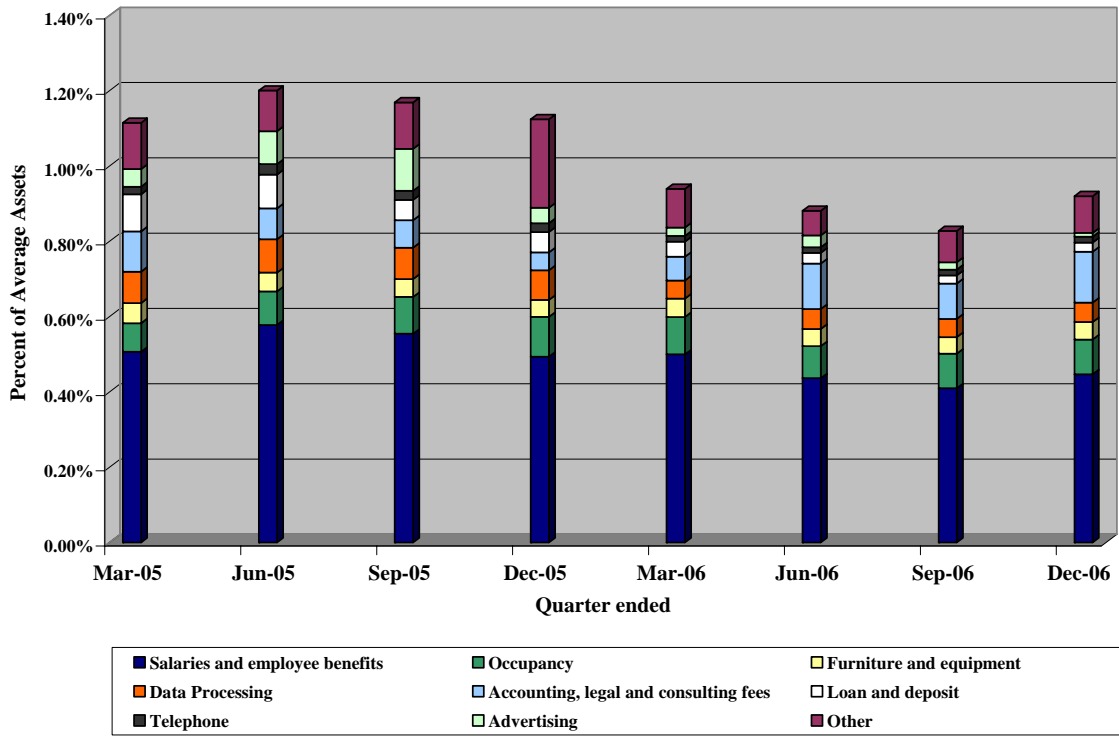
	As of December 31,						Percent Change	
	2006	Mix	2005	Mix	2004	Mix	2006/2005	2005/2004
<b>CORE DEPOSITS</b>								
Noninterest bearing	\$ 23,471	7.51 %	\$ 19,684	8.46 %	\$ 20,956	9.72 %	19.24 %	(6.07) %
NOW and money market	73,188	23.43	64,566	27.75	53,468	24.79	13.35	20.76
Savings and IRAs	22,231	7.12	22,555	9.70	25,570	11.86	(1.44)	(11.79)
Certificates of deposit <\$100,000	80,719	25.83	67,725	29.12	53,100	24.63	19.19	27.54
<i>Total core deposits</i>	<b>199,609</b>	<b>63.89</b>	174,530	75.03	153,094	71.00	<b>14.37</b>	14.00
<b>NON-CORE DEPOSITS</b>								
Certificates of deposit >\$100,000	23,645	7.57	12,335	5.30	10,726	4.97	91.69	15.00
Internet CDs	1,189	0.38	35,811	15.39	51,830	24.03	(96.68)	(30.91)
Brokered CDs	87,978	28.16	9,956	4.28	-	-	783.67	-
<i>Total non-core deposits</i>	<b>112,812</b>	<b>36.11</b>	58,102	24.97	62,556	29.00	<b>94.16</b>	(7.12)
<b>TOTAL DEPOSITS</b>	<b>\$ 312,421</b>	<b>100.00 %</b>	\$ 232,632	100.00 %	\$ 215,650	100.00 %	<b>34.30 %</b>	7.87 %

Core Deposit Totals



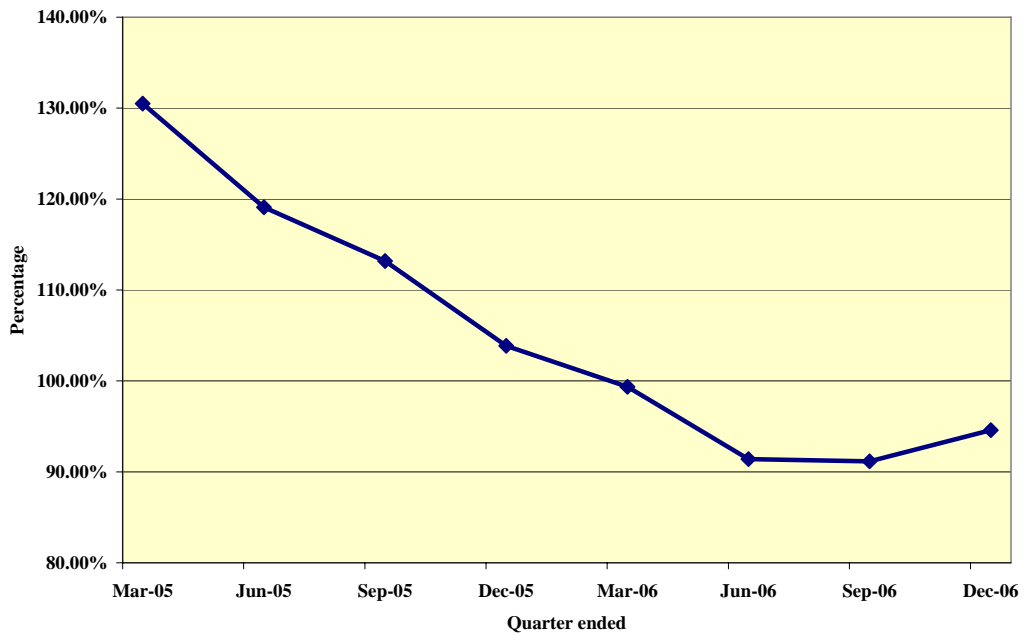


Noninterest Expense as Percent of Average Assets



The chart below illustrates the impact of controlling expenses and expanding our net interest margin has on our efficiency ratio.

Efficiency Ratio\*



COMPONENTS OF THE EFFICIENCY RATIO\*

(dollars in thousands)	2005 - Quarter Ended,			
	March 31	June 30	September 30	December 31
Net interest income (FTE basis)	\$ 2,351	\$ 2,528	\$ 2,643	\$ 2,822
Noninterest income, excluding securities gain/loss	185	272	254	303
Total operating income (FTE basis)	2,536	2,800	2,897	3,125
Noninterest expense	\$ 3,310	\$ 3,335	\$ 3,279	\$ 3,196
Efficiency ratio	130.52 %	119.11 %	113.19 %	102.27 %

	2006 - Quarter Ended,			
	March 31	June 30	September 30	December 31
Net interest income (FTE basis)	\$ 2,800	\$ 3,055	\$ 3,052	\$ 3,108
Noninterest income, excluding securities gain/loss	216	250	241	276
Total operating income (FTE basis)	3,016	3,305	3,293	3,384
Noninterest expense	\$ 2,997	\$ 3,021	\$ 3,002	\$ 3,201
Efficiency ratio	99.37 %	91.41 %	91.17 %	94.60 %

\*The efficiency ratio calculation excludes the FHLB prepayment penalty and the data processing conversion costs.

As illustrated above, this measurement of operational efficiency has shown improvement. The fourth quarter 2006 increase is primarily due to legal costs and year-end bonus payments and not indicative of ongoing increased operational costs. We recognize that cost control is extremely important given interest margin pressures and our limited opportunities to increase noninterest income. The efficiency ratio for our peer group is still well below our current levels but we expect continued improvement as we increase margin dollars and attain modest growth from current noninterest income initiatives.

**Capital**

The Bank and Corporation were both well capitalized as of the end of 2006. We increased Bank capital in 2006 by infusing capital from the holding company. This funding was provided under a new line of credit established early in 2006 with a correspondent bank. This line of credit will also support “projected” growth in 2007.

**Looking Forward**

For 2007, we have taken steps to address our need to leverage our branching system. We recently appointed executive officers in our regional offices to the position of Regional President with increased responsibility for day to day management along with specific loan and deposit goals. We have also initiated a deposit and loan growth incentive program for 2007. As mentioned above, to further emphasize our 2007 objective for core deposit growth, we added staff that specializes in corporate cash management services. These individuals will work directly with regional presidents, branch personnel and loan officers in each of our regions to develop existing and seek new customer relationships with the primary goal of increasing core transactional account deposit balances.

We believe that 2007 will prove to be pivotal in the evolution of your Corporation. We have set the foundation which provides base profitability. We have developed an Operating Plan which will increase our profitability in 2007 and, if successful, bring profits more in line with peer. We have begun work on the modification of our longer term Strategic Plan to address our deficiencies, which include our weakness in generating noninterest income, our need to increase core deposit growth and our near and long term needs for increased capital to support projected growth. While we are facing a stiff headwind with Michigan’s economy, our size, agility and ability to provide exceptional customer service provides us with confidence that we will be able to generate shareholder value and provide good returns on invested capital. As always, we thank you for your continued support and welcome your comments.

Sincerely,



**Paul D. Tobias**  
Chairman and CEO