

# Mackinac Financial

130 South Cedar Street  
Manistique, Michigan 49854

## NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To Be Held May 31, 2006

**NOTICE IS HEREBY GIVEN** that the Annual Meeting of Shareholders of Mackinac Financial Corporation (the "Corporation"), a Michigan corporation, will be held on Wednesday, May 31, 2006, at 12:00 noon, at the Comfort Inn, 726 East Lakeshore Drive, Manistique, Michigan 49854, for the following purposes:

1. To elect three (3) Directors, each to hold office for a three-year term.
2. To transact such other business as may properly come before the annual meeting, all in accordance with the accompanying proxy statement.

The Board of Directors has fixed April 24, 2006, as the record date for the determination of shareholders entitled to notice of and to vote at the meeting or any adjournment of the meeting.

By order of the Board of Directors

Paul D. Tobias  
Chairman and Chief Executive Officer

**Your vote is important. Even if you plan to attend the meeting, please date and sign the enclosed proxy form, indicate your choice with respect to the matters to be voted upon, and return it promptly in the enclosed envelope. Note that if the stock is held in more than one name, all parties must sign the proxy form.**

Dated: May 1, 2006

**MACKINAC FINANCIAL CORPORATION**  
**130 South Cedar Street**  
**Manistique, Michigan 49854**

**PROXY STATEMENT**

This proxy statement and the enclosed proxy are furnished in connection with the solicitation of proxies by the Board of Directors of Mackinac Financial Corporation (the "Corporation"), a Michigan corporation, to be voted at the Annual Meeting of Shareholders of the Corporation to be held on Wednesday, May 31, 2006, at 12:00 noon, at the Comfort Inn, 726 East Lakeshore Drive, Manistique, Michigan 49854, for the purposes set forth in the accompanying notice and in this proxy statement.

This proxy statement is being mailed on or about May 1, 2006, to all holders of record of common stock of the Corporation as of the record date. The Board of Directors of the Corporation has fixed the close of business on April 24, 2006, as the record date for the determination of shareholders entitled to notice of and to vote at the meeting and any adjournment of the meeting. As of April 24, 2006, there were 3,428,695 shares of common stock outstanding. Each outstanding share will entitle the holder to one vote on each matter presented for vote at the meeting.

If a proxy in the enclosed form is properly executed and returned to the Corporation, the shares represented by the proxy will be voted at the meeting and any adjournment of the meeting. If a shareholder specifies a choice, the proxy will be voted as specified. If no choice is specified, the shares represented by the proxy will be voted for the election of all of the nominees named in the proxy statement and in accordance with the judgment of the persons named as proxies with respect to any other matter which may come before the meeting. A proxy may be revoked before exercise by notifying the Chief Executive Officer of the Corporation in writing or in open meeting, by submitting a proxy of a later date or attending the meeting and voting in person. All shareholders are encouraged to date and sign the enclosed proxy, indicate your choice with respect to the matters to be voted upon, and return it to the Corporation.

Votes cast at the meeting and submitted by proxy are counted by the inspectors of the meeting, who are appointed by the Corporation. A plurality of the votes cast at the meeting is required to elect the nominees as Directors of the Corporation. The three nominees who receive the largest number of affirmative votes cast at the meeting will be elected as Directors. Shares not voted at the meeting, whether by broker nonvote, or otherwise, will not be treated as votes cast at the meeting and will have no effect on the outcome of the voting. An abstention will have no effect on the voting for Directors.

**ELECTION OF DIRECTORS**

The Bylaws of the Corporation provide for a Board of Directors consisting of a minimum of five (5) and a maximum of sixteen (16) members. The Board of Directors has fixed the number of Directors at eight (8). The Articles of Incorporation of the Corporation and the Bylaws also provide for the division of the Board of Directors into three (3) classes of nearly equal size with staggered three-year terms of office. Three persons have been nominated for election to the Board, each to serve a three-year term expiring at the 2009 Annual Meeting of Shareholders.

Unless otherwise directed by a shareholder's proxy, the persons named as proxy holders in the accompanying proxy will vote for Messrs. Aspatore, Orley and Paschke, the nominees named below. Messrs. Aspatore, Orley, and Paschke are currently Directors of the Corporation, and its subsidiary, mBank (the "Bank"), and members of the class of Directors of the Corporation whose terms expire at the 2006 Annual Meeting. In the event that any of the nominees shall become unavailable, which is not anticipated, the Board of Directors at its discretion, may reduce the number of Directors or designate substitute nominees, in which event the enclosed proxy will be voted for such substitute nominees. Proxies cannot be voted for a greater number of persons than the number of nominees named.

**The Board of Directors recommends a vote FOR the election of Messrs. Aspatore, Orley and Paschke, the three persons nominated by the Board.**

**Information About Directors and Nominees**

***Director Information***

The following information has been furnished to the Corporation by the respective Directors. Each of them has been engaged in the occupations stated below during the periods indicated, or if no period is indicated, for more than five years.

	<u>Age</u>	<u>Principal Occupation</u>	<u>Director of Corporation Since</u>
<b>Nominees Standing for Election as Directors For Terms Expiring in 2009</b>			
Walter J. Aspatore . . . . .	63	Investment Banking, Amherst Partners	2004
Robert H. Orley . . . . .	50	Real Estate Developer, Vice President and Secretary of Real Estate Investment Group, Inc.	2004
Randolph C. Paschke . . . . .	56	From May 1970 to August 2002 — worked in Tax Services at Arthur Anderson, LLP. Served as a partner in Arthur Anderson, LLP from September 1982 until August 2002. Served as Managing Partner — U.S. International Tax Trade Services at Arthur Anderson, LLP from 2001 — 2002. Served as Managing Partner-Great Lakes International Tax Services at Arthur Anderson, LLP from 1999 — 2001. From August 2002 to present-Chair, Department of Accounting in the School of Business Administration at Wayne State University.	2004

**Continuing Directors**

**Directors Whose Terms Expire in 2007**

Eliot R. Stark . . . . . (See below for prior occupations)	53	Executive Vice President and Chief Financial Officer of the Corporation and the Bank from December 2004 to present.	2004
Paul D. Tobias . . . . . (See below for prior occupations)	55	Chairman and Chief Executive Officer of the Corporation and Chairman of the Bank from December 2004 to present.	2004

**Directors Whose Terms Expire in 2008**

C. James Bess . . . . . (See below for prior occupations)	68	Vice Chairman of the Corporation and the Bank	2003
Dennis B. Bittner . . . . .	57	Owner and President, Bittner Engineering	2001

The Corporation’s Board has considered the independence of the nominees for election at the Annual Meeting and the continuing Directors under the rules of the Nasdaq Stock Market (“Nasdaq”). The Board has determined that all of the nominees and continuing Directors are independent under Nasdaq rules except Mr. Tobias, Chairman and Chief Executive Officer of the Corporation and Chairman of the Bank, Mr. Bess, Vice Chairman of the Corporation and the Bank and Mr. Stark, Executive Vice President and Chief Financial Officer of the Corporation and the Bank. Messrs. Tobias, Bess and Stark are not independent because of their services as Executive Officers of the Corporation.

## *Executive Officers*

The Executive Officers of the Corporation serve at the pleasure of the Board of Directors. Set forth below are the current Executive Officers of the Corporation and a brief explanation of their principal employment during the last five years. Additional information concerning employment agreements of Executive Officers of the Corporation is included elsewhere in the Proxy under the heading "Executive Compensation."

**Paul D. Tobias** — Age 55 — Chairman of the Board and Chief Executive Officer. Mr. Tobias was appointed to his present position with the Corporation and as Chairman of the Bank on December 16, 2004. Mr. Tobias was appointed Chief Executive Officer of the Bank in July 2005. Prior to this, Mr. Tobias served as Chief Executive Officer of Munder Capital Management from April of 1995 to October 1999. From January of 2000 to the present, he has served as Chairman and Chief Executive Officer of Mackinac Partners, LLC.

**C. James Bess** — Age 68 — Vice Chairman. Mr. Bess has served as Vice Chairman of the Corporation and the Bank since July 15, 2005. Mr. Bess served as President and Chief Executive Officer of the Bank and Vice Chairman of the Corporation from December 16, 2004 to July 2005. Mr. Bess served as President and Chief Executive Officer of the Corporation and Bank from August 2003 to December 15, 2004. Prior to such time, Mr. Bess served as President and Chief Executive Officer of The Commercial and Savings Bank of Millersburg, Ohio from December 2000 to July 2003. Mr. Bess served as President and Chief Executive Officer of Security Dollar Bank of Niles, Ohio from February 2000 through November 2000. Mr. Bess was engaged as a consultant to various financial service companies from January 1, 1999 to February 2000.

**Eliot R. Stark** — Age 53 — Executive Vice President and Chief Financial Officer. Mr. Stark was appointed to his current positions with the Corporation and the Bank on December 16, 2004. From June of 1995 to January of 2001, Mr. Stark served as Executive Vice President of Compuware Corporation. From January of 2001 to the present, he has served as the Managing Director of Mackinac Partners Consultants.

**Ernie R. Krueger** — Age 56 — Senior Vice President and Controller. Prior to his current position with the Corporation, Mr. Krueger served as a financial consultant from 1997 to 2000 with First Union Securities and from 2000 to 2002 with Smith Barney.

## **Board of Directors Meetings and Committees**

### *Audit Committee*

The Audit Committee is a separately-designated standing Committee of the Board of Directors established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The Audit Committee has responsibility for:

- Appointing or replacing the Corporation's independent auditors;
- Overseeing the work of the independent auditors (including resolution of any disagreements between management and the auditors regarding financial reporting);
- Reviewing the independent auditors' performance, qualifications and independence;
- Approving all auditing and permitted non-auditing services to be performed by the independent auditors with limited exceptions;
- Reviewing the Corporation's financial statements, internal audit function and system of internal controls;
- Overseeing compliance by the Corporation with legal and regulatory requirements and with the Corporation's Code of Business Conduct and Ethics; and
- Producing the report required by federal securities regulations for inclusion in the Corporation's Proxy Statement.

The current members of the Audit Committee are Messrs. Paschke (chairman), Aspatore and Orley, all of whom are independent. The Board has determined that Mr. Paschke is an "audit committee financial expert"

as that term is defined by the Securities and Exchange Commission. The Audit Committee held 7 meetings in 2005. Messrs. Aspatore, Orley and Paschke all attended the majority of these meetings.

#### *Nominating Committee*

The Nominating Committee is responsible for:

- Identifying new candidates who are qualified to serve as Directors of the Corporation;
- Recommending to the Board of Directors the candidates for election to the Board and for appointment to the Board's Committees; and
- Considering any nominations for Director submitted by shareholders.

The current members of the Nominating Committee are Messrs. Aspatore (chairman), Orley and Paschke. All members are independent under the Nasdaq Stock Market rules defining independence. The Nominating Committee held 1 meeting in 2005. Messrs. Aspatore, Orley and Paschke were in attendance.

The Board of Directors has adopted a Charter for the Nominating Committee. A copy of this Charter was filed, as Appendix A, with the Corporation's 2004 proxy. In the past, the committee has identified potential nominees through recommendations made by executive officers and non-management directors and has evaluated them based on their resumes and through references and personal interviews. No shareholder, other than an officer or director, has ever submitted a suggestion for a nominee, but if the committee were to receive such a suggestion, it expects it would evaluate that potential nominee in substantially the same manner.

The Nominating Committee will consider candidates nominated by shareholders in accordance with the procedures set forth in the Corporation's Bylaws and Articles of Incorporation. Under the Corporation's Bylaws and Articles of Incorporation, nominations other than those made by the Board of Directors or the Nominating Committee, must be made pursuant to timely notice in proper written form to the Secretary of the Corporation. To be timely, a shareholder's request to nominate a person for election to the Board, together with the written consent of such person to serve as a Director, must be received by the Secretary of the Corporation not less than 60 nor more than 90 days prior to the first anniversary date of the Annual Meeting of Shareholders in the immediately preceding year. To be in proper written form, the notice must contain certain information concerning the nominee and the shareholder submitting the nomination.

With respect to each person proposed to be nominated, the Nominating Committee shall be provided with the following information: (i) the name, address (business and residence), date of birth, principal occupation or employment of such person (present and for the past five (5) years); (ii) the number of shares of the Corporation such person beneficially owns (as such term is defined by Section 13(d) of the Securities Exchange Act of 1934, as amended [the "Exchange Act"]); and (iii) any other information relating to such person that would be required to be disclosed in a definitive proxy statement to shareholders prepared in connection with an election of Directors pursuant to Section 14(a) of the Exchange Act. The Nominating Committee may require any proposed nominee to furnish additional information as may be reasonably required to determine the qualifications of such person to serve as a Director of the Corporation. No person shall be eligible for election as a Director of the Corporation unless nominated in accordance with the procedures set forth in the Bylaws and Articles of Incorporation.

#### *Compensation Committee*

The current Compensation Committee of the Board of Directors is comprised of Robert H. Orley (chairman), Walter J. Aspatore and Randolph C. Paschke, each of whom is independent under the Nasdaq Stock Market rules defining independence. One meeting of this Committee was held in 2005. Messrs. Aspatore and Paschke were in attendance. This Committee's primary functions are to recommend annually to the Board the salary of the Executive Officers, review with management the annual projected salary ranges and recommend those for Board approval, and review the written personnel policy and the employee benefit package annually. The

primary responsibilities of the Compensation Committee are to ensure that the compensation available to the Board of Directors and officers of the Corporation:

- Enables the Corporation to attract and retain high quality leadership;
- Provides competitive compensation opportunities;
- Supports the Corporation's overall business strategy; and
- Maximizes shareholder value.

### **Attendance of Directors**

The Board of Directors held a total of 12 meetings during 2005. No Director attended less than 75% of the aggregate number of meetings of the Board of Directors and the Committees on which he served in 2005, with the exception of Mr. Orley, who attended 65% of the Board of Directors meetings and 56% of the Committee meetings. There are no family relationships between or among any of the Directors, nominees, or Executive Officers of the Corporation.

### **Communication with Directors and Attendance at Annual Meetings**

The Corporation's Board provides a process for shareholders to send communications to the Board or any of the Directors. Shareholders may send written communications to the Board or any one or more of the individual Directors by mail, c/o Corporate Secretary, Mackinac Financial Corporation, 130 South Cedar Street, Manistique, MI 49854. All communications will be compiled by the Corporation's Corporate Secretary and submitted to the Board or the individual Directors on a regular basis unless such communications are considered, in the reasonable judgment of the Corporate Secretary, to be improper for submission to the intended recipient(s). Examples of shareholder communications that would be considered improper for submission include without limitation, customer complaints, solicitations, communications that do not relate directly or indirectly to the Corporation's business, or communications that relate to improper or irrelevant topics.

It is the Corporation's policy that all of the Directors and nominees for election as Directors at the Annual Meeting attend the Annual Meeting except in cases of extraordinary circumstances. All of the nominees for election at the 2005 Annual Meeting of Shareholders and all other Directors attended the 2005 Annual Meeting of Shareholders. The Corporation expects all nominees and Directors to attend the 2006 Annual Meeting.

### **Remuneration of Directors**

The members of the Board of Directors currently receive remuneration in the form of monthly attendance fees, committee fees and an annual retainer. In 2004 Mr. Bess was paid \$1,000 per month in Director fees and Mr. Bittner was paid an annual retainer of \$1,200 and \$1,000 per month. The remainder of the current Directors of the Corporation and Bank received no fees in 2004. For 2005, the external, non-employee Directors of the Corporation and the Bank received an annual retainer of \$15,000, and a fee of \$750 for each meeting that was held by the Board of Directors of the Corporation. Messrs. Aspatore, Orley and Paschke received an award of 10,000 option shares to purchase the Corporation's common stock. Attendance is a requirement in order for the Directors to be paid the monthly fee. There is no anticipated change for Director remuneration in 2006.

The Corporation's 2000 Stock Incentive Plan provides for the grant of options to eligible Directors (i.e., nonemployee Directors of the Corporation or the Bank) in addition to key employees. Options are granted at the discretion of the Compensation Committee of the Board of Directors of the Corporation. The term of each option is ten (10) years, subject to earlier termination in certain events, and the option price is 100% of fair market value on the date of grant. The options issued to Messrs. Tobias and Stark were granted at an exercise price of \$9.75 per share, which was the fair market value of the Corporation's common stock sold in the private placement to recapitalize the Corporation. In 2005, Messrs. Aspatore, Bittner, Paschke and Orley were each granted 10,000 option shares exercisable at \$11.50 per share, which was the fair market value on the date of the grant.

## EXECUTIVE COMPENSATION

### Summary Compensation Table

The following table sets forth the compensation received by the named Executive Officers for the three years ended December 31, 2005:

Name and Principal Position	Year	Annual Compensation		Other Annual(3)	Long-Term Compensation	All Other Compensation(4)
		Salary	Bonus		Number of Options Granted	
Paul D. Tobias * . . . . . Chairman and Chief Executive Officer of the Corporation and Chairman of the Bank	2005	\$225,000	\$ 25,000	\$ -0-	-0-	\$14,992
	2004	6,923	-0-	-0-	150,005	-0-
C. James Bess . . . . . Vice Chairman of the Corporation	2005	\$202,446	\$360,000(1)	\$ -0-	-0-	\$28,138
	2004	360,000	907,740(2)	12,000	-0-	88,970
	2003	152,163	10,000	5,000	-0-	21,104
Kelly W. George. . . . . President and Chief Lending Officer of the Bank	2005	\$175,000	\$200,000(1)	\$ -0-	20,000	\$35,351
	2004	175,000	311,774(2)	-0-	-0-	47,515
Joseph E. Petterson . . . . . Executive Vice President of the Corporation and the Bank	2005	\$ 76,655	\$175,000(1)	\$ -0-	-0-	\$12,621
	2004	175,000	288,173(2)	-0-	-0-	17,931
Eliot R. Stark * . . . . . Executive Vice President and Chief Financial Officer of the Corporation and the Bank	2005	\$200,000	\$ 25,000	\$ -0-	-0-	\$14,989
	2004	6,154	-0-	-0-	107,147	-0-
Ernie R. Krueger . . . . . Senior Vice President and Controller of the Corporation and the Bank	2005	\$135,000	\$ 70,000(1)	\$ -0-	10,000	\$23,050
	2004	131,667	50,000(2)	-0-	-0-	29,898

\* The 2004 compensation for Messrs. Tobias and Stark is shown from December 15, 2004 to December 31, 2004, the period in 2004 in which they served as Executive Officers.

- (1) Represents payment pursuant to employee contract provision on removal of formal regulatory Cease and Desist Order for Messrs. Bess, \$360,000; George, \$175,000; Petterson, \$175,000; and Krueger, \$50,000. Messrs. George and Krueger also received annual bonuses in 2005 of \$25,000 and \$20,000, respectively.
- (2) Represents payment pursuant to employee contract provision on change in control triggered by recapitalization of the Corporation.
- (3) Represents Director fees paid.
- (4) The amounts shown include the taxable amount of group life insurance cost paid by the Corporation for Messrs. Tobias, \$414; Bess, \$5,539; George, \$324; Petterson, \$655; Stark, \$414; and Krueger, \$1,373. Other compensation for Messrs. Bess, George, Petterson and Krueger includes the amounts paid by the Corporation for housing, auto expenses and the taxable portion of the benefit of a corporate owned auto provided for Mr. Bess (\$3,402) and Mr. Krueger (\$1,800).

**Employment and Consulting Agreements**

The Corporation has employment agreements with Executive Officers as described below.

**Paul D. Tobias** — Mr. Tobias’s agreement provides for him to be employed and appointed as our Chairman of the Board and the Chief Executive Officer of the Corporation and the Chairman of the Board of the Bank. He is to receive an initial annual base salary of \$225,000, subject to annual increases by the Board. We are to develop an incentive plan or plans for annual cash bonuses to be awarded to eligible employees (including Mr. Tobias).

The agreement has an initial three-year term which renews for an additional year on each anniversary date of the agreement unless we or Mr. Tobias elects to not renew at least sixty (60) days prior to the renewal date.

In addition to the compensation noted above, the agreement provides for health and other benefits to be provided to him at least substantially equivalent to other management employees holding comparable positions. The agreement also requires us to reimburse him for all reasonable out-of-pocket expenses in connection with his employment, including a car allowance of \$750 per month and a per diem allowance for living expenses while in Manistique, Michigan, of at least \$100 per day, not to exceed \$1,000 in any calendar month, but subject to upward adjustment upon demonstration that the reasonable ordinary living expenses exceed the per diem amount. We have also agreed in the employment agreement to pay the reasonable costs of an office in Oakland County and a personal secretary and other assistance unless we otherwise provide him with an office and support staff in that county.

Under the agreement, Mr. Tobias was awarded options under the Corporation’s 2000 Stock Incentive Plan to purchase 150,005 shares of common stock at an exercise price of \$9.75 per share.

If the agreement is terminated, we are to make termination payments in amounts and in a lump sum or over time depending on the reason the agreement is terminated. The table below summarizes the termination payments under the agreement.

<u>Reason for Termination</u>	<u>Termination Payments</u>
By us for cause . . . . .	No termination payments required
By us without cause and not due to disability, or by the Executive for Good Reason . . . . .	Three years; base salary, highest bonus and benefits
Death . . . . .	One year; base salary and benefits
Disability . . . . .	Two years; base salary and benefits, subject to reduction for long term disability benefits received by the Executive
Following a Change in Control, either by Executive Good Reason or by us other than for cause or disability . . . . .	Lump sum; 300% of aggregate of base salary and highest bonus. Three years for benefits.
By Executive without Good Reason following a Change in Control . . . . .	Lump sum; 100% of base salary and highest bonus
By mutual agreement. . . . .	Per the mutual agreement

The agreement provides for a specified adjustment to the termination payments should they be determined to constitute a parachute payment under Section 280G of the Internal Revenue Code. The agreement also provides for us to pay interest at an annual rate equal to 120% of the applicable federal rate and to indemnify Mr. Tobias for expenses, including reasonable attorneys’ and consultants’ fees, incurred to collect any unpaid amounts. We are also required to indemnify him for costs and expenses, on an as incurred basis, as a result of any dispute or controversy, regardless of the outcome of the dispute or controversy.

The agreement includes confidentiality obligations of Mr. Tobias and provides that he will not engage in competitive activities while employed by us. If his employment is terminated, the restriction on Mr. Tobias’s competitive activities will continue after termination in certain instances for a period of 1 to 3 years, depending on the reason for the termination.

**C. James Bess** — Mr. Bess and the Corporation, on July 15, 2005, entered into an amendment of an original employment agreement dated August 10, 2004. This amended agreement replaced the original agreement, and provided for Mr. Bess to be employed as the Vice Chairman of the Corporation and the Bank. The agreement has an original term of two years.

He is to receive base salary at the annual rate of \$150,000 and an additional incentive bonus in accordance with our, or the Bank’s policy or plan for the first year of the contract. Effective July 1, 2006, Mr. Bess’s salary will be reduced to \$75,000 for the remainder of his contract term. In addition, we are to provide him with a per diem allowance for living expenses while in Manistique, Michigan, of at least \$125 per day. In addition, we are to provide him with the use of the automobile presently used by him through June 30, 2006, and thereafter be reimbursed for mileage in conjunction with business travel. He will also be entitled to participate in our and the Bank’s employee benefit plans.

The agreement provides that if his employment is terminated as a result of his disability, by us without cause or if we elect to not extend the term of the agreement, he will be entitled to his base salary for a period of one year, except that, if termination occurs during the initial 18 month period, he will only be entitled to the payments for the shorter on one year or the balance of the initial period. The agreement includes confidentiality obligations, but does not include any non-competition provisions.

**Kelly W. George** — Mr. George’s agreement provides for him to be employed as our President and Chief Lending Officer of the Bank. He is to receive an initial annual base salary of \$175,000, subject to annual increases by the Board. We are to develop an incentive plan or plans for annual cash bonuses to be awarded to eligible employees (including Mr. George).

The agreement has an initial three-year term which renews for additional one-year terms after the initial employment period unless we or Mr. George elects not to renew prior to the termination date.

In addition to the compensation noted above, the agreement provides for health and other benefits to be provided to him at least substantially equivalent to other management employees holding comparable positions. The agreement also requires us to reimburse him for all reasonable out-of-pocket expenses in connection with his employment, including a car allowance of \$450 per month.

Under the agreement, Mr. George was awarded options under the Corporation’s 2000 Stock Incentive Plan to purchase 20,000 shares of common stock at an exercise price of \$12.00 per share.

If the agreement is terminated, we are to make termination payments in amounts and in a lump sum or over time depending on the reason the agreement is terminated. The table below summarizes the termination payments under the agreement.

<u>Reason for Termination</u>	<u>Termination Payments</u>
By death, us for cause, or expiration of employment contract term . . . . .	No termination payments required
By us without cause or disability . . . . .	The greater of one year or remainder of contract term, base salary, highest bonus and benefits
Following a Change in Control, either by Executive Good Reason or by us other than for cause or disability . . . . .	Lump sum; 200% of aggregate of base salary and highest bonus.
By mutual agreement. . . . .	Per the mutual agreement

The agreement provides for a specified adjustment to the termination payments should they be determined to constitute a parachute payment under Section 280G of the Internal Revenue Code.

The agreement includes confidentiality obligations of Mr. George and provides that he will not engage in competitive activities while employed by us. If his employment is terminated, the restriction on his competitive activities will continue after termination in certain instances for a period of 1 to 3 years, depending on the reason for the termination.

**Eliot R. Stark** — Mr. Stark’s agreement provides for him to be employed and appointed as our Executive Vice President and Chief Financial Officer of the Corporation and the Bank. He is to receive an initial annual base salary of \$200,000, subject to annual increases by the Board. We are to develop an incentive plan or plans for annual cash bonuses to be awarded to eligible employees (including Mr. Stark).

The agreement has an initial three-year term which renews for an additional year on each anniversary date of the agreement unless we or Mr. Stark elects to not renew at least sixty (60) days prior to the renewal date.

In addition to the compensation noted above, the agreement provides for health and other benefits to be provided to Mr. Stark at least substantially equivalent to other management employees holding comparable positions. The agreement also requires us to reimburse him for all reasonable out-of-pocket expenses in connection with his employment, including a car allowance of \$750 per month and a per diem allowance for living expenses while in Manistique, Michigan, of at least \$100 per day, not to exceed \$1,000 in any calendar month, but subject to upward adjustment upon demonstration that the reasonable ordinary living expenses exceed the per diem amount. We have also agreed in the employment agreement to pay the reasonable costs of an office in Oakland County and a personal secretary and other assistance unless we otherwise provide him with an office and support staff in that county.

Under the agreement, Mr. Stark is to be awarded options under the Corporation’s 2000 Stock Incentive Plan to purchase 107,147 shares of common stock at an exercise price of \$9.75 per share.

If the agreement is terminated, we are to make termination payments in amounts and in a lump sum or over time depending on the reason the agreement is terminated. The table below summarizes the termination payments under the agreement.

<u>Reason for Termination</u>	<u>Termination Payments</u>
By us for cause . . . . .	No termination payments required
By us without cause and not due to disability, or by the Executive for Good Reason . . . . .	Three years; base salary, highest bonus and benefits
Death . . . . .	One year; base salary and benefits
Disability . . . . .	Two years; base salary and benefits, subject to reduction for long term disability benefits received by the Executive
Following a Change in Control, either by Executive Good Reason or by us other than for cause or disability . . . . .	Lump sum; 300% of aggregate of base salary and highest bonus. Three years for benefits.
By Executive without Good Reason following a Change in Control . . . . .	Lump sum; 100% of base salary and highest bonus
By mutual agreement. . . . .	Per the mutual agreement

The agreement provides for a specified adjustment to the termination payments should they be determined to constitute a parachute payment under Section 280G of the Internal Revenue Code. The agreement also provides for us to pay interest at an annual rate equal to 120% of the applicable federal rate and to indemnify Mr. Stark for expenses, including reasonable attorneys’ and consultants’ fees, incurred to collect any unpaid amounts. We are also required to indemnify him for costs and expenses, on an as incurred basis, as a result of any dispute or controversy, regardless of the outcome of the dispute or controversy.

The agreement includes confidentiality obligations of Mr. Stark and provides that he will not engage in competitive activities while employed by us. If his employment is terminated, the restriction on his competitive activities will continue after termination in certain instances for a period of 1 to 3 years, depending on the reason for the termination.

**Ernie R. Krueger** — Mr. Krueger’s agreement provides for him to be employed as our Senior Vice President and Controller of the Corporation and the Bank. He is to receive an initial annual base salary of \$135,000, subject to annual increases by the Board. We are to develop an incentive plan or plans for annual cash bonuses to be awarded to eligible employees (including Mr. Krueger).

The agreement has an initial three-year term which renews for additional one-year terms after the initial employment period unless we or Mr. Krueger elects not to renew prior to the termination date.

In addition to the compensation noted above, the agreement provides for health and other benefits to be provided to Mr. Krueger at least substantially equivalent to other management employees holding comparable positions. The agreement also requires us to reimburse him for all reasonable out-of-pocket expenses in connection with his employment, including a car allowance of \$450 per month and a living expense of \$1,000 per month.

Under the agreement, Mr. Krueger was awarded options under the Corporation's 2000 Stock Incentive Plan to purchase 10,000 shares of common stock at an exercise price of \$12.00 per share.

If the agreement is terminated, we are to make termination payments in amounts and in a lump sum or over time depending on the reason the agreement is terminated. The table below summarizes the termination payments under the agreement.

<u>Reason for Termination</u>	<u>Termination Payments</u>
By death, us for cause, or expiration of employment contract term . . . . .	No termination payments required
By us without cause or disability . . . . .	The greater of one year or remainder of contract term, base salary and highest bonus and benefits
Following a Change in Control, either by Executive Good Reason or by us other than for cause or disability . . . . .	Lump sum; 200% of aggregate of base salary and highest bonus.
By mutual agreement. . . . .	Per the mutual agreement

The agreement provides for a specified adjustment to the termination payments should they be determined to constitute a parachute payment under Section 280G of the Internal Revenue Code.

**Option Grants In Last Fiscal Year**

The Corporation's 2000 Stock Incentive Plan provides for the grant of options to key employees of the Corporation as well as eligible Directors. Options are granted at the discretion of the Compensation Committee of the Board of Directors of the Corporation. The term of each option is up to ten (10) years, subject to earlier termination in certain events, and the option price is 100% of fair market value on the date of grant.

The following table provides information on options granted in 2005 to the executives listed in the Executive Compensation Table and the potential realizable value of the options.

	Shares Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price Per Share	Expiration Date	Assumed Annual Rates of Stock Appreciation of Option Term	
					5%	10%
Paul D. Tobias . . . . .	-0-	-0-%	\$ N/A	N/A	\$ N/A	\$ N/A
C. James Bess . . . . .	-0-	-0-	N/A	N/A	N/A	N/A
Kelly W. George . . . . .	20,000	28	12.00	6/10/2014	12,000	24,000
Joseph E. Petterson . . .	-0-	-0-	N/A	N/A	N/A	N/A
Eliot R. Stark . . . . .	-0-	-0-	N/A	N/A	-0-	N/A
Ernie R. Krueger . . . . .	10,000	14	12.00	6/10/2014	6,000	12,000

### Aggregate Stock Option Exercises in 2005 and Year-End Option Values

The following table provides information on the exercise of stock options during 2005 by the executives listed in the Summary Compensation Table and the value of unexercised options at December 31, 2005.

	Shares Acquired on Exercise	Value Realized	Number of Shares Underlying Unexercised Options at 12/31/05	Value of Unexercised In-the-Money Options at 12/31/05(1)
			# Exercisable/# Unexercisable	Exercisable/Unexercisable
Paul D. Tobias . . . . .	\$-0-	\$-0-	70,502/79,503	\$ -0-/\$-0-
C. James Bess . . . . .	-0-	-0-	N/A/N/A	N/A/N/A
Kelly W. George . . . . .	-0-	-0-	4,000/16,000	-0- / -0-
Joseph E. Petterson . . .	-0-	-0-	N/A/N/A	N/A \$N/A
Eliot R. Stark . . . . .	-0-	-0-	50,359/56,788	-0- / -0-
Ernie R. Krueger . . . . .	-0-	-0-	2,000/8,000	-0- / -0-

(1) Values are based on the difference between the last reported sale price of the Corporation's common stock on December 31, 2005 (\$9.10), and the exercise prices of the options.

### Equity Compensation Plan Information

The following table reflects information about the securities authorized for issuance under the Corporation's equity compensation plans as of December 31, 2005.

Plan Category	(a)	(b)	(c)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders . .	282,999	\$34.55	138,899
Equity compensation plans not approved by security holders . .	<u>N/A</u>	<u>—</u>	<u>N/A</u>
TOTAL . . . . .	<u>282,999</u>	<u>\$34.55</u>	<u>138,899</u>

### Compensation Committee Interlock and Insider Participation

Members of the Compensation Committee who served during 2005 were Robert H. Orley (Chairman), Walter J. Aspatore and Randolph C. Paschke. All members are considered independent. No one who served on the Compensation Committee is or ever has been an officer or employee of the corporation or any of its subsidiaries.

### COMPENSATION COMMITTEE REPORT

Decisions on the compensation of the Corporation's Executive Officers in 2005 were made by the Board's Compensation Committee comprised of nonemployee Directors. The current Compensation Committee consists of Robert H. Orley (Chairman), Walter J. Aspatore and Randolph C. Paschke. This Committee report addresses the Corporation's compensation policies and programs for the year ended December 31, 2005.

Base Salary — Excluding consideration of other relevant factors, which may include individual performance, experience, expertise and tenure, the Board intends to maintain the base salaries of the Corporation's Executive Officers and senior managers within peer group levels.

Members of the Compensation Committee considered numerous factors, including individual performance, financial results of the Corporation, and relative peer compensation in rewarding 2005 bonuses to executive officers of the Corporation.

Annually, the Committee reviews and approves the Corporation's annual salary structure and benefit programs for consideration by the entire Board of Directors. The Committee's recommendation is based upon compensation levels established by the Corporation's peers and evaluations by consultants.

Long-Term Incentives — To align the interests of its Executive Officers and senior managers with the Corporation's shareholders, the Board's compensation strategy provides for a 401(k) matching contribution and equity-based compensation under the Corporation's stock compensation plans. Each of the Corporation's compensation plans has been adopted by the Board of Directors, and the equity-based compensation plans have been approved by the Corporation's shareholders.

Compensation Committee  
Robert H. Orley      Walter J. Aspatore      Randolph C. Paschke

### **AUDIT COMMITTEE REPORT**

The Corporation has established an Audit Committee of the Board of Directors, which currently consists of Randolph C. Paschke (Chairman), Walter J. Aspatore and Robert H. Orley.

The Board of Directors has determined that each of the Audit Committee members is independent, as independence for Audit Committee members is defined in the listing standards of the Nasdaq Stock Market and the rules of the Securities and Exchange Commission. The Board of Directors has adopted a written Audit Committee Charter. A copy of the Charter was included as Appendix B on the Corporation's 2004 Proxy.

The Audit Committee has reviewed and discussed the Corporation's audited financial statements with management.

The Audit Committee has discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61 (SAS 61), "Communication with Audit Committees," as amended, by the Auditing Standards Board of the American Institute of Certified Public Accountants. The Audit Committee has considered the compatibility of the provision of non-audit services with maintaining the auditors' independence.

The Audit Committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board No. 1, "Independence Discussions with Audit Committees," as amended, and has discussed with the independent accountant the independent accountant's independence.

Based on the review and discussions referred to above, the Audit Committee has recommended to the Board of Directors that the audited financial statements be included in the Corporation's Annual Report on Form 10-K for 2005.

Audit Committee  
Randolph C. Paschke      Walter J. Aspatore      Robert H. Orley

### Principal Accountant Fees and Services

The following table summarizes fees for professional services rendered by Plante & Moran, PLLC, the principal accountant for the years ended December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Audit fees(1) . . . . .	\$131,116	\$105,000
Audit-related fees(2) . . . . .	10,000	8,475
Tax fees(3) . . . . .	17,500	34,133
All other fees(4) . . . . .	<u>44,899</u>	<u>131,142</u>
Total fees . . . . .	<u>\$203,515</u>	<u>\$278,950</u>

- (1) Audit fees consist of fees billed for professional services performed by Plante & Moran for the audit of the Company's annual financial statements and internal control over financial reporting included in Form 10-K, the review of financial statements included in the Company's 10-Q filings and services that are normally provided in connection with regulatory filings or engagements.
- (2) Represents fees for review and audit of employee 401(k) employee benefit plan.
- (3) Represents fees billed for tax services, including tax reviews and planning. For 2005, a majority of the fees in this category represent preparation of 2005 consolidated tax returns.
- (4) The majority of all other fees, \$44,899, represent fees paid for regulatory compliance work performed.

The Audit Committee is required to review and pre-approve both audit and non-audit services to be provided by the independent auditor (other than with respect to *de minimis* exceptions permit by the Sarbanes-Oxley Act of 2002). During 2005, all services provided by Plante Moran, PLLC were pre-approved by the Audit Committee. To the extent required by the rules of the Nasdaq Stock Market or any other applicable legal or regulatory requirements, approval of non-audit services shall be disclosed to investors in periodic reports required by Section 13(a) of the Securities Exchange Act of 1934.

### INDEBTEDNESS OF AND TRANSACTIONS WITH MANAGEMENT

Certain of the Directors and officers of the Corporation have had and are expected to have in the future, transactions with the Bank, or have been Directors or officers of corporations, or members of partnerships or limited liability companies, which have had and are expected to have in the future, transactions with the Bank. In the opinion of management, all such transactions (i) were made in the ordinary course of business, (ii) on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and (iii) did not involve more than normal risk of collectibility or present other unfavorable features. The outstanding indebtedness to Directors and Executive Officers as of December 31, 2005, consisted of the following: a line of credit to Dennis B. Bittner in the amount of \$350,000, which had a 2005 year-end balance of \$86,000. Robert H. Orley also has a related party interest in a line of credit in the amount of \$496,000, which had a 2005 year-end balance of \$491,000. Both lines of credit referred to above bear interest at prevailing market rates for similar credit arrangements at the Bank. The largest outstanding balance during 2005, was \$350,000 for Mr. Bittner and \$496,000 for Mr. Orley.

**BENEFICIAL OWNERSHIP OF COMMON STOCK**

As of April 24, 2006, no person was known by management to be the beneficial owner of more than 5% of the outstanding common stock of the Corporation, except as follows:

<u>Name and Address of Beneficial Owner</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percent of Class</u>
Financial Stocks Capital Partners III LP 441 Vine Street, Suite 507 Cincinnati, OH 45202	340,000 Common Shares	9.92%
Gerlach & Co. FBO Banc Fund VI LP C/O Midbanc VI LP 208 LaSalle Street, Suite 1680 Chicago, IL 60604	300,000 Common Shares	8.75%
Hot Creek Ventures 2, LP 6900 South McCarran Blvd., Suite 3040 Reno, NV 89509	300,000 Common Shares	8.75%
Endicott Partners 237 Park Avenue, Suite 801 New York, NY 10017	299,700 Common Shares	8.74%
Axia Partners Qualified LP C/O Axia Capital Management LLC 425 Eagle Rock Avenue Roseland, NJ 07068	298,206 Common Shares	8.70%
Wellington Management Company LLP 75 State Street Boston, MA 02109	212,380 Common Shares	6.20%
PRB Investors, LP 600 Third Ave., 17 <sup>th</sup> Floor New York, NY 10016	181,503 Common Share	5.29%

The information in the following table sets forth the beneficial ownership of the Corporation's common stock by each of the Corporation's Directors, each of the Executive Officers listed in the Summary Compensation Table and by all Directors and Executive Officers of the Corporation as a group, as of April 24, 2006. Except as noted, beneficial ownership is direct and the person indicated has sole voting and investment power.

<u>Name of Beneficial Owner</u>	<u>Amount and Nature of Beneficial Ownership(1)</u>	<u>Percent of Class</u>
Walter J. Aspatore	4,564	*
C. James Bess	—	*
Dennis B. Bittner	2,387	*
Kelly W. George	4,000	*
Ernie R. Krueger	2,000	*
Robert H. Orley	27,641	*
Randolph C. Paschke	7,128	*
Joseph E. Petterson	—	*
Eliot R. Stark	76,000(2)	2.13%
Paul D. Tobias	<u>121,784(3)</u>	<u>3.42%</u>
All Directors and Executive Officers as a group (10 persons)	<u>211,236</u>	<u>6.89%</u>

\* Less than 1.0%

- (1) Includes options for Mr. Aspatore (2,000), Mr. Bittner (2,325), Mr. George (4,000), Mr. Krueger (2,000), Mr. Orley (2,000), Mr. Paschke (2,000), Mr. Stark (50,359), Mr. Tobias (70,502), and for all Directors and officers as a group (135,186).
- (2) Includes 25,641 shares owned by Mr. Stark in his IRA account.
- (3) Includes 10,256 shares owned by Tobias Capital LLC, which is 35% owned by Mr. Tobias and his wife.

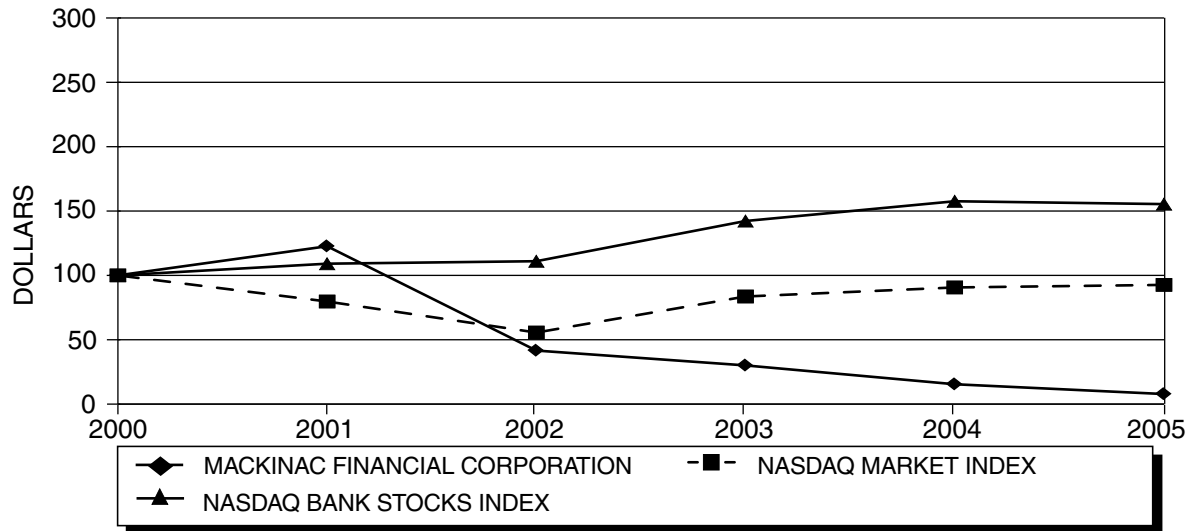
**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires the Corporation's officers and Directors, and persons who own more than 10% of the Corporation's common stock to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Based solely on a review of filings furnished to it, the Corporation noted that late filings were made by Messrs. Aspatore, Bittner, George, Krueger and Paschke. Each of Messrs. Aspatore, George, Krueger and Paschke were untimely in the filing of one report on Form 4 relative to the grant to them of options during 2005. Mr. Bittner was untimely in the filing of a Form 3 relative to his appointment to the Board and shareholders at the time of appointment, a Form 4 relative to a change in beneficial ownership in 2004, and a Form 4 relative to the grant to him of options in 2005.

## SHAREHOLDER RETURN PERFORMANCE GRAPH

Set forth below is a line graph comparing the yearly percentage change in the cumulative total shareholder return on the Corporation's common stock with that of the cumulative total return on the NASDAQ Bank Stocks Index and the NASDAQ Market Index for the five-year period ended December 31, 2005. The following information is based on an investment of \$100, on December 31, 2000 in the Corporation's common stock, the NASDAQ Bank Stocks Index, and the NASDAQ Market Index, with dividends reinvested. Prior to April 18, 2000, there had been only limited trading in the Corporation's common stock, there had been no market makers for such shares, and the Corporation's common stock had not traded on any stock exchange or on the NASDAQ market. Accordingly, the returns reflected in the following graph and table for the period prior to April 18, 2000 are based on sale prices of the Corporation's stock of which management is aware. There may have been sales at higher or lower prices of which management is not aware. Between April 18, 2000 and August 30, 2001, the Corporation's common stock was traded on the NASDAQ Bulletin Board. From August 31, 2001 to December 15, 2004, the Corporation's common stock traded on the NASDAQ SmallCap Market under the symbol "NCFC." Effective with the recapitalization and the 20:1 reverse stock split on December 16, 2004, the Corporation's stock began trading on the NASDAQ Small Cap Market under the symbol "MFNC".

### COMPARE 5-YEAR CUMULATIVE TOTAL RETURN AMONG MACKINAC FINANCIAL CORPORATION NASDAQ MARKET INDEX AND PEER GROUP INDEX



### ASSUMES \$100 INVESTED ON DECEMBER 31, 1999 ASSUMES DIVIDEND PAYMENTS REINVESTED FISCAL YEARS ENDING DECEMBER 31

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Mackinac Financial Corporation	100.00	122.64	41.60	30.06	15.43	7.82
NASDAQ Bank Stocks Index	100.00	109.09	111.02	142.25	157.60	155.38
NASDAQ Market Index	100.00	79.71	55.60	83.60	90.63	92.62

Source: Hemscott, Inc, Richmond, Virginia.

## RELATIONSHIP WITH INDEPENDENT PUBLIC ACCOUNTANTS

### Independent Auditors

The financial statements of the Corporation for the year ended December 31, 2005 have been examined by Plante & Moran, PLLC, an independent registered public accounting firm. A representative of Plante & Moran, PLLC is expected to be at the meeting and will have an opportunity to make a statement and will be available to answer appropriate questions. Plante & Moran, PLLC has been appointed by the Audit Committee of the Board of Directors as the independent public accountants of the Corporation and its subsidiaries for the year ending December 31, 2005 and 2004.

### Changes of Accountants

There was no change of the Corporation's independent public accountants during 2004 and 2005.

## SHAREHOLDER PROPOSALS

A proposal submitted by a shareholder for the 2007 Annual Meeting of Shareholders must be sent to the Secretary of the Corporation, 130 South Cedar Street, Manistique, Michigan 49854 and must be received by the Corporation no later than January 25, 2007 to be eligible for inclusion in the Corporation's proxy materials for the 2007 Annual Meeting of Shareholders. A shareholder proposal must (i) comply with the other requirements in the Corporation's Bylaws and Articles of Incorporation as to form and content, and (ii) be received by the Corporation (a) at least 30 days prior to the meeting, or (b) not later than the close of business on the (10<sup>th</sup>) day following the date on which notice of the scheduled meeting was first mailed to the shareholders, if less than 40 days notice of the meeting is given by the Corporation, in order to be considered at the meeting.

## OTHER MATTERS

A shareholder who intends to present a proposal to the 2006 Annual Meeting of Shareholders, other than pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, must provide the Corporation with notice of such intention by at least April 24, 2006, or the persons named in the proxy to vote the proxies will have discretionary voting authority at the 2006 Annual Meeting with respect to any such proposal without discussion of the matter in the Corporation's proxy statement.

The Board of Directors is not aware of any matter to be presented for action at the meeting, other than the matters set forth herein. If any other business should properly come before the meeting, the proxy will be voted regarding the matter in accordance with the best judgment of the persons authorized in the proxy, and discretionary authority to do so is included in the proxy.

The cost of soliciting proxies will be borne by the Corporation. If requested, the Corporation will reimburse banks, brokerage houses and other custodians, nominees and certain fiduciaries for their reasonable expenses incurred in mailing proxy materials to their principals. In addition to solicitation by mail, officers and other employees of the Corporation and its subsidiaries may solicit proxies by telephone, facsimile or in person, without compensation other than their regular compensation.

The Annual Report of the Corporation for 2005 is included with this proxy statement. Copies of the report will also be available for all shareholders attending the annual meeting.

**THE ANNUAL REPORT ON FORM 10-K TO THE SECURITIES AND EXCHANGE COMMISSION WILL BE PROVIDED FREE TO SHAREHOLDERS UPON WRITTEN REQUEST. WRITE SHAREHOLDER RELATIONS DEPARTMENT, MACKINAC FINANCIAL CORPORATION, 130 SOUTH CEDAR STREET, MANISTIQUE, MICHIGAN 49854.**

Shareholders are urged to sign and return the enclosed proxy in the enclosed envelope. A prompt response will be helpful and appreciated.