USA Zhimingde International Group Corp
Form 10-Q
May 13, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark one)

S Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2013

£ Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______________ to _____________

Commission File Number: 0-52072

USA Zhimingde International Group Corporation

(Exact name of registrant as specified in its charter)

Nevada	**62-1299374**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

225 Broadway, Suite 910, New York, NY 10007

(Address of principal executive offices)

(212) 608-8858

(Registrant's Telephone Number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES £ NO x

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

Large accelerated filer	£	Accelerated filer	£
Non-accelerated filer	£	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):
YES x NO £

As of May 10, 2013, there are 1,853,207 shares of common stock outstanding.

USA Zhimingde International Group Corporation

Form 10-Q for the Quarter ended March 31, 2013

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Part I

Item 1 - Financial Statements

USA Zhimingde International Group Corporation

Condensed Balance Sheets

	(Unaudited) *March 31,* 2013	*December 31,* 2012
ASSETS		
Current Assets		
Cash	$—	$—
Total Assets	$—	$—
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Liabilities		
Current Liabilities		
Accrued expenses	$18,000	$13,000
Total Liabilities	18,000	13,000
Commitments and Contingencies		
Stockholders' Deficiency		
Preferred stock - $0.001 par value. 50,000,000 shares authorized None issued and outstanding	—	—
Common stock - $0.001 par value. 100,000,000 shares authorized. 1,853,207 shares issued and outstanding	1,853	1,853
Additional paid-in capital	632,846	582,233
Accumulated deficiency	(652,699)	(597,086)
Total Stockholders' Deficiency	(18,000)	(13,000)
Total Liabilities and Stockholders' Deficiency	$—	$—

The accompanying notes are an integral part of these condensed financial statements.

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USA Zhimingde International Group Corporation

Condensed Statements of Operations

For the three months ended March 31, 2013 and 2012

(Unaudited)

	Three months ended March 31, 2013	Three months ended March 31, 2012
Revenues	$—	$—
Operating Expenses		
Professional fees	54,000	6,880
General and administrative expenses	1,613	889
Total Operating Expenses	55,613	7,769
Loss from operations	(55,613)	(7,769)
Net Loss	$(55,613)	$(7,769)
Basic and diluted net loss per share	$(0.03)	$(0.00)
Weighted-average number of shares outstanding - basic and diluted	1,853,207	1,853,207

The accompanying notes are an integral part of these condensed financial statements.

USA Zhimingde International Group Corporation

Condensed Statements of Cash Flows

For the three months ended March 31, 2013 and 2012

(Unaudited)

	Three months ended March 31, 2013	Three months ended March 31, 2012
Cash Flows from Operating Activities		
Net loss	$(55,613)	$(7,769)
Adjustments to reconcile net loss to net cash used in operating activities		
Accounts payable - trade	—	(1,500)
Accrued expenses	5,000	—
Net cash used in operating activities	(50,613)	(9,269)
Net Cash Flows from Investing Activities	—	—
Cash Flows from Financing Activities		
Capital contributed to support operations	50,613	9,269
Net cash provided by financing activities	50,613	9,269
Net Change in Cash	—	—
Cash - beginning	—	—
Cash - ending	$—	$—

The accompanying notes are an integral part of these condensed financial statements.

USA ZHIMINGDE INTERNATIONAL GROUP CORPORATION

Notes to Condensed Financial Statements

March 31, 2013 (unaudited)

Note A - Organization and Description of Business

USA Zhimingde International Group Corporation (formerly Marketing Acquisition Corporation) (the "Company") was originally incorporated on July 26, 1990 in accordance with the Laws of the State of Florida as Marketing Educational Corporation. The Company changed its corporate name to Marketing Acquisition Corporation on February 28, 2006. On June 13, 2006, the Company changed its state of incorporation from Florida to Nevada by means of a merger with and into a Nevada corporation formed on June 8, 2006 solely for the purpose of effecting the reincorporation.

On December 7, 2012, USA Zhimingde International Group Inc., a New Jersey corporation ("Zhimingde Inc.") purchased 1,687,502 shares of common stock, par value $0.001 per share, of the Company from Halter Financial Investments, L.P. ("HFI"), Glenn A. Little ("Little") and The Halter Group, Inc. pursuant to Securities Purchase Agreement ("SPA" and the transaction contemplated there in as "Purchase"). The 1,687,502 shares represent approximately 91% of all of the issued and outstanding common stock of the Company. Following the Purchase, Zhimingde owned approximately 91% of the voting securities of the Company. The Purchase has resulted in a change in control of the Company. As a result, the Company changed its name to USA Zhimingde International Group Corporation effective on February 4, 2013.

The Company is currently a shell company with no operations, sources of revenue, significant assets or liabilities. See Note B.

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. Accordingly, they do not include all of the information and disclosures required by GAAP for annual financial statements. In the opinion of management, such statements include all adjustments (consisting only of normal recurring items) which are considered necessary for a fair presentation of the condensed financial statements of the Company as of March 31, 2013 and for the three months ended March 31, 2013 and 2012. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the operating results for the full year ending December 31, 2013. These condensed financial statements should be read in conjunction with the financial statements and related disclosures of the Company as of December 31, 2012 and for the year then ended, which were filed with the Securities and Exchange Commission on Form 10-K on March 29, 2013.

Note B - Going Concern and Management Plans

The Company has not generated any revenue, nor does it have any significant operations. As of March 31, 2013, the Company does not have any cash or cash equivalents and has a working capital deficiency and stockholders' deficiency of $18,000. The Company has incurred net losses of approximately $56,000 during the three months ended March 31, 2013. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company's current business plan is to seek an acquisition or merger with a private operating company. However, there is no assurance that the Company will be able to successfully obtain debt or equity financing, consummate an acquisition or merger with a private operating company or, that the Company will identify any debt or equity financing sources to support its operations or a potential acquisition or merger. If we are unable to obtain financing, the Company may be unable to complete its business plan, and would, instead, delay all cash intensive activities. Without necessary cash flow, the Company may become dormant during the next twelve months, or until such time as necessary funds could be raised.

Accordingly, the accompanying condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern and the realization of assets and satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the financial statements do not necessarily purport to represent realizable or settlement values. The condensed financial statements do not include any adjustment that might result from the outcome of this uncertainty.

Note C - Summary of Significant Accounting Policies

Use of Estimates

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

Net Loss per Share

Basic earnings (loss) per common share are computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net earnings by the weighted average number of common shares outstanding, plus the issuance of common shares, if dilutive, resulting from the exercise of outstanding preferred stock, stock options and warrants. As of March 31, 2013, there were no common stock equivalents outstanding.

Subsequent events

Management has evaluated subsequent events or transactions occurring through the date on which the financial statements were issued.

Note D - Related Party Transactions

During the three months ended March 31, 2012, the Company received additional capital to support its operations from its former stockholders or their affiliates aggregating $9,269.

During the three months ended March 31, 2013, the Company received additional capital to support its operations from affiliates of its stockholders aggregating $50,613.

Note E - Commitments and Contingencies

In the normal course of business, the Company may be involved in legal proceedings, claims and assessments arising in the ordinary course of business. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. There are no such matters as of March 31, 2013.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Caution Regarding Forward-Looking Information

Certain statements contained in this annual filing, including, without limitation, statements containing the words "believes", "anticipates", "expects" and words of similar import, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

Such factors include, among others, the following: international, national and local general economic and market conditions: demographic changes; the ability of the Company to sustain, manage or forecast its growth; the ability of the Company to successfully make and integrate acquisitions; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; and other factors referenced in this and previous filings.

Given these uncertainties, readers of this Form 10-Q and investors are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

General

USA Zhimingde International Group Corporation (formerly, Marketing Acquisition Corporation, the "Company") was originally incorporated on July 26, 1990 in accordance with the laws of the State of Florida as Marketing Educational Corp. As used in this report, the terms "company", "we", "us", and "our" refer to USA Zhimingde International Group Corporation.

The Company has had no operations since 1992 and is currently a “shell company” as defined in Rule 405 under the Securities Act of 1933 (“Securities Act”) and Rule 12b-2 under the Securities Exchange Act of 1934 (“Exchange Act”). We are defined as a shell company because we have no operations and no or nominal assets.

On December 7, 2012, USA Zhimingde International Group Inc., a New Jersey corporation (“Zhimingde Inc.”) purchased 1,687,502 shares of common stock, par value $0.001 per share, of the Company from Halter Financial Investments, L.P., Glenn A. Little and The Halter Group, Inc. pursuant to Securities Purchase Agreement (“SPA” and the transaction contemplated therein as “Purchase”). The 1,687,502 shares represent approximately 91% of all of the issued and outstanding common stock of the Company. Following the Purchase, Zhimingde owned approximately 91% of the voting securities of the Company. The Purchase has resulted in a change in control of the Company. As a result, the Company changed its name to USA Zhimingde International Group Corporation effective on February 4, 2013.

Results of Operations

The Company had no revenue for either of the three month periods ended March 31, 2013 or 2012, respectively.

Operating expenses for each of the three month periods ended March 31, 2013 or 2012, respectively, were $55,613 and $7,769. These expenses were primarily related to the maintenance of the corporate entity and the preparation and filing of periodic reports pursuant to the Exchange Act.

During the three months ended March 31, 2012, the Company received additional capital to support its operations from its former stockholders or their affiliates aggregating $9,269.

During the three months ended March 31, 2013, the Company received additional capital to support its operations from affiliates of its stockholders aggregating $50,613.

Earnings per share for the respective three month periods ended March 31, 2013 and 2012 were $(0.03) and $(0.00) based on the weighted-average shares outstanding at the end of each respective period.

It is anticipated that future expenditure levels will remain in line relatively consistent until such time that the Company completes a business combination transaction. Upon completion of a business combination transaction, it is

anticipated that the Company's expenses will increase significantly.

The Company does not expect to generate any meaningful revenue or incur operating expenses for purposes other than fulfilling the obligations of a reporting company under the Exchange Act unless and until such time that the Company begins meaningful operations.

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Plan of Business

General

The Company's current purpose is to seek, investigate and, if such investigation warrants, merge or acquire an interest in business opportunities which desire to seek the perceived advantages of an Exchange Act registered corporation.

Pending negotiation and consummation of a combination, the Company anticipates that it will have, aside from carrying on its search for a combination partner, no business activities, and, thus, will have no source of revenue. Should the Company incur any significant liabilities prior to a combination with a private company, it may not be able to satisfy such liabilities as are incurred.

If the Company's management pursues one or more combination opportunities beyond the preliminary negotiations stage and those negotiations are subsequently terminated, it is foreseeable that such efforts will exhaust the Company's ability to continue to seek such combination opportunities before any successful combination can be consummated. In that event, the Company's common stock will become worthless and holders of the Company's common stock will receive a nominal distribution, if any, upon the Company's liquidation and dissolution.

Management

The Company is a shell company, and currently has no full-time employees. Zhongquan Zou is the Company's sole officer, director, and beneficial owner of Zhimingde Inc, the controlling stockholder. All references herein to management of the Company are to Mr. Zou. Mr. Zou, as President of the Company, has agreed to allocate a limited portion of his time to the activities of the Company without compensation.

The amount of time spent by Mr. Zou on the activities of the Company is not predictable. Such time may vary widely from an extensive amount when reviewing a target company to an essentially quiet time when activities of management focus elsewhere, or some amount in between. It is impossible to predict with any precision the exact amount of time Mr. Zou will actually be required to spend to locate a suitable target company. Mr. Zou estimates that the business plan of the Company can be implemented by devoting less than 4 hours per month but such figure cannot be stated with precision.

Liquidity and Capital Resources

The Company has not generated any revenue, nor does it have any significant operations as of March 31, 2013, the Company does not have any cash or cash equivalents and has a working capital deficiency and stockholders' deficiency of $18,000. The Company has incurred net losses of approximately $56,000 during the three months ended March 31, 2013. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company's current business plan is to seek an acquisition or merger with a private operating company. However, there is no assurance that the Company will be able to successfully obtain debt or equity financing, consummate an acquisition or merger with a private operating company or, that the Company will identify any debt or equity financing sources to support its operations or a potential acquisition or merger. If we are unable to obtain financing, the Company may be unable to complete its business plan, and would, instead, delay all cash intensive activities. Without necessary cash flow, the Company may become dormant during the next twelve months, or until such time as necessary funds could be raised.

Accordingly, the accompanying condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern and the realization of assets and satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the financial statements do not necessarily purport to represent realizable or settlement values. The condensed financial statements do not include any adjustment that might result from the outcome of this uncertainty.

Critical Accounting Policies

Our financial statements and related public financial information are based on the application of accounting principles generally accepted in the United States ("GAAP"). GAAP requires the use of estimates; assumptions, judgments and subjective interpretations of accounting principles that have an impact on the assets, liabilities, revenue and expense amounts reported. These estimates can also affect supplemental information contained in our external disclosures including information regarding contingencies, risk and financial condition. We believe our use of estimates and underlying accounting assumptions adhere to GAAP and are consistently and conservatively applied. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions. We continue to monitor significant estimates made during the preparation of our financial statements.

Our significant accounting policies are summarized in Note B of our condensed financial statements. While all these significant accounting policies impact our financial condition and results of operations, we view certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on our financial statements and require management to use a greater degree of judgment and estimates. Actual results may differ from those estimates. Our management believes that given current facts and circumstances, it is unlikely that applying any other reasonable judgments or estimate methodologies would cause effect on our condensed consolidated results of operations, financial position or liquidity for the periods presented in this report.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

In future periods, the Company may become subject to certain market risks, including changes in interest rates and currency exchange rates. At the present time, the Company has no identified exposure and does not undertake any specific actions to limit exposures, if any.

Item 4 - Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive and Financial Officer ("Certifying Officer"), has evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15 promulgated under the Exchange Act as of the end of the period covered by this Annual Report. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and include controls and procedures designed to ensure that information we are required to disclose in such reports is accumulated and communicated to management, including our Certifying Officer, as appropriate, to allow timely decisions regarding required disclosure. Based upon that evaluation, our Certifying Officer concluded that as of such date, our disclosure controls and procedures were not effective to ensure that the information required to be disclosed by us in our reports is recorded, processed, summarized and reported within the time periods specified by the SEC due to material weaknesses in our internal controls including (1) there are no entity level controls because there is only one person serving in the dual capacity of sole officer and sole director, (2) there are no segregation of duties as that same person approves and directs the payment of the Company's bills, and (3) there is no independent audit committee. However, our Certifying Officer believes that the financial statements included in this report fairly present, in all material respects, our financial condition, results of operations and cash flows for the respective periods presented.

Changes in Internal Controls

There was no change in our internal control over financial reporting that occurred during the quarter ended March 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting which internal controls will remain deficient until such time as the Company completes a merger transaction or acquisition of an operating business at which time management will be able to implement effective controls and procedures.

Part II - Other Information

Item 1 - Legal Proceedings

None

Item 2 - Recent Sales of Unregistered Securities and Use of Proceeds

None

Item 3 - Defaults upon Senior Securities

None

Item 4 - Mine Safety Disclosures

N/A

Item 5 - Other Information

None

Item 6 - Exhibits

31.1 Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002 *
32.1 Certification pursuant to Section 906 of Sarbanes-Oxley Act of 2002 *
101.INS ** XBRL Instance Document
101.SCH ** XBRL Taxonomy Extension Schema Document
101.CAL ** XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF ** XBRL Taxonomy Extension Definition Linkbase Document
101.LAB ** XBRL Taxonomy Extension Label Linkbase Document
101.PRE ** XBRL Taxonomy Extension Presentation Linkbase Document

* filed herein.

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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.

Dated: May 10, 2013

USA Zhimingde International Group Corporation

Reports of Independent Registered Public Accounting Firm dated February 20, 2007
Consolidated Balance Sheets December 31, 2006 and 2005
Consolidated Statements of Income for each of the three years in the period ended December 31, 2006
Consolidated Statements of Changes in Shareholders Equity for each of the three years in the period ended December 31, 2006
Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2006
Notes to Consolidated Financial Statements

The financial statements, the notes to financial statements, and the reports of independent registered public accounting firm listed above are incorporated by reference in Item 8 of this report.

(2) Financial Statement Schedules

Not applicable

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(b) Exhibits:

EXHIBIT NO.	EXHIBIT DESCRIPTION
3.1	Our Articles of Incorporation are incorporated by reference to exhibit 3.1 of our Form 10-Q for the quarter ended June 30, 2004
3.2	Our Amended and Restated Bylaws dated as of January 16, 2003 are incorporated by reference to exhibit 3.2 of our Registration Statement on Form S-3 (Commission File No. 333-103376) that became effective on February 21, 2003
10.1	Our 1997 Employee Stock Option Plan is incorporated by reference to exhibit 10.1 of our Registration Statement on Form SB-2 (Commission File No. 333-33081) that became effective on October 23, 1997 *
10.2	Our 2000 Employee Stock Option Plan is incorporated by reference to exhibit 10.14 of our Form 10-K for the year ended December 31, 2000 *
10.3	Our 2004 Employee Stock Option Plan is incorporated by reference to exhibit 10.1 of our Form 10-Q for the quarter ended September 30, 2004 *
10.4	Form of Stock Option Agreement for options under the 2004 Employee Stock Option Plan is incorporated by reference to exhibit 10.2 of our Form 10-Q for the quarter ended September 30, 2004 *
10.5	Our Independent Director Stock Option Plan is incorporated by reference to exhibit 10.26 of our Form 10-K for the year ended December 31, 2002 *
10.6	Form of Stock Option Agreement for options under the Independent Director Stock Option Plan is incorporated by reference to exhibit 10.1 of our Form 8-K dated October 21, 2004 *
10.7	Nonlender Bonus Plan is incorporated by reference to exhibit 10.3 of our Form 10-Q for the quarter ended September 30, 2004 *
10.8	Mercantile Bank of West Michigan Deferred Compensation Plan for Members of the Board of Directors (1999) is incorporated by reference to Exhibit 10.6 of the Registration Statement of the company and our trust on Form SB-2 (Commission File Nos. 333-84313 and 333-84313-01) that became effective on September 13, 1999 *
10.9	Agreement between Fiserv Solutions, Inc. and our bank dated September 10, 1997, is incorporated by reference to exhibit 10.3 of our Registration Statement on Form SB-2 (Commission File No. 333-33081) that became effective on October 23, 1997
10.10	Extension Agreement of Data Processing Contract between Fiserv Solutions, Inc. and our bank dated May 12, 2000 extending the agreement between Fiserv Solutions, Inc. and our bank dated September 10, 1997, is incorporated by reference to exhibit 10.15 of our Form 10-K for the year ended December 31, 2000
10.11	

Extension Agreement of Data Processing Contract between Fiserv Solutions, Inc. and our bank dated November 22, 2002 extending the agreement between Fiserv Solutions, Inc. and our bank dated September 10, 1997, is incorporated by reference to exhibit 10.5 of our Form 10-K for the year ended December 31, 2002

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EXHIBIT NO.	EXHIBIT DESCRIPTION
10.12	Amended and Restated Employment Agreement dated as of October 18, 2001, among the company, our bank and Gerald R. Johnson, Jr., is incorporated by reference to exhibit 10.21 of our Form 10-K for the year ended December 31, 2001 *
10.13	Amended and Restated Employment Agreement dated as of October 18, 2001, among the company, our bank and Michael H. Price, is incorporated by reference to exhibit 10.22 of our Form 10-K for the year ended December 31, 2001 *
10.14	Employment Agreement dated as of October 18, 2001, among the company, our bank and Robert B. Kaminski, Jr., is incorporated by reference to exhibit 10.23 of our Form 10-K for the year ended December 31, 2001 *
10.15	Employment Agreement dated as of October 18, 2001, among the company, our bank and Charles E. Christmas, is incorporated by reference to exhibit 10.23 of our Form 10-K for the year ended December 31, 2001 *
10.16	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Gerald R. Johnson, Jr., is incorporated by reference to exhibit 10.21 of our Form 10-K for the year ended December 31, 2002 *
10.17	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Michael H. Price, is incorporated by reference to exhibit 10.22 of our Form 10-K for the year ended December 31, 2002 *
10.18	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Robert B. Kaminski, Jr., is incorporated by reference to exhibit 10.23 of our Form 10-K for the year ended December 31, 2002 *
10.19	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Charles E. Christmas, is incorporated by reference to exhibit 10.24 of our Form 10-K for the year ended December 31, 2002 *
10.20	Amendment to Employment Agreement dated as of October 28, 2004, among the company, our bank and Robert B. Kaminski, Jr., is incorporated by reference to exhibit 10.21 of our Form 10-K for the year ended December 31, 2004 *
10.21	Junior Subordinated Indenture between us and Wilmington Trust Company dated September 16, 2004 providing for the issuance of the Series A and Series B Floating Rate Junior Subordinated Notes due 2034 is incorporated by reference to exhibit 10.1 of our Form 8-K dated December 15, 2004
10.22	Amended and Restated Trust Agreement dated September 16, 2004 for Mercantile Bank Capital Trust I is incorporated by reference to exhibit 10.2 of our Form 8-K dated December 15, 2004
10.23	

	Placement Agreement between us, Mercantile Bank Capital Trust I, and SunTrust Capital Markets, Inc. dated September 16, 2004 is incorporated by reference to exhibit 10.3 of our Form 8-K dated December 15, 2004
10.24	Guarantee Agreement dated September 16, 2004 between Mercantile as Guarantor and Wilmington Trust Company as Guarantee Trustee is incorporated by reference to exhibit 10.4 of our Form 8-K dated December 15, 2004

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EXHIBIT NO.	EXHIBIT DESCRIPTION
10.25	Non-Lender Bonus Plan 2006, is incorporated by reference to exhibit 10.1 of our Form 8-K dated November 22, 2005 *
10.26	Form of Agreement Amending Stock Option Agreement, dated November 17, 2005 issued under our 2004 Employee Stock Option Plan, is incorporated by reference to exhibit 10.1 of our Form 8-K dated December 12, 2005 *
10.27	Second Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Gerald R. Johnson, Jr. is incorporated by reference to exhibit 10.28 of our Form 10-K for the year ended December 31, 2005 *
10.28	Second Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Michael H. Price is incorporated by reference to exhibit 10.29 of our Form 10-K for the year ended December 31, 2005 *
10.29	Third Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Robert B. Kaminski, Jr. is incorporated by reference to exhibit 10.30 of our Form 10-K for the year ended December 31, 2005 *
10.30	Second Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Charles E. Christmas is incorporated by reference to exhibit 10.31 of our Form 10-K for the year ended December 31, 2005 *
10.31	Form of Mercantile Bank of Michigan Executive Deferred Compensation Agreement, that has been entered into between our bank and each of Gerald R. Johnson, Jr., Michael H. Price, Robert B. Kaminski, Jr., Charles E. Christmas, and certain other officers of our bank is incorporated by reference to exhibit 10.32 of our Form 10-K for the year ended December 31, 2005 *
10.32	Form of Mercantile Bank of Michigan Split Dollar Agreement that has been entered into between our bank and each of Gerald R. Johnson, Jr., Michael H. Price, Robert B. Kaminski, Jr., Charles E. Christmas, and certain other officers of our bank is incorporated by reference to exhibit 10.33 of our Form 10-K for the year ended December 31, 2005 *
10.33	Director Fee Summary *
10.34	Lease Agreement between our bank and Joe D. Pentecost Trust dated April 29, 2005 for our East Lansing, Michigan office is incorporated by reference to exhibit 10.35 of our Form 10-K for the year ended December 31, 2005
10.35	Lease Agreement between our bank and The Conlin Company dated July 12, 2005 for our Ann Arbor, Michigan office is incorporated by reference to exhibit 10.36 of our Form 10-K for the year ended December 31, 2005
10.36	Stock Incentive Plan of 2006 is incorporated by reference to Appendix A of our proxy statement for our April 27, 2006 annual meeting of shareholders that was filed with the

Securities and Exchange Commission *

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EXHIBIT NO.	EXHIBIT DESCRIPTION
10.37	Form of Notice of Grant of Incentive Stock Option and Stock Option Agreement for incentive stock options granted under our Stock Incentive Plan of 2006 is incorporated by reference to exhibit 10.1 of our Form 8-K dated November 22, 2006 *
10.38	Form of Restricted Stock Award Agreement Notification of Award and Terms and Conditions of Award for restricted stock under our Stock Incentive Plan of 2006 is incorporated by reference to exhibit 10.2 of our Form 8-K dated November 22, 2006 *
10.39	Executive Officer Bonus Plan for 2007 is incorporated by reference to exhibit 10.1 of our Form 8-K dated January 29, 2007 *
21	Subsidiaries of the company
23	Consent of Independent Registered Public Accounting Firm
31	Rule 13a-14(a) Certifications
32.1	Section 1350 Chief Executive Officer Certification
32.2	Section 1350 Chief Financial Officer Certification

* Management contract or compensatory plan

(c) Financial Statements Not Included In Annual Report

Not applicable

MERCANTILE BANK CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005
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MERCANTILE BANK CORPORATION
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SELECTED FINANCIAL DATA

	2006	2005	2004	2003	2002
	(Dollars in thousands except per share data)				
Consolidated Results of Operations:					
Interest income	$ 137,260	$ 102,130	$ 69,022	$ 54,658	$ 47,632
Interest expense	75,673	46,838	26,595	23,395	24,026
Net interest income	61,587	55,292	42,427	31,263	23,606
Provision for loan and lease losses	5,775	3,790	4,674	3,800	3,002
Noninterest income	5,261	5,661	4,302	4,409	3,101
Noninterest expense	32,262	31,117	23,198	18,071	12,781
Income before income tax expense	28,811	26,046	18,857	13,801	10,924
Income tax expense	8,964	8,145	5,136	3,785	3,167
Net income	$ 19,847	$ 17,901	$ 13,721	$ 10,016	$ 7,757
Consolidated Balance Sheet Data:					
Total assets	$ 2,067,268	$ 1,838,210	$ 1,536,119	$ 1,203,337	$ 922,360
Cash and cash equivalents	51,380	36,753	20,811	16,564	28,117
Securities	202,419	181,614	152,965	121,510	96,893
Loans and leases, net of deferred fees	1,745,478	1,561,812	1,317,124	1,035,963	771,554
Allowance for loan and lease losses	21,411	20,527	17,819	14,379	10,890
Bank owned life insurance policies	30,858	28,071	23,750	16,441	14,876
Deposits	1,646,903	1,419,352	1,159,181	902,892	754,113
Securities sold under agreements to repurchase	85,472	72,201	56,317	49,545	50,335
Federal Home Loan Bank advances	95,000	130,000	120,000	90,000	15,000
Subordinated debentures	32,990	32,990	32,990	16,495	16,495
Shareholders equity	171,915	155,125	141,617	130,201	79,834
Consolidated Financial Ratios:					
Return on average assets	1.01%	1.05%	0.99%	0.96%	0.97%
	12.19%	12.05%	10.16%	10.61%	10.30%

Return on average shareholders equity										
Average shareholders equity to average assets		8.31%		8.73%		9.79%		9.00%		9.45%
Nonperforming loans and leases to total loans and leases		0.49%		0.26%		0.22%		0.17%		0.10%
Allowance for loan and lease losses to total loans and leases		1.23%		1.31%		1.35%		1.39%		1.41%
Tier 1 leverage capital		10.04%		10.45%		11.53%		12.49%		10.72%
Tier 1 leverage risk-based capital		10.37%		10.82%		11.82%		12.60%		10.85%
Total risk-based capital		11.45%		12.00%		13.03%		13.84%		12.10%
Per Share Data:										
Net Income:										
Basic	$	2.48	$	2.25	$	1.73	$	1.49	$	1.23
Diluted		2.45		2.20		1.69		1.46		1.22
Book value at end of period		21.43		19.46		17.78		16.40		12.66
Dividends declared		0.51		0.41		0.32		0.27		NA
Dividend payout ratio		20.34%		17.79%		18.60%		18.41%		NA

NA Not Applicable

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The following discussion and other portions of this Annual Report contain forward-looking statements that are based on management s beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and about our company. Words such as anticipates, believes, estimates, expects, forecasts, intends, is likely, plans, projects, and variations of such words an expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions (Future Factors) that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. We undertake no obligation to update, amend, or clarify forward-looking statements, whether as a result of new information, future events (whether anticipated or unanticipated), or otherwise.

Future Factors include changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking regulation; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; governmental and regulatory policy changes; the outcomes of contingencies; trends in customer behavior as well as their ability to repay loans; changes in the national and local economies; and other risk factors described in Item 1A of this Annual Report. These are representative of the Future Factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Management s Discussion and Analysis of Financial Condition and Results of Operations is based on Mercantile Bank Corporation s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan and lease losses, and actual results could differ from those estimates.

The allowance for loan and lease losses is maintained at a level we believe is adequate to absorb probable incurred losses identified and inherent in the loan and lease portfolio. Our evaluation of the adequacy of the allowance for loan and lease losses is an estimate based on reviews of individual loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience. The allowance for loan and lease losses represents management s best estimate, but significant downturns in circumstances relating to loan and lease quality or economic conditions could result in a requirement for an increased allowance for loan and lease losses in the near future. Likewise, an upturn in loan and lease quality or improved economic conditions may result in a decline in the required allowance for loan and lease losses. In either instance, unanticipated changes could have a significant impact on operating earnings.

The allowance for loan and lease losses is increased through a provision charged to operating expense. Uncollectible loans and leases are charged-off through the allowance for loan and lease losses. Recoveries of loans and leases previously charged-off are added to the allowance for loan and lease losses. A loan is considered impaired when it is probable that contractual interest and principal payments will not be collected either for the amounts or by the dates as scheduled in the loan agreement. Our policy for recognizing income on impaired loans is to accrue interest unless a loan is placed on nonaccrual status.

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INTRODUCTION

This Management s Discussion and Analysis should be read in conjunction with the consolidated financial statements contained in this Annual Report. This discussion provides information about the consolidated financial condition and results of operations of Mercantile Bank Corporation and its consolidated subsidiary, Mercantile Bank of Michigan (our bank), and of Mercantile Bank Mortgage Company, LLC (our mortgage company), Mercantile Bank Real Estate Co., L.L.C. (our real estate company) and Mercantile Insurance Center, Inc. (our insurance company), which are subsidiaries of our bank. Unless the text clearly suggests otherwise, references to us, we, our, or the company include Mercantile Bank Corporation and its wholly-owned subsidiaries referred to above.

We were incorporated on July 15, 1997 as a bank holding company to establish and own our bank. Our bank, after receiving all necessary regulatory approvals, began operations on December 15, 1997. Our bank has a strong commitment to community banking and offers a wide range of financial products and services, primarily to small- to medium-sized businesses, as well as individuals. Our bank s lending strategy focuses on commercial lending, and, to a lesser extent, residential mortgage and consumer lending. Our bank also offers a broad array of deposit products, including checking, savings, money market, and certificates of deposit, as well as security repurchase agreements. Our primary markets are the Grand Rapids, Holland, Lansing and Ann Arbor metropolitan areas. Our bank utilizes certificates of deposit from customers located outside of the primary market area to assist in funding the rapid asset growth our bank has experienced since inception.

We formed a business trust, Mercantile Bank Capital Trust I (the trust), in 2004 to issue trust preferred securities. We issued subordinated debentures to the trust in return for the proceeds raised from the issuance of the trust preferred securities. In accordance with FASB Interpretation No. 46, the trust is not consolidated, but instead we report the subordinated debentures issued to the trust as a liability.

Our mortgage company s predecessor, Mercantile Bank Mortgage Company, was formed to increase the profitability and efficiency of the company s mortgage loan operations. Mercantile Bank Mortgage Company initiated business on October 24, 2000 from our bank s contribution of most of its residential mortgage loan portfolio and participation interests in certain commercial mortgage loans. On the same date, our bank had also transferred its residential mortgage origination function to Mercantile Bank Mortgage Company. On January 1, 2004, Mercantile Bank Mortgage Company was reorganized as Mercantile Bank Mortgage Company, LLC, a limited liability company. Mortgage loans originated and held by our mortgage company are serviced by our bank pursuant to a servicing agreement.

Our insurance company acquired, at nominal cost, an existing shelf insurance agency effective April 15, 2002. An Agency and Institution Agreement was entered into among our insurance company, our bank and Hub International for the purpose of providing programs of mass marketed personal lines of insurance. Insurance product offerings include private passenger automobile, homeowners, personal inland marine, boat owners, recreational vehicle, dwelling fire, umbrella policies, small business and life insurance products, all of which are provided by and written through companies that have appointed Hub International as their agent.

Our real estate company was organized on July 21, 2003, principally to develop, construct and own our new facility in downtown Grand Rapids which serves as our bank s new main office and Mercantile Bank Corporation s headquarters. Construction was completed during the second quarter of 2005.

FINANCIAL CONDITION

We continued to experience strong asset growth during 2006. Assets increased from $1,838.2 million on December 31, 2005 to $2,067.3 million on December 31, 2006. This represents an increase in total assets of $229.1 million, or 12.5%. The increase in total assets was primarily comprised of a $182.8 million increase in net loans and leases, a $20.8 million increase in securities and a $14.6 million increase in cash and cash equivalents. The increase in assets was primarily funded by a $227.6 million increase in deposits, a $13.3 million increase in repurchase agreements and a $16.8 million increase in shareholders equity.

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Earning Assets

Average earning assets equaled 94.9% of average total assets during 2006, compared to 94.8% during 2005. Although we experienced strong asset growth during 2006, the asset composition remained relatively constant. The loan portfolio continued to comprise a majority of earning assets, followed by securities and federal funds sold.

Our loan and lease portfolio, which equaled 89.2% of average earnings assets during 2006, is primarily comprised of commercial loans and leases. Constituting over 92% of loans and leases and growing by $177.3 million during 2006, the commercial loan and lease portfolio represents loans to businesses generally located within our market areas. Approximately 70% of the commercial loan and lease portfolio is primarily secured by real estate properties, with the remaining generally secured by other business assets such as accounts receivable, inventory, and equipment. The continued significant concentration of the loan and lease portfolio in commercial loans and leases and the strong growth of this portion of our lending business are consistent with our strategy of focusing a substantial amount of our efforts on wholesale banking. Corporate and business lending continues to be an area of expertise for our senior management team, and our commercial lenders have extensive commercial lending experience, with most having at least ten years experience. Of each of the loan categories that we originate, commercial loans and leases are most efficiently originated and managed, thus limiting overhead costs by necessitating the attention of fewer full-time employees. Our commercial lending business generates the greatest amount of local deposits and is virtually our only source of significant demand deposits.

Residential mortgage and consumer loans, while equaling less than 8% of total loans and leases during 2006, also experienced strong growth; however, while we expect the residential mortgage loan and consumer loan portfolios to increase in future periods, the commercial sector of the lending efforts and resultant assets are expected to remain the dominant loan portfolio category given our wholesale banking strategy.

The following tables present the maturity of total loans outstanding as of December 31, 2006, according to scheduled repayments of principal on fixed rate loans and repricing frequency on variable rate loans. Floating rate loans that are currently at interest rate ceilings, totaling $281.0 million as of December 31, 2006, are treated as fixed rate loans and are reflected using maturity date and not repricing frequency.

	0-1 Year	1-5 Years	After 5 Years	Total
Construction and land development	$ 246,656,000	$ 33,858,000	$ 13,142,000	$ 293,656,000
Real estate secured by 1-4 family properties	64,832,000	53,131,000	13,681,000	131,644,000
Real estate secured by multi-family properties	16,005,000	14,566,000	432,000	31,003,000
Real estate secured by nonresidential properties	310,559,000	466,547,000	31,153,000	808,259,000
Commercial	380,139,000	86,222,000	4,911,000	471,272,000
Leases	33,000	1,355,000	0	1,388,000
Consumer	3,303,000	4,208,000	745,000	8,256,000
	$ 1,021,527,000	$ 659,887,000	$ 64,064,000	$ 1,745,478,000
Fixed rate loans	$ 93,126,000	$ 658,425,000	$ 64,064,000	$ 815,615,000
Floating rate loans	928,401,000	1,462,000	0	929,863,000

	$ 1,021,527,000	$ 659,887,000	$ 64,064,000	$ 1,745,478,000

Our credit policies establish guidelines to manage credit risk and asset quality. These guidelines include loan review and early identification of problem loans to provide effective loan portfolio administration. The credit policies and procedures are meant to minimize the risk and uncertainties inherent in lending. In following these policies and procedures, we must rely on estimates, appraisals and evaluations of loans and the possibility that changes in these could occur quickly because of changing economic conditions. Identified problem loans, which exhibit characteristics (financial or otherwise) that could cause the loans to become nonperforming or require restructuring in the future, are included on the internal Watch List. Senior management reviews this list regularly.

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Although the level of net loan and lease charge-offs and nonperforming loans and leases increased during 2006, the quality of our loan portfolio remains good. The levels of net loan and lease charge-offs and nonperforming loans and leases approximated banking industry averages during 2006, compared to levels that were below banking industry averages in prior years. As of December 31, 2006, nonperforming loans and leases totaled $8.6 million, or 0.49% of total loans and leases. At December 31, 2005, nonperforming loans and leases totaled $4.0 million, or 0.26% of total loans and leases. Net loan and lease charge-offs during 2006 totaled $4.9 million, or 0.29% of average total loans and leases. During 2005, net loan and lease charge-offs totaled $1.1 million, or 0.08% of average total loans and leases. Over 98% of the loan and lease portfolio consists of loans and leases extended directly to companies or individuals doing business and residing within our market areas. The remaining portion is comprised of commercial loans participated with certain unaffiliated commercial banks outside of our market areas, which are underwritten using the same loan criteria as though our bank was the originating bank.
The following table summarizes nonperforming loans and leases and troubled debt restructurings.

	December 31,2006	December 31, 2005	December 31, 2004	December 31, 2003	December 31, 2002
Loans and leases on nonaccrual status	$ 7,752,000	$ 3,601,000	$ 2,842,000	$ 233,000	$ 796,000
Loans and leases 90 days or more past due and accruing interest	819,000	394,000	0	1,552,000	0
Troubled debt restructurings	0	0	0	0	0
Total	$ 8,571,000	$ 3,995,000	$ 2,842,000	$ 1,785,000	$ 796,000

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The following table summarizes changes in the allowance for loan and lease losses for the past five years.

	2006	2005	2004	2003	2002
Loan and leases outstanding at year-end	$ 1,745,478,000	$ 1,561,812,000	$ 1,317,124,000	$ 1,035,963,000	$ 771,554,000
Daily average balance of loans and leases outstanding	$ 1,660,284,000	$ 1,432,609,000	$ 1,177,568,000	$ 887,512,000	$ 669,781,000
Balance of allowance at beginning of year	$ 20,527,000	$ 17,819,000	$ 14,379,000	$ 10,890,000	$ 8,494,000
Loans and leases charged-off:					
Commercial, financial and agricultural	(5,208,000)	(718,000)	(1,328,000)	(471,000)	(696,000)
Construction and land development	0	(521,000)	0	0	0
Leases	0	0	0	0	0
Residential real estate	(50,000)	(131,000)	(16,000)	(26,000)	0
Instalment loans to individuals	(131,000)	(22,000)	(61,000)	(99,000)	(10,000)
Total loans and leases charged-off	(5,389,000)	(1,392,000)	(1,405,000)	(596,000)	(706,000)
Recoveries of previously charged-off loans and leases:					
Commercial, financial and	487,000	298,000	150,000	257,000	78,000

agricultural					
Construction and land development	0	2,000	0	0	0
Leases	0	0	0	0	0
Residential real estate	2,000	6,000	0	22,000	4,000
Instalment loans to individuals	9,000	4,000	21,000	6,000	18,000
Total recoveries	498,000	310,000	171,000	285,000	100,000
Net charge-offs	(4,891,000)	(1,082,000)	(1,234,000)	(311,000)	(606,000)
Provision for loan and leases losses	5,775,000	3,790,000	4,674,000	3,800,000	3,002,000
Balance of allowance at year-end	$ 21,411,000	$ 20,527,000	$ 17,819,000	$ 14,379,000	$ 10,890,000
Ratio of net charge-offs during the period to average loans and leases outstanding during the period	(0.29%)	(0.08%)	(0.10%)	(0.04%)	(0.09%)
Ratio of allowance to loans and leases outstanding at end of the period	1.23%	1.31%	1.35%	1.39%	1.41%

In each accounting period, we adjust the allowance to the amount we believe is necessary to maintain the allowance at adequate levels. Through the loan and lease review and credit departments, we attempt to allocate specific portions of the allowance based on specifically identifiable problem loans and leases. The evaluation of the allowance is further based on, but not limited to, consideration of the internally prepared Reserve

Analysis, composition of the loan and lease portfolio, third party analysis of the loan and lease administration processes and portfolio and general economic conditions. In addition, the strong commercial loan and lease growth is taken into account.

The Reserve Analysis, used since our inception and completed monthly, applies reserve allocation factors to outstanding loan and lease balances to calculate an overall allowance dollar amount. For commercial loans and leases, which continue to comprise a vast majority of our total loans and leases, reserve allocation factors are based upon the loan ratings as determined by our standardized grade paradigms. For retail loans, reserve allocation factors are based upon the type of credit. Adjustments for specific lending relationships, including impaired loans and leases, are made on a case-by-case basis. The reserve allocation factors are primarily based on the recent levels and historical trends of net loan charge-offs and non-performing assets, the comparison of the recent levels and historical trends of net loan charge-offs and non-performing assets with a customized peer group consisting of ten similarly-sized publicly traded banking organizations conducting business in the states of Michigan, Illinois, Indiana and/or Ohio, the review and consideration of our loan migration analysis and the experience of senior management making similar loans and leases for an extensive period of time. We regularly review the Reserve Analysis and make adjustments periodically based upon identifiable trends and experience.

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The following table illustrates the breakdown of the allowance balance to loan type (dollars in thousands) and of the total loan and lease portfolio (in percentages).

	December 31, 2006		December 31, 2005		December 31, 2004		December 31, 2003		December 31, 2002	
	Amount	Loan Portfolio	Amount	Loan Portfolio	Amount	Loan Portfolio	Amount	Loan Portfolio	Amount	Loan Portfolio
Commercial, financial and agricultural	$ 15,706	75.1%	$ 16,507	76.9%	$ 15,457	79.8%	$ 12,220	79.0%	$ 9,188	77.9%
Construction and land development	3,975	16.8	2,868	14.5	1,581	10.3	1,571	11.4	1,143	13.5
Leases	15	0.1	30	0.1	39	0.2	26	0.2	11	0.1
Residential real estate	1,591	7.5	1,020	8.2	557	9.3	450	8.9	443	7.9
Instalment loans to individuals	124	0.5	102	0.3	185	0.4	112	0.5	105	0.6
Unallocated	0	NA	0	NA	0	NA	0	NA	0	NA
Total	$ 21,411	100.0%	$ 20,527	100.0%	$ 17,819	100.0%	$ 14,379	100.0%	$ 10,890	100.0%

The primary risk elements with respect to commercial loans and leases are the financial condition of the borrower, the sufficiency of collateral, and lack of timely payment. We have a policy of requesting and reviewing periodic financial statements from commercial loan and lease customers, and we periodically review the existence of collateral and its value. The primary risk element with respect to each instalment and residential real estate loan is lack of timely payment. We have a reporting system that monitors past due loans and have adopted policies to pursue creditor s rights in order to preserve our bank s position.

Although we believe that the allowance is adequate to sustain losses as they arise, there can be no assurance that our bank will not sustain losses in any given period that could be substantial in relation to, or greater than, the size of the allowance.

The securities portfolio also experienced strong growth during 2006, increasing from $181.6 million on December 31, 2005 to $202.4 million at December 31, 2006. During 2006, the securities portfolio equaled 10.2% of average earning assets. We maintain the portfolio at levels to provide adequate pledging for the repurchase agreement program and secondary liquidity for our daily operations. In addition, the portfolio serves a primary interest rate risk management function. At December 31, 2006, the portfolio was comprised of high credit quality U.S. Government Agency issued bonds (38%), municipal general obligation and revenue bonds (32%), U.S. Government Agency issued and guaranteed mortgage-backed securities (26%), Federal Home Loan Bank stock (4%) and a mutual fund (less than 1%).

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The following table reflects the composition of the securities portfolio, excluding Federal Home Loan Bank stock.

	December 31, 2006 Carrying Value	December 31, 2006 Percentage	December 31, 2005 Carrying Value	December 31, 2005 Percentage	December 31, 2004 Carrying Value	December 31, 2004 Percentage
U.S. Government agency debt obligations	$ 76,836,000	39.4%	$ 63,712,000	36.7%	$ 56,025,000	38.3%
Mortgage-backed securities	53,083,000	27.2	48,237,000	27.7	37,801,000	25.9
Municipal general obligations	56,870,000	29.2	53,685,000	30.9	45,063,000	30.8
Municipal revenue bonds	7,073,000	3.6	7,081,000	4.1	7,278,000	5.0
Mutual fund	1,048,000	0.6	1,012,000	0.6	0	NA
Total	$ 194,910,000	100.0%	$ 173,727,000	100.0%	$ 146,167,000	100.0%

All securities, with the exception of tax-exempt municipal bonds, have been designated as available for sale as defined in Financial Accounting Standards Board Standard (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Securities designated as available for sale are stated at fair value, with the unrealized gains and losses, net of income tax, reported as a separate component of shareholders equity in accumulated other comprehensive income. The fair value of securities designated as available for sale at December 31, 2006 and 2005 was $131.0 million and $113.0 million, respectively. The net unrealized loss recorded at December 31, 2006 was $1.7 million, compared to the net unrealized loss of $2.2 million as of December 31, 2005. All tax-exempt municipal bonds have been designated as held to maturity as defined in SFAS No. 115, and are stated at amortized cost. As of December 31, 2006 and 2005, held to maturity securities had an amortized cost of $63.9 million and $60.8 million and a fair value of $65.0 million and $62.9 million, respectively.

The following table shows by class of maturities as of December 31, 2006, the amounts and weighted average yields of investment securities [1]:

	Carrying Value	Average Yield
	(Dollars in thousands)	
U.S. Treasury securities and obligations of U.S. Government agencies and corporations		
One year or less	$ 0	NA
Over one through five years	17,647,000	4.72%
Over five through ten years	59,189,000	5.21
Over ten years	0	NA
	76,836,000	5.10

Obligations of states and political subdivisions		
One year or less	2,593,000	7.11
Over one through five years	8,798,000	6.87
Over five through ten years	11,533,000	6.38
Over ten years	41,019,000	6.39
	63,943,000	6.48
Mortgage-backed securities	53,083,000	5.03
Mutual fund	1,048,000	4.36
	$ 194,910,000	5.53%

(1) Yields on tax-exempt securities are computed on a fully taxable-equivalent basis.

Federal funds sold, consisting of excess funds sold overnight to correspondent banks, are used to manage daily liquidity needs and interest rate sensitivity. During 2006, the average balance of these funds equaled 0.5% of average earning assets, unchanged from the level during 2005. The levels maintained during 2006 and 2005 are well within our internal policy guidelines, and future levels are not expected to change significantly.

Cash and due from bank balances increased from $36.2 million at December 31, 2005, to $51.4 million on December 31, 2006, an increase of $15.2 million. The increase was primarily the result of larger amounts of deposits made by our deposit customers on the last business day of 2006 when compared to the last business day of 2005. Our commercial lending and wholesale funding focus results in relatively large day-to-day fluctuations of our cash and due from bank balances; however, relative to our asset size the average balances are generally stable. Cash and due from bank balances averaged $38.3 million, or 2.0% of average assets during 2006, compared to $36.8 million, or 2.2% of average assets, during 2005.

Net premises and equipment increased from $30.2 million at December 31, 2005, to $33.5 million on December 31, 2006, an increase of $3.3 million. The increase primarily reflects the land acquisition and initial construction costs associated with our new office facility currently under construction in East Lansing, Michigan. Construction on this new facility is expected to be completed during the second quarter of 2007.

Source of Funds

Our major sources of funds are from deposits, repurchase agreements and Federal Home Loan Bank (FHLB) advances. Total deposits increased from $1,419.4 million at December 31, 2005, to $1,646.9 million on December 31, 2006, an increase of $227.5 million, or 16.0%. Included within these numbers is the success we achieved in generating deposit growth from customers located within our market areas during 2006. Local deposits increased from $456.5 million at December 31, 2005, to $633.1 million on December 31, 2006, an increase of $176.6 million, or 38.7%. Despite this success in obtaining funds from local customers, the substantial asset growth has necessitated the continued acquisition of funds from depositors outside of our market areas and FHLB advances. Out-of-area deposits increased from $962.8 million at December 31, 2005, to $1,013.8 million on December 31, 2006, an increase of $51.0 million, or 5.3%. Repurchase agreements increased from $72.2 million at December 31, 2005, to $85.5 million on December 31, 2006, an increase of $13.3 million, or 18.4%. FHLB advances decreased from $130.0 million at December 31, 2005, to $95.0 million on December 31, 2006, a decrease of $35.0 million, or 26.9%. At December 31, 2006, local deposits and repurchase agreements equaled 38.4% of total funding liabilities, compared to 31.8% on December 31, 2005.

During 2006, we experienced strong growth in our noninterest-bearing checking deposit accounts. Comprised primarily of business loan customers, noninterest-bearing checking deposit accounts grew $12.4 million, or 10.2%, and equaled 6.4% of average total liabilities during 2006. Interest-bearing checking accounts increased $0.2 million, or 0.4%, and equaled 2.0% of average total liabilities during 2006. Money market deposit accounts decreased $0.9 million, or 9.0%, and equaled 0.6% of average total liabilities during 2006. Business loan customers also comprise the majority of interest-bearing checking and money market deposit accounts, although to a lesser extent than noninterest-bearing checking accounts. Pursuant to Federal law and regulations, incorporated businesses may not own interest-bearing checking accounts and transactions from money market accounts are limited. We anticipate continued overall growth of our check-writing deposit accounts as additional business loans are extended and through the efforts of our branch network and business development activities.

During 2006, savings account balances recorded a decrease of $13.9 million, or 13.1%, and equaled 5.2% of average total liabilities. The decline in savings account balances during 2006 is primarily due to customers opening certificates of deposit with funds from their savings accounts, as rates offered on certificates of deposit have risen at a faster pace than rates offered on savings accounts. Business loan customers also comprise the majority of savings account holders, although to a lesser extent than check-writing accounts. While we anticipate an increase in savings account balances as additional business loans are extended and through the efforts of our branch network and business development activities, the increase may be negatively impacted by potential continued fund transfers to certificate of deposit products.

Certificates of deposit purchased by customers located within our market areas increased significantly during 2006, growing from $179.3 million at December 31, 2005, to $358.2 million on December 31, 2006, an increase of $178.9 million, or 99.8%. These deposits accounted for 15.9% of average total liabilities during 2006. The growth was attributable to individuals, businesses and municipalities, and includes new monies to our bank from existing and new customers as well as transfers from existing savings accounts. The increase in local municipality certificates of deposit has been facilitated by our qualifying for funds from new municipal customers and additional funds from existing customers through a combination of our asset growth and increased profitability as measured by the municipalities investment policy guidelines, and is a trend that we expect to continue.

During 2006, certificates of deposit obtained from customers located outside of our market areas increased by $51.0 million, and represented 55.9% of average total liabilities. At December 31, 2006, out-of-area deposits totaled $1,013.8 million. Out-of-area deposits consist primarily of certificates of deposit placed by deposit brokers for a fee, but also include certificates of deposit obtained from the deposit owners directly. The owners of the out-of-area deposits include individuals, businesses and governmental units located throughout the country. Out-of-area deposits are utilized to support our asset growth, and are generally a lower cost source of funds when compared to the interest rates that would have to be offered in the local market to generate a sufficient level of funds. During most of 2006, rates paid on new out-of-area deposits were very similar to rates paid on new certificates of deposit issued to local customers. In addition, the overhead costs associated with the out-of-area deposits are considerably less than the overhead costs that would be incurred to administer a similar level of local deposits. Although local deposits have and are expected to increase as new business, governmental and individual deposit relationships are established and as existing customers increase the balances in their deposit accounts, the relatively high reliance on out-of-area deposits will likely remain.

Repurchase agreements increased $13.3 million and equaled 4.0% of average total liabilities during 2006. As part of our sweep account program, collected funds from certain business noninterest-bearing checking accounts are invested in overnight interest-bearing repurchase agreements. Although not considered a deposit account and therefore not afforded federal deposit insurance, the repurchase agreements are a means of providing a return for business customers that are not permitted to have an interest-bearing checking account.

FHLB advances decreased $35.0 million and equaled 6.8% of average total liabilities during 2006. FHLB advances are collateralized by residential mortgage loans, first mortgage liens on multi-family residential property loans, first mortgage liens on commercial real estate property loans, and substantially all other assets of our bank, under a blanket lien arrangement. Our borrowing line of credit at December 31, 2006 totaled $322.6 million. We first started to use FHLB advances in late 2002, and expect to continue to use this funding source, along with out-of-area certificates of deposit, as part of our wholesale funding program.

Shareholders equity increased $16.8 million and equaled 8.3% of average assets during 2006. The increase was primarily attributable to net income from operations. Net income from operations totaled $19.8 million during 2006. Also positively impacting shareholders equity was a $0.3 million mark-to-market adjustment for available for sale securities as defined in SFAS No. 115, plus proceeds totaling $0.4 million relating to stock option exercises and our dividend reinvestment and employee stock purchase plans. Negatively impacting shareholders equity during 2006 was the payment of cash dividends, which totaled $4.0 million.

RESULTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2006 and 2005

Summary

We recorded strong earnings performance during 2006. Net income was $19.8 million, or $2.48 per basic share and $2.45 per diluted share. This earnings performance compares favorably to net income of $17.9 million, or $2.25 per basic share and $2.20 per diluted share, recorded in 2005. The $1.9 million improvement in net income represents an increase of 10.9%, while diluted earnings per share were up 11.4%. The earnings improvement during 2006 over that of 2005 is primarily attributable to higher net interest income, which more than offset increases in provision expense and overhead costs.

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The following table shows some of the key performance and equity ratios for the years ended December 31, 2006 and 2005.

	2006	2005
Return on average total assets	1.01%	1.05%
Return on average equity	12.19	12.05
Dividend payout ratio	20.34	17.79
Average equity to average assets	8.31	8.73

Net Interest Income

Net interest income, the difference between revenue generated from earning assets and the interest cost of funding those assets, is our primary source of earnings. Interest income (adjusted for tax-exempt income) and interest expense totaled $138.5 million and $75.7 million during 2006, respectively, providing for net interest income of $62.8 million. This performance compares favorably to that of 2005 when interest income and interest expense were $103.2 million and $46.8 million, respectively, providing for net interest income of $56.4 million. In comparing 2006 with 2005, interest income increased 34.1%, interest expense was up 61.6% and net interest income increased 11.3%. The level of net interest income is primarily a function of asset size, as the weighted average interest rate received on earning assets is greater than the weighted average interest cost of funding sources; however, factors such as types of assets and liabilities, interest rate environment, interest rate risk, common stock sales, liquidity, and customer behavior also impact net interest income as well as the net interest margin.

The net interest margin declined from 3.50% in 2005 to 3.37% in 2006, a decrease of 3.7%. Our net interest margin during 2004 was 3.30%. Throughout 2005 and during the first half of 2006, our net interest margin was generally on an increasing trend. From June 2004 through June 2006, the Federal Open Market Committee (FOMC) increased the federal funds rate by 25 basis points at 17 consecutive meetings, causing the prime rate to increase from 4.00% in June 2004 to 8.25% in June 2006. Our yield on assets increased significantly during this time period, as the interest rates on over 70% of our total loans and leases were tied to the prime rate. Our cost of funds also increased during this time period, as interest rates paid on our deposits and borrowings increased as well. However, our cost of funds increased at a slower rate than the increase in our yield on assets, with a significant portion of our interest-bearing liabilities comprised of fixed rate certificates of deposit and borrowings, resulting in a lagged increased cost of funds. The FOMC has left the federal funds rate unchanged since June 2006, resulting in a relatively steady yield on assets. However, our cost of funds has continued to increase as maturing fixed rate certificates of deposit and borrowings, which were obtained during lower interest rate environments, are replaced or renewed at higher interest rates. Assuming no major changes in the federal funds rate in the near future, we expect our cost of funds, and therefore our net interest margin, to level-out during the second quarter of 2007.

The following table depicts the average balance, interest earned and paid, and weighted average rate of our assets, liabilities and shareholders equity during 2006, 2005 and 2004. The table also depicts the dollar amount of change in interest income and interest expense of interest-earning assets and interest-bearing liabilities, segregated between change due to volume and change due to rate. For tax-exempt investment securities, interest income and yield have been computed on a tax equivalent basis using a marginal tax rate of 35%. Securities interest income was increased by $1.2 million, $1.1 million and $1.0 million in 2006, 2005 and 2004, respectively.

(Dollars in thousands)	Years ended December 31,								
	2006			2005			2004		
	Average		Average			Average	Average	Average	Averag
	Balance	Interest	Rate	Balance	Interest	Rate	Balance	Interest	Rate
Taxable securities	$ 128,382	$ 6,557	5.11%	$ 114,097	$ 5,588	4.90%	$ 82,107	$ 3,935	4.79
Tax exempt securities	61,949	3,930	6.34	58,005	3,703	6.38	48,322	3,174	6.57
Total securities	190,331	10,487	5.51	172,102	9,291	5.40	130,429	7,109	5.45
Loans and leases	1,660,284	127,470	7.68	1,432,609	93,666	6.54	1,177,568	62,791	5.33
Short term investments	320	12	3.75	582	14	2.41	593	4	0.67
Federal funds sold	9,745	482	4.95	8,156	266	3.26	5,942	75	1.26
Total earning assets	1,860,680	138,451	7.44	1,613,449	103,237	6.40	1,314,532	69,979	5.32
Allowance for loan and lease losses	(21,464)			(19,048)			(16,203)		
Cash and due from banks	38,298			36,827			31,587		
Other non earning assets	82,419			70,769			49,262		
Total assets	$ 1,959,933			$ 1,701,997			$ 1,379,178		
Interest bearing demand deposits	$ 36,530	$ 1,069	2.93%	$ 36,319	$ 707	1.95%	$ 32,994	$ 427	1.29
Savings deposits	93,046	3,328	3.58	113,945	2,934	2.57	136,214	2,497	1.83
Money market accounts	10,326	325	3.15	9,478	211	2.23	8,788	129	1.47
Time deposits	1,289,777	60,033	4.65	1,036,457	35,032	3.38	780,867	18,733	2.40
Total interest bearing deposits	1,429,679	64,755	4.53	1,196,199	38,884	3.25	958,863	21,786	2.27
Short term borrowings	75,885	2,867	3.78	66,814	1,795	2.69	55,816	877	1.57
Federal Home Loan Bank advances	121,932	5,393	4.42	131,137	4,200	3.20	112,869	2,471	2.19
Long term borrowings	35,895	2,658	7.40	35,014	1,959	5.59	18,938	1,461	7.71
Total interest bearing liabilities	1,663,391	75,673	4.55	1,429,164	46,838	3.28	1,146,486	26,595	2.32

Demand deposits	115,390	111,892	90,534
Other liabilities	18,371	12,352	7,156
Total liabilities	1,797,152	1,553,408	1,244,176
Average equity	162,781	148,589	135,002
Total liabilities and equity	$ 1,959,933	$ 1,701,997	$ 1,379,178
Net interest income	$ 62,778	$ 56,399	$ 43,384
Rate spread	2.89%	3.12%	3.00%
Net interest margin	3.37%	3.50%	3.30%

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	Years ended December 31,					
	2006 over 2005			2005 over 2004		
	Total	Volume	Rate	Total	Volume	Rate
Increase (decrease) in interest income						
Taxable securities	$ 969,000	$ 722,000	$ 247,000	$ 1,653,000	$ 1,565,000	$ 88,000
Tax exempt securities	227,000	250,000	(23,000)	529,000	620,000	(91,000)
Loans	33,804,000	16,123,000	17,681,000	30,875,000	15,104,000	15,771,000
Short term investments	(2,000)	(8,000)	6,000	10,000	0	10,000
Federal funds sold	216,000	59,000	157,000	191,000	36,000	155,000
Net change in tax-equivalent income	35,214,000	17,146,000	18,068,000	33,258,000	17,325,000	15,933,000
Increase (decrease) in interest expense						
Interest-bearing demand deposits	362,000	4,000	358,000	280,000	47,000	233,000
Savings deposits	394,000	(605,000)	999,000	437,000	(456,000)	893,000
Money market accounts	114,000	20,000	94,000	82,000	11,000	71,000
Time deposits	25,001,000	9,832,000	15,169,000	16,299,000	7,246,000	9,053,000
Short term borrowings	1,072,000	268,000	804,000	918,000	199,000	719,000
Federal Home Loan Bank advances	1,193,000	(312,000)	1,505,000	1,729,000	448,000	1,281,000
Long term borrowings	699,000	50,000	649,000	498,000	983,000	(485,000)
Net change in interest expense	28,835,000	9,257,000	19,578,000	20,243,000	8,478,000	11,765,000
Net change in tax-equivalent net interest income	$ 6,379,000	$ 7,889,000	$ (1,510,000)	$ 13,015,000	$ 8,847,000	$ 4,168,000

Interest income is primarily generated from the loan and lease portfolio, and to a lesser degree from securities, federal funds sold and short term investments. Interest income increased $35.3 million during 2006 from that

earned in 2005, totaling $138.5 million in 2006 compared to $103.2 million in the previous year. The increase is primarily due to the growth in earning assets and a higher interest rate environment during 2006 when compared to 2005. Reflecting the higher interest rate environment, the yield on average earning assets increased from 6.40% recorded in 2005 to 7.44% in 2006.

The growth in interest income is primarily attributable to an increase in earning assets and an increase in earning asset yields. During 2006, average earning assets increased $247.3 million, increasing from $1,613.4 million in 2005 to $1,860.7 million during 2006. Growth in average total loans and leases, totaling $227.7 million, comprised 92.1% of the increase in average earning assets during 2006. Interest income generated from the loan and lease portfolio increased $33.8 million during 2006 over the level earned in 2005, comprised of an increase of $16.1 million from the growth in the loan and lease portfolio and an increase of $17.7 million due to the increase in the yield earned on the loan portfolio to 7.68% from 6.54%. The increase in the loan and lease portfolio yield is primarily due to a higher interest rate environment during 2006 than in 2005.

Growth in the securities portfolio and an improved overall yield also added to the increase in interest income during 2006 over that of 2005. Average securities increased by $18.2 million in 2006, increasing from $172.1 million in 2005 to $190.3 million in 2006. The growth equated to an increase in interest income of $1.0 million, while an improved yield earned on the securities portfolio from 5.40% to 5.51% increased interest income by $0.2 million. Interest income earned on federal funds sold increased by $0.2 million due to a small increase in the average balance and a higher yield during 2006.

Interest expense is primarily generated from interest-bearing deposits, and to a lesser degree from repurchase agreements, FHLB advances and subordinated debentures. Interest expense increased $28.8 million during 2006 from that expensed in 2005, totaling $75.6 million in 2006 compared to $46.8 million in the previous year. The increase in interest expense is primarily attributable to the impact of an increase in interest-bearing liabilities and a higher interest rate environment during 2006 when compared to 2005. Interest-bearing liabilities averaged $1,663.4 million during 2006, or $234.2 million higher than the average interest-bearing liabilities of $1,429.2 million during 2005. This growth resulted in increased interest expense of $9.3 million. An increase in interest expense of $19.6 million was recorded during 2006 primarily due to a higher interest rate environment during 2006 than in 2005. The cost of average interest-bearing liabilities increased from the 3.28% recorded in 2005 to 4.55% in 2006.

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Average certificate of deposit growth during 2006 of $253.3 million equated to an increase in interest expense of $9.8 million, with an additional $15.2 million expensed due to the increase in the average rate paid as lower-rate certificates of deposit matured and were either renewed or replaced with higher-costing certificates of deposit throughout 2006. A decline in average savings deposits, totaling $20.9 million, equated to a decrease in interest expense of $0.6 million; however, interest expense of $1.0 million was recorded due to an increase in the average rate paid during 2006. Growth in average interest-bearing checking accounts of $0.2 million equated to a less than $0.1 million increase in interest expense, with an additional $0.4 million of interest expense recorded due to a higher average rate paid during 2006.

Average short term borrowings, comprised of repurchase agreements and federal funds purchased, increased $9.1 million during 2006, resulting in increased interest expense of $0.3 million, with an additional interest expense of $0.8 million recorded due to an increase in the average rate paid during 2006. Average FHLB advances decreased $9.2 million, equating to a decrease in interest expense of $0.3 million, with an increased average rate adding $1.5 million to interest expense. Growth in average long-term borrowings, comprised of subordinated debentures and deferred director and officer compensation programs, equated to an increase in interest expense of less than $0.1 million during 2006, with an increased average rate adding $0.6 million to interest expense.

Provision for Loan and Lease Losses

The provision for loan and lease losses totaled $5.8 million during 2006, compared to the $3.8 million expensed during 2005. The increase primarily reflects an increase in the volume of loan and lease net charge-offs during 2006 when compared to 2005, partially offset by lower loan and lease growth in 2006. Net loan and lease charge-offs during 2006 totaled $4.9 million, or 0.29% of average total loans and leases. Net loan and lease charge-offs during 2005 totaled $1.1 million, or 0.08% of average total loans and leases. Loan and lease growth during 2006 equaled $183.7 million, compared to loan and lease growth of $244.7 million during 2005. The allowance as a percentage of total loans outstanding as of December 31, 2006 was 1.23%, compared to 1.31% at year-end 2005.

In each accounting period, we adjust the allowance by the amount we believe is necessary to maintain the allowance at adequate levels. Through the loan and lease review and credit departments, we attempt to allocate specific portions of the allowance based on specifically identifiable problem loans and leases. The evaluation of the allowance is further based on, but not limited to, consideration of the internally prepared Reserve Analysis, composition of the loan and lease portfolio, third party analysis of the loan and lease administration processes and portfolio and general economic conditions. In addition, the strong commercial loan and leases growth is taken into account.

The Reserve Analysis, used since our inception and completed monthly, applies reserve allocation factors to outstanding loan and lease balances to calculate an overall allowance dollar amount. For commercial loans and leases, which continue to comprise a vast majority of our total loans and leases, reserve allocation factors are based upon the loan ratings as determined by our standardized grade paradigms. For retail loans, reserve allocation factors are based upon the type of credit. Adjustments for specific lending relationships, including impaired loans and leases, are made on a case-by-case basis. The reserve allocation factors are primarily based on the recent levels and historical trends of net loan charge-offs and non-performing assets, the comparison of the recent levels and historical trends of net loan charge-offs and non-performing assets with a customized peer group consisting of ten similarly-sized publicly traded banking organizations conducting business in the states of Michigan, Illinois, Indiana and/or Ohio, the review and consideration of our loan migration analysis and the experience of senior management making similar loans and leases for an extensive period of time. We regularly review the Reserve Analysis and make adjustments periodically based upon identifiable trends and experience.

Noninterest Income

Noninterest income totaled $5.3 million in 2006, a decrease of $0.4 million from the $5.7 million earned in 2005. Other noninterest income during 2005 included a one-time gain of $0.7 million which was recorded from the sale of state tax credits derived from the construction of the new main office in downtown Grand Rapids. Deposit and repurchase agreement service charges were unchanged in 2006 when compared to 2005; although the number of deposit accounts increased during 2006, the earnings credit rate also increased, reducing the level of fees paid by our depositors. Earnings from increased cash surrender value of bank owned life insurance policies increased $0.2 million in 2006, primarily reflecting a higher balance from the purchase of additional policies during the year. We recorded increases in virtually all other fee income-producing activities in 2006 when compared to 2005, with the exception of residential mortgage banking fees, which decreased $0.1 million due to lower volume of activity.

Noninterest Expense

Noninterest expense during 2006 totaled $32.3 million, an increase of $1.2 million over the $31.1 million expensed in 2005. Salary expense and benefit costs increased $0.3 million in 2006 when compared to 2005. Base compensation increased approximately $2.9 million, primarily reflecting the increase in full-time equivalent employees from 273 at year-end 2005 to 291 at year-end 2006 and annual pay increases. However, bonus expense declined $2.6 million during 2006 when compared to 2005. Occupancy, furniture and equipment costs increased $0.9 million in 2006, primarily reflecting a full year s expense associated with the opening of our new main office in downtown Grand Rapids during the second quarter of 2005, and the opening of our new leased facilities in Lansing and Ann Arbor during the third quarter of 2005. All other non-interest expenses, in aggregate, were relatively unchanged in 2006 when compared to 2005.

While the dollar amount of noninterest costs has increased, the growth of net interest income and fee income has increased more. Noninterest costs during 2006 were $1.2 million higher than the level of overhead costs expensed during 2005; however, net interest income and fee income increased a combined $5.9 million during the same time period. Monitoring and controlling our noninterest costs, while at the same time providing high quality service to our customers, is one of our priorities. The efficiency ratio, a banking industry standardized calculation that attempts to reflect the utilization of overhead costs, improved during 2006 and remained well below banking industry averages. Computed by dividing noninterest expenses by net interest income plus noninterest income, the efficiency ratio was 48.3% during 2006, compared to 51.1% during 2005.

Federal Income Tax Expense

Federal income tax expense was $9.0 million in 2006, an increase of $0.9 million over the $8.1 million expensed during 2005. The increase during 2006 is primarily due to the growth in our pre-federal income tax profitability. The effective tax rate for 2006 was 31.1%, compared to 31.3% in 2005.

RESULTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

Summary

We recorded strong earnings performance during 2005. Net income was $17.9 million, or $2.25 per basic share and $2.20 per diluted share. This earnings performance compares favorably to net income of $13.7 million, or $1.73 per basic share and $1.69 per diluted share, recorded in 2004. The $4.2 million improvement in net income represents an increase of 30.5%, while diluted earnings per share were up 30.2%. The earnings improvement during 2005 over that of 2004 is primarily attributable to higher net interest income and a lower provision expense, which more than offset an increase in overhead costs.

Net income for 2004 includes an $845,000 ($548,000 after-tax) write-off associated with the unamortized balance of issuance costs related to the redemption of the $16.0 million of 9.60% Cumulative Preferred Securities issued in 1999 by MBWM Capital Trust I. Excluding this one-time expense, net income for 2004 was $14.3 million ($1.80 per basic share and $1.76 per diluted share). We believe excluding the impact of the one-time charge from 2004 operating results and performance measures allows a more meaningful comparison of 2005 results to 2004 results; therefore, the following discussion of our results of operations for the years ended December 31, 2005 and December 31, 2004 includes both GAAP and non-GAAP facts and figures

where appropriate.

The following table shows some of the key performance and equity ratios for the years ended December 31, 2005 and 2004.

	2005	2004
Return on average total assets	1.05%	0.99%
Return on average equity	12.05	10.16
Dividend payout ratio	17.79	18.60
Average equity to average assets	8.73	9.79

Net Interest Income

Net interest income, the difference between revenue generated from earning assets and the interest cost of funding those assets, is our primary source of earnings. Interest income (adjusted for tax-exempt income) and interest expense totaled $103.2 million and $46.8 million during 2005, respectively, providing for net interest income of $56.4 million. This performance compares favorably to that of 2004 when interest income and interest expense were $70.0 million and $26.6 million, respectively, providing for net interest income of $43.4 million. In comparing 2005 with 2004, interest income increased 47.4%, interest expense was up 76.0% and net interest income increased 30.0%. The level of net interest income is primarily a function of asset size, as the weighted average interest rate received on earning assets is greater than the weighted average interest cost of funding sources; however, factors such as types of assets and liabilities, interest rate risk, common stock sales, liquidity, and customer behavior also impact net interest income as well as the net interest margin. The net interest margin improved from 3.30% in 2004 to 3.50% in 2005, an increase of 6.1%, primarily due to earning assets repricing faster than interest-bearing liabilities during the increasing interest rate environment that existed during virtually all of 2005.

Interest income is primarily generated from the loan portfolio, and to a lesser degree from securities, federal funds sold and short term investments. Interest income increased $33.3 million during 2005 from that earned in 2004, totaling $103.2 million in 2005 compared to $70.0 million in the previous year. The increase is primarily due to the growth in earning assets and a higher interest rate environment during 2005 when compared to 2004. Reflecting the higher interest rates, the yield on average earning assets increased from 5.32% recorded in 2004 to 6.40% in 2005.

The growth in interest income is primarily attributable to an increase in earning assets and an increase in earning asset yields. During 2005, average earning assets increased $298.9 million, increasing from $1,314.5 million in 2004 to $1,613.4 million during 2005. Growth in average total loans and leases, totaling $255.0 million, comprised 85.3% of the increase in average earning assets during 2005. Interest income generated from the loan and lease portfolio increased $30.9 million during 2005 over the level earned in 2004, comprised of an increase of $15.1 million from the growth in the loan and lease portfolio and an increase of $15.8 million due to the increase in the yield earned on the loan and lease portfolio to 6.54% from 5.33%. The increase in the loan and lease portfolio yield is primarily due to a higher interest rate environment during 2005 than in 2004.

Growth in the securities portfolio, partially offset by a slightly lower yield, also added to the increase in interest income during 2005 over that of 2004. Average securities increased by $41.7 million in 2005, increasing from $130.4 million in 2004 to $172.1 million in 2005. The growth equated to an increase in interest income of $2.2 million, while a decrease in the yield earned on the securities portfolio from 5.45% to 5.40% reduced interest income by $0.1 million. Interest income earned on federal funds sold increased by $0.2 million due to a small increase in the average balance and a higher yield during 2005.

Interest expense is primarily generated from interest-bearing deposits, and to a lesser degree from repurchase agreements, FHLB advances and subordinated debentures. Interest expense increased $20.2 million during 2005 from that expensed in 2004, totaling $46.8 million in 2005 compared to $26.6 million in the previous year. The increase in interest expense is primarily attributable to the impact of an increase in interest-bearing liabilities and a higher interest rate environment during 2005 when compared to 2004. Interest-bearing liabilities averaged $1,429.2 million during 2005, or $282.7 million higher than the average interest-bearing

liabilities of $1,146.5 million during 2004. This growth resulted in increased interest expense of $8.5 million. An increase in interest expense of $11.7 million was recorded during 2005 primarily due to a higher interest rate environment during 2005 than in 2004. The cost of average interest-bearing liabilities increased from the 2.32% recorded in 2004 to 3.28% in 2005.

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Growth in average certificates of deposits, totaling $255.6 million, comprised 90.4% of the increase in average interest-bearing liabilities between 2005 and 2004. Average FHLB advances increased $18.2 million, or 6.4% of the increase in average interest-bearing liabilities in 2005. The certificate of deposit growth during 2005 equated to an increase in interest expense of $7.2 million, with an additional $9.1 million expensed due to the increase in the average rate paid as lower-rate certificates of deposit matured and were either renewed or replaced with higher-costing certificates of deposit during most of 2005. FHLB advance growth during 2005 equated to an increase in interest expense of $0.4 million, with an increased average rate adding an additional $1.3 million to interest expense.

A decline in average savings deposits, totaling $22.3 million, equated to a decrease in interest expense of $0.5 million; however, interest expense of $0.9 million was recorded due to an increase in the average rate paid during 2005. Growth in average interest-bearing checking accounts of $3.3 million equated to a less than $0.1 million increase in interest expense, with an additional $0.2 million of interest expense recorded due to a higher average rate paid during 2005. Average short term borrowings, comprised of repurchase agreements and federal funds purchased, increased $11.0 million during 2005, resulting in increased interest expense of $0.2 million, with an additional interest expense of $0.7 million recorded due to an increase in the average rate paid during 2005.

Growth of $16.1 million in average long-term borrowings, comprised primarily of subordinated debentures but also including deferred director and officer compensation programs, equated to an increase in interest expense of $1.0 million during 2005; however, a decline in the average rate paid on subordinated debentures resulting from the September 2004 refinance, equated to a $0.5 million reduction of interest expense during 2005.

Provision for Loan and Lease Losses

The provision for loan and lease losses totaled $3.8 million during 2005, compared to the $4.7 million expensed during 2004. The decline primarily reflects lower loan and lease loan growth and a decline in the volume of loan and lease net charge-offs during 2005 when compared to 2004. The allowance as a percentage of total loans outstanding as of December 31, 2005 was 1.31%, compared to 1.35% at year-end 2004. Loan and lease growth during 2005 equaled $244.7 million, compared to loan and lease growth of $281.2 million during 2004. Net loan and lease charge-offs during 2005 totaled $1.1 million, or 0.08% of average total loans and leases. Net loan and lease charge-offs during 2004 totaled $1.2 million, or 0.10% of average total loans and leases.

In each accounting period, we adjust the allowance by the amount we believe is necessary to maintain the allowance at adequate levels. Through the loan and lease review and credit departments, we attempt to allocate specific portions of the allowance based on specifically identifiable problem loans and leases. The evaluation of the allowance is further based on, but not limited to, consideration of the internally prepared Reserve Analysis, composition of the loan and lease portfolio, third party analysis of the loan and lease administration processes and portfolio and general economic conditions. In addition, the strong commercial loan and lease growth is taken into account.

The Reserve Analysis, used since our inception and completed monthly, applies reserve allocation factors to outstanding loan and lease balances to calculate an overall allowance dollar amount. For commercial loans and leases, which continue to comprise a vast majority of our total loans and leases, reserve allocation factors are based upon the loan ratings as determined by our standardized grade paradigms. For retail loans, reserve allocation factors are based upon the type of credit. Adjustments for specific lending relationships, including impaired loans and leases, are made on a case-by-case basis. The reserve allocation factors are primarily based on the recent levels and historical trends of net loan charge-offs and non-performing assets, the comparison of the recent levels and historical trends of net loan charge-offs and non-performing assets with a customized peer group consisting of ten similarly-sized publicly traded banking organizations conducting business in the states of Michigan, Illinois, Indiana and/or Ohio, the review and consideration of our loan migration analysis and the experience of senior management making similar loans and leases for an extensive period of time. We regularly review the Reserve Analysis and make adjustments periodically based upon identifiable trends and

experience.

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Noninterest Income

Noninterest income totaled $5.7 million in 2005, an increase of $1.4 million from the $4.3 million earned in 2004. Deposit and repurchase agreement service charges increased $0.1 million in 2005, primarily reflecting the growth in the number of deposit accounts and modest increases in the deposit fee structure. The cash surrender value of bank owned life insurance policies increased $0.3 million in 2005, primarily reflecting a higher balance from the purchase of additional policies during the year. Primarily reflecting an increase in volume of activity, residential mortgage banking fees increased $0.2 million during 2005. Other noninterest income includes a gain of $0.7 million which was recognized during 2005 from the sale of state tax credits derived from the construction of the new main office in downtown Grand Rapids.

Noninterest Expense

Noninterest expense during 2005 totaled $31.1 million, an increase of $7.9 million over the $23.2 million expensed in 2004. Noninterest expense during 2004 includes an $845,000 write-off associated with the unamortized balance of issuance costs related to the redemption of the $16.0 million of 9.60% Cumulative Preferred Securities issued in 1999 by the MBWM Capital Trust I. Excluding this one-time write-off, noninterest expense during 2004 totaled $22.4 million, with the growth in overhead costs during 2005 equating to $8.7 million.

Of the $8.7 million growth in overhead costs, $4.7 million (54.0% of total) was in salaries and benefits, which primarily reflects the increase in full-time equivalent employees from 194 at year-end 2004 to 273 at year-end 2005 and annual pay increases. Occupancy, furniture and equipment costs increased $1.6 million (18.4% of total) in 2005, primarily reflecting the opening of our Holland banking office in October of 2004, the opening of our new main office in downtown Grand Rapids during the second quarter of 2005, the opening of our new leased facilities in Lansing and Ann Arbor during the third quarter of 2005 and our increased staffing level. While the dollar amount of noninterest costs has increased, the growth of net interest income and fee income has increased more. Noninterest costs during 2005 were $8.7 million higher than the level of overhead costs expensed during 2004; however, net interest income and fee income increased a combined $14.2 million during the same time period. Monitoring and controlling our noninterest costs, while at the same time providing high quality service to our customers, is one of our priorities. The efficiency ratio, a banking industry standardized calculation that attempts to reflect the utilization of overhead costs, declined during 2004 but remained well below banking industry averages. Computed by dividing noninterest expenses by net interest income plus noninterest income, the efficiency ratio was 51.1% during 2005, compared to 49.6% during 2004. If the one-time write-off addressed above is excluded from the calculation, our 2004 efficiency ratio improves to 47.8%. The decline in the efficiency ratio is primarily related to the initial overhead costs associated with our expansion into Lansing and Ann Arbor, especially salary and benefit and occupancy expenses.

Federal Income Tax Expense

Federal income tax expense was $8.1 million in 2005, an increase of $3.0 million over the $5.1 million expensed during 2004. The increase during 2005 is primarily due to the growth in our pre-federal income tax profitability and an increase in the effective tax rate, the latter of which reflects a lower level of tax-exempt income as a percent of total income.

CAPITAL RESOURCES

Shareholders equity is a noninterest-bearing source of funds that provides support for our asset growth. Shareholders equity was $171.9 million and $155.1 million at December 31, 2006 and 2005, respectively. The $16.8 million increase during 2006 is primarily attributable to net income from operations. Net income from operations totaled $19.8 million during 2006. Also positively impacting shareholders equity was a $0.3 million mark-to-market adjustment for available for sale securities as defined in SFAS No. 115, plus proceeds totaling $0.4 million relating to stock option exercises and our dividend reinvestment and employee stock purchase plans.

Negatively impacting shareholders equity during 2006 was the payment of cash dividends, which totaled $4.0 million.

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We and our bank are subject to regulatory capital requirements administered by state and federal banking agencies. Failure to meet the various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements. Our and our bank s capital ratios as of December 31, 2006 and 2005 are disclosed under Note 16 on pages F-55 and F-56 of the Notes to Consolidated Financial Statements.

Our ability to pay cash and stock dividends is subject to limitations under various laws and regulations and to prudent and sound banking practices. On April 11, 2006, we declared a 5% common stock dividend, payable on May 16, 2006 to record holders as of April 24, 2006. This represented the sixth consecutive year we have paid a 5% stock dividend. Also during 2006, we paid a cash dividend on our common stock each calendar quarter. These cash dividends totaled $0.51 per share for 2006, and $4.0 million in aggregate amount. On January 9, 2007, we declared a $0.14 per common share cash dividend that will be paid on March 9, 2007 to shareholders of record on February 9, 2007.

LIQUIDITY

Liquidity is measured by our ability to raise funds through deposits, borrowed funds, capital or cash flow from the repayment of loans and investment securities. These funds are used to meet deposit withdrawals, maintain reserve requirements, fund loans and operate our company. Liquidity is primarily achieved through the growth of deposits (both local and out-of-area) and liquid assets such as securities available for sale, matured securities, and federal funds sold. Asset and liability management is the process of managing the balance sheet to achieve a mix of earning assets and liabilities that maximizes profitability, while providing adequate liquidity.

Our liquidity strategy is to fund loan growth with deposits, repurchase agreements and other borrowed funds and to maintain an adequate level of short- and medium-term investments to meet typical daily loan and deposit activity. Net deposit and repurchase agreement growth from customers located in our market areas increased by $189.8 million, or 35.9%, during 2006. This strong growth was not fully sufficient to meet the earning asset growth of $204.2 million. To assist in providing the additional needed funds, we regularly obtained certificates of deposit from customers outside of our market areas. As of December 31, 2006, out-of-area deposits totaled $1,013.8 million, an increase in dollar volume of $51.0 million from the $962.8 million outstanding at December 31, 2005. However, as a percent of combined total deposits and repurchase agreements, out-of-area deposits declined from 64.6% as of December 31, 2005 to 58.5% at December 31, 2006.

As a member of the Federal Home Loan Bank of Indianapolis, our bank has access to the FHLB advance borrowing programs. As of December 31, 2006, advances totaled $95.0 million, compared to $130.0 million outstanding as of December 31, 2005. Our borrowing line of credit at December 31, 2006 totaled $322.6 million, with availability of $216.5 million.

We have the ability to borrow money on a daily basis through correspondent banks using established federal funds purchased lines. During 2006, our federal funds purchased position averaged $3.7 million, compared to an average federal funds sold position of $9.7 million. At December 31, 2006, our established unsecured federal funds purchased lines totaled $72.0 million.

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The following table reflects, as of December 31, 2006, significant fixed and determinable contractual obligations to third parties by payment date.

	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	$ 274,919,000	$ 0	$ 0	$ 0	$ 274,919,000
Certificates of deposits	1,027,309,000	313,680,000	30,995,000	0	1,371,984,000
Short term borrowings	95,272,000	0	0	0	95,272,000
Federal Home Loan Bank advances	80,000,000	15,000,000	0	0	95,000,000
Subordinated debentures	0	0	0	32,990,000	32,990,000
Other borrowed money	0	0	0	3,316,000	3,316,000
Operating leases	207,000	324,000	83,000	0	614,000

In addition to normal loan funding and deposit flow, we also need to maintain liquidity to meet the demands of certain unfunded loan commitments and standby letters of credit. At December 31, 2006, we had a total of $451.1 million in unfunded loan commitments and $73.2 million in unfunded standby letters of credit. Of the total unfunded loan commitments, $390.2 million were commitments available as lines of credit to be drawn at any time as customers cash needs vary, and $60.9 million were for loan commitments scheduled to close and become funded within the next twelve months. We monitor fluctuations in loan balances and commitment levels, and include such data in our overall liquidity management.

The following table depicts our loan commitments at the end of the past three years.

	December 31, 2006	December 31, 2005	December 31, 2004
Commercial unused lines of credit	$ 345,195,000	$ 303,115,000	$ 226,935,000
Unused lines of credit secured by 1-4 family residential properties	29,314,000	27,830,000	24,988,000
Credit card unused lines of credit	8,510,000	7,971,000	8,307,000
Other consumer unused lines of credit	7,197,000	10,791,000	5,155,000
Commitments to make loans	60,850,000	83,280,000	55,440,000
Standby letters of credit	73,241,000	59,058,000	56,464,000
Total	$ 524,307,000	$ 492,045,000	$ 377,289,000

MARKET RISK ANALYSIS

Our primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of our transactions are denominated in U.S. dollars with no specific foreign exchange exposure. We have only limited agricultural-related loan assets and therefore have no significant exposure to changes in commodity prices. Any impact that changes in foreign exchange rates and commodity prices would have on interest rates

is assumed to be insignificant. Interest rate risk is the exposure of our financial condition to adverse movements in interest rates. We derive our income primarily from the excess of interest collected on interest-earning assets over the interest paid on interest-bearing liabilities. The rates of interest we earn on our assets and owe on our liabilities generally are established contractually for a period of time. Since market interest rates change over time, we are exposed to lower profitability if we cannot adapt to interest rate changes. Accepting interest rate risk can be an important source of profitability and shareholder value; however, excessive levels of interest rate risk could pose a significant threat to our earnings and capital base. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to our safety and soundness.

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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. Our 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, we assess the existing and potential future effects of changes in interest rates on our financial condition, including capital adequacy, earnings, liquidity and asset quality.

We use two interest rate risk measurement techniques. The first, which is commonly referred to as GAP analysis, measures the difference between the dollar amounts of interest-sensitive assets and liabilities that will be refinanced or repriced during a given time period. A significant repricing gap could result in a negative impact to the net interest margin during periods of changing market interest rates.

The following table depicts our GAP position as of December 31, 2006 (dollars in thousands).

	Within Three Months	Three to Twelve Months	One to Five Years	After Five Years	Total
Assets:					
Commercial loans [1]	$ 893,234	$ 60,125	$ 601,193	$ 49,638	$ 1,604,190
Leases	11	22	1,355	0	1,388
Residential real estate loans	60,235	4,597	53,131	13,681	131,644
Consumer loans	3,169	134	4,208	745	8,256
Securities [2]	8,711	2,478	34,159	157,071	202,419
Short term investments	282	0	0	0	282
Allowance for loan and lease losses	0	0	0	0	(21,411)
Other assets	0	0	0	0	140,500
Total assets	965,642	67,356	694,046	221,135	2,067,268
Liabilities:					
Interest-bearing checking	39,943	0	0	0	39,943
Savings	92,370	0	0	0	92,370
Money market accounts	9,409	0	0	0	9,409
Time deposits under $100,000	34,550	53,196	42,424	0	130,170
Time deposits $100,000 and over	351,745	587,818	302,251	0	1,241,814
Short term borrowings	95,272	0	0	0	95,272
Federal Home Loan Bank advances	30,000	50,000	15,000	0	95,000
Long term borrowings	36,306	0	0	0	36,306
Noninterest-bearing checking	0	0	0	0	133,197
Other liabilities	0	0	0	0	21,872
Total liabilities	689,595	691,014	359,675	0	1,895,353
Shareholders equity	0	0	0	0	171,915
Total sources of funds	689,595	691,014	359,675	0	2,067,268
Net asset (liability) GAP	$ 276,047	$ (623,658)	$ 334,371	$ 221,135	

Cumulative GAP	$ 276,047	$ (347,611)	$ (13,240)	$ 207,895
Percent of cumulative GAP to total assets	13.4%	(16.8)%	(0.6)%	10.1%

(1) Floating rate loans that are currently at interest rate ceilings are treated as fixed rate loans and are reflected using maturity date and not repricing frequency.

(2) Mortgage-backed securities are categorized by expected maturities based upon prepayment trends as of December 31, 2006.

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The following table depicts our GAP position as of December 31, 2005 (dollars in thousands).

	Within Three Months	Three to Twelve Months	One to Five Years	After Five Years	Total
Assets:					
Commercial loans [1]	$ 947,769	$ 37,000	$ 408,931	$ 32,832	$ 1,426,532
Leases	6	485	1,295	0	1,786
Residential real estate loans	61,448	3,861	49,302	13,500	128,111
Consumer loans	1,699	134	3,011	539	5,383
Securities [2]	8,899	1,007	32,095	139,613	181,614
Short term investments	545	0	0	0	545
Allowance for loan and lease losses	0	0	0	0	(20,527)
Other assets	0	0	0	0	114,766
Total assets	1,020,366	42,487	494,634	186,484	1,838,210
Liabilities:					
Interest-bearing checking	39,792	0	0	0	39,792
Savings	106,247	0	0	0	106,247
Money market accounts	10,344	0	0	0	10,344
Time deposits under $100,000	30,475	37,109	36,370	0	103,954
Time deposits $100,000 and over	255,351	465,018	317,818	0	1,038,187
Short term borrowings	81,801	0	0	0	81,801
Federal Home Loan Bank advances	25,000	75,000	30,000	0	130,000
Long term borrowings	35,337	0	0	0	35,337
Noninterest-bearing checking	0	0	0	0	120,828
Other liabilities	0	0	0	0	16,595
Total liabilities	584,347	577,127	384,188	0	1,683,085
Shareholders equity	0	0	0	0	155,125
Total sources of funds	584,347	577,127	384,188	0	1,838,210
Net asset (liability) GAP	$ 436,019	$ (534,640)	$ 110,446	$ 186,484	
Cumulative GAP	$ 436,019	$ (98,621)	$ 11,825	$ 198,309	
Percent of cumulative GAP to total assets	23.7%	(5.4)%	0.6%	10.8%	

(1)

Floating rate loans that are currently at interest rate ceilings are treated as fixed rate loans and are reflected using maturity date and not repricing frequency.

(2) Mortgage-backed securities are categorized by expected maturities based upon prepayment trends as of December 31, 2005.

The second interest rate risk measurement used is commonly referred to as net interest income simulation analysis. We believe that this methodology provides a more accurate measurement of interest rate risk than the GAP analysis, and therefore, it serves as our primary interest rate risk measurement technique. The simulation model assesses the direction and magnitude of variations in net interest income resulting from potential changes in market interest rates. Key assumptions in the model include prepayment speeds on various loan and investment assets; cash flows and maturities of interest-sensitive assets and liabilities; and changes in market conditions impacting loan and deposit volume and pricing. These assumptions are inherently uncertain, subject to fluctuation and revision in a dynamic environment; therefore, the model cannot precisely estimate net interest income or exactly predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude, and frequency of interest rate changes and changes in market conditions and our strategies, among other factors.

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We conducted multiple simulations as of December 31, 2006, in which it was assumed that changes in market interest rates occurred ranging from up 200 basis points to down 200 basis points in equal quarterly instalments over the next twelve months. The following table reflects the suggested impact on net interest income over the next twelve months, which is well within our policy parameters established to manage and monitor interest rate risk.

Interest Rate Scenario	Dollar Change In Net Interest Income	Percent Change In Net Interest Income
Interest rates down 200 basis points	$ (2,776,000)	(4.4)%
Interest rates down 100 basis points	(2,064,000)	(3.3)
No change in interest rates	(1,438,000)	(2.3)
Interest rates up 100 basis points	569,000	0.9
Interest rates up 200 basis points	2,552,000	4.0

In addition to changes in interest rates, the level of future net interest income is also dependent on a number of other variables, including: the growth, composition and absolute levels of loans, deposits, and other earning assets and interest-bearing liabilities; economic and competitive conditions; potential changes in lending, investing, and deposit gathering strategies; client preferences; and other factors.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Mercantile Bank Corporation
Grand Rapids, Michigan

We have audited the accompanying consolidated balance sheets of Mercantile Bank Corporation as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of Mercantile s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mercantile Bank Corporation as of December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Mercantile Bank Corporation s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 20, 2007 expressed an unqualified opinion thereon.

/s/ Crowe Chizek and Company LLC
Crowe Chizek and Company LLC

Grand Rapids, Michigan
February 20, 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Mercantile Bank Corporation
Grand Rapids, Michigan

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that Mercantile Bank Corporation maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Mercantile Bank Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Mercantile Bank Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Mercantile Bank Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Mercantile Bank Corporation and our report dated February 20, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ Crowe Chizek and Company LLC
Crowe Chizek and Company LLC

Grand Rapids, Michigan
February 20, 2007

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February 20, 2007

REPORT BY MERCANTILE BANK CORPORATION S MANAGEMENT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining an effective system of internal control over financial reporting presented in conformity with generally accepted accounting principles. There are inherent limitations in the effectiveness of any system of internal control. Accordingly, even an effective system of internal control can provide only reasonable assurance with respect to financial statement preparation.

Management assessed the Company s systems of internal control over financial reporting presented in conformity with generally accepted principles as of December 31, 2006. This assessment was based on criteria for effective internal control over financial reporting described in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2006, Mercantile Bank Corporation maintained effective control over financial reporting presented in conformity with generally accepted accounting principles based on those criteria.

The Company s independent auditors have issued an audit report on our assessment of the Company s internal control over financial reporting.

Mercantile Bank Corporation

/s/ Gerald R. Johnson, Jr.

Gerald R. Johnson, Jr.
Chairman and Chief Executive
Officer

/s/ Charles E. Christmas

Charles E. Christmas
Senior Vice President Chief
Financial Officer

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MERCANTILE BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2006 and 2005

	2006	2005
ASSETS		
Cash and due from banks	$ 51,098,000	$ 36,208,000
Short term investments	282,000	545,000
Total cash and cash equivalents	51,380,000	36,753,000
Securities available for sale	130,967,000	112,961,000
Securities held to maturity (fair value of $65,025,000 at December 31, 2006 and $62,850,000 at December 31, 2005)	63,943,000	60,766,000
Federal Home Loan Bank stock	7,509,000	7,887,000
Total loans and leases	1,745,478,000	1,561,812,000
Allowance for loan and lease losses	(21,411,000)	(20,527,000)
Total loans and leases, net	1,724,067,000	1,541,285,000
Premises and equipment, net	33,539,000	30,206,000
Bank owned life insurance policies	30,858,000	28,071,000
Accrued interest receivable	10,287,000	8,274,000
Other assets	14,718,000	12,007,000
Total assets	$ 2,067,268,000	$ 1,838,210,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest-bearing	$ 133,197,000	$ 120,828,000
Interest-bearing	1,513,706,000	1,298,524,000
Total	1,646,903,000	1,419,352,000
Securities sold under agreements to repurchase	85,472,000	72,201,000
Federal funds purchased	9,800,000	9,600,000
Federal Home Loan Bank advances	95,000,000	130,000,000
Subordinated debentures	32,990,000	32,990,000
Other borrowed money	3,316,000	2,347,000
Accrued expenses and other liabilities	21,872,000	16,595,000
Total liabilities	1,895,353,000	1,683,085,000
Shareholders equity		
Preferred stock, no par value; 1,000,000 shares authorized, none issued	0	0

Common stock, no par value; 20,000,000 shares authorized; 8,022,221 and 7,590,526 shares issued and outstanding at December 31, 2006 and 2005	161,223,000	148,533,000
Retained earnings	11,794,000	8,000,000
Accumulated other comprehensive income (loss)	(1,102,000)	(1,408,000)
Total shareholders equity	171,915,000	155,125,000
Total liabilities and shareholders equity	$ 2,067,268,000	$ 1,838,210,000

See accompanying notes to consolidated financial statements.

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MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Interest income			
Loans and leases, including fees	$ 127,470,000	$ 93,666,000	$ 62,791,000
Securities, taxable	6,557,000	5,588,000	3,935,000
Securities, tax-exempt	2,739,000	2,596,000	2,217,000
Federal funds sold	482,000	266,000	75,000
Short-term investments	12,000	14,000	4,000
Total interest income	137,260,000	102,130,000	69,022,000
Interest expense			
Deposits	64,755,000	38,884,000	21,786,000
Short-term borrowings	2,867,000	1,795,000	877,000
Federal Home Loan Bank advances	5,393,000	4,200,000	2,471,000
Long-term borrowings	2,658,000	1,959,000	1,461,000
Total interest expense	75,673,000	46,838,000	26,595,000
Net interest income	61,587,000	55,292,000	42,427,000
Provision for loan and lease losses	5,775,000	3,790,000	4,674,000
Net interest income after provision for loan and lease losses	55,812,000	51,502,000	37,753,000
Noninterest income			
Service charges on accounts	1,386,000	1,391,000	1,255,000
Increase in cash surrender value of bank owned life insurance policies	1,165,000	997,000	735,000
Letter of credit fees	443,000	422,000	450,000
Residential mortgage banking fees	553,000	634,000	440,000
Gain on sale of commercial loans	29,000	84,000	225,000
Gain on sale of securities	0	0	78,000
Other income	1,685,000	2,133,000	1,119,000
Total noninterest income	5,261,000	5,661,000	4,302,000
Noninterest expense			
Salaries and benefits	18,983,000	18,635,000	13,956,000
Occupancy	3,136,000	2,641,000	1,588,000
Furniture and equipment	2,050,000	1,667,000	1,093,000
Data processing	1,657,000	1,186,000	880,000
Advertising	600,000	554,000	465,000

Other expense	5,836,000	6,434,000	5,216,000
Total noninterest expenses	32,262,000	31,117,000	23,198,000
Income before federal income tax expense	28,811,000	26,046,000	18,857,000
Federal income tax expense	8,964,000	8,145,000	5,136,000
Net income	$ 19,847,000	$ 17,901,000	$ 13,721,000
Earnings per share:			
Basic	$ 2.48	$ 2.25	$ 1.73
Diluted	$ 2.45	$ 2.20	$ 1.69

See accompanying notes to consolidated financial statements.

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
Years ended December 31, 2006, 2005 and 2004

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders Equity
Balances, January 1, 2004	$ 118,560,000	$ 11,421,000	$ 220,000	$ 130,201,000
Payment of 5% stock dividend	12,111,000	(12,115,000)		(4,000)
Employee stock purchase plan, 2,388 shares	79,000			79,000
Dividend reinvestment plan, 3,754 shares	123,000			123,000
Stock option exercises, 57,011 shares	524,000			524,000
Stock tendered for stock option exercises, 12,058 shares	(387,000)			(387,000)
Cash dividends ($0.34 per share)		(2,552,000)		(2,552,000)
Comprehensive income:				
Net income		13,721,000		13,721,000
Change in net unrealized gain on securities available for sale, net of reclassifications and tax effect			(88,000)	(88,000)
Total comprehensive income				13,633,000
Balances, December 31, 2004	131,010,000	10,475,000	132,000	141,617,000
Payment of 5% stock dividend	17,187,000	(17,191,000)		(4,000)
Employee stock purchase plan, 2,491 shares	97,000			97,000
Dividend reinvestment plan, 4,099 shares	159,000			159,000
Stock option exercises, 41,885 shares	396,000			396,000

Stock tendered for stock option exercises, 8,043 shares	(316,000)			(316,000)
Cash dividends ($0.41 per share)		(3,185,000)		(3,185,000)
Comprehensive income:				
Net income		17,901,000		17,901,000
Change in net unrealized gain (loss) on securities available for sale, net of reclassifications and tax effect			(1,540,000)	(1,540,000)
Total comprehensive income				16,361,000
Balances, December 31, 2005	148,533,000	8,000,000	(1,408,000)	155,125,000

See accompanying notes to consolidated financial statements.

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Continued)
Years ended December 31, 2006, 2005 and 2004

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders Equity
Balances, December 31, 2005	$ 148,533,000	$ 8,000,000	$ (1,408,000)	$ 155,125,000
Payment of 5% stock dividend	12,014,000	(12,018,000)		(4,000)
Employee stock purchase plan, 2,774 shares	107,000			107,000
Dividend reinvestment plan, 2,531 shares	98,000			98,000
Stock option exercises, 61,897 shares	814,000			814,000
Stock tendered for stock option exercises, 14,939 shares	(585,000)			(585,000)
Cash dividends ($0.51 per share)		(4,035,000)		(4,035,000)
Equity compensation expense	242,000			242,000
Comprehensive income:				
Net income		19,847,000		19,847,000
Change in net unrealized loss on securities available for sale, net of reclassifications and tax effect			306,000	306,000
Total comprehensive income				20,153,000
Balances, December 31, 2006	$ 161,223,000	$ 11,794,000	$ (1,102,000)	$ 171,915,000

See accompanying notes to consolidated financial statements.

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MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Cash flows from operating activities			
Net income	$ 19,847,000	$ 17,901,000	$ 13,721,000
Adjustments to reconcile net income to net cash from operating activities			
Depreciation and amortization	2,887,000	2,555,000	1,699,000
Provision for loan and lease losses	5,775,000	3,790,000	4,674,000
Equity compensation expense	242,000	0	0
Federal Home Loan Bank stock dividends	0	(146,000)	(72,000)
Gain on sale of commercial loans	(29,000)	(84,000)	(225,000)
Gain on sale of securities	0	0	(78,000)
Earnings on bank owned life insurance policies	(1,166,000)	(997,000)	(735,000)
Net change in			
Accrued interest receivable	(2,013,000)	(2,630,000)	(1,546,000)
Other assets	(1,068,000)	(981,000)	(1,478,000)
Accrued expenses and other liabilities	5,277,000	7,190,000	2,315,000
Net cash from operating activities	29,752,000	26,598,000	18,275,000
Cash flows from investing activities			
Purchases of:			
Securities available for sale	(24,886,000)	(38,217,000)	(54,718,000)
Securities held to maturity	(4,567,000)	(10,065,000)	(8,521,000)
Federal Home Loan Bank stock	0	(943,000)	(1,749,000)
Proceeds from:			
Sales of securities available for sale	0	0	1,748,000
Maturities, calls and repayments of securities available for sale	7,423,000	16,686,000	30,382,000
Maturities, calls and repayments of securities held to maturity	1,330,000	1,586,000	1,256,000
Redemption of Federal Home Loan Bank stock	378,000	0	0
Loan originations and payments, net	(190,657,000)	(247,242,000)	(282,170,000)
Purchases of premises and equipment, net	(5,911,000)	(7,677,000)	(10,516,000)
Purchases of bank owned life insurance policies	(1,621,000)	(3,324,000)	(6,574,000)
Net cash from investing activities	(218,511,000)	(289,196,000)	(330,862,000)
Cash flows from financing activities			
Net increase in deposits	227,551,000	260,171,000	256,289,000
Net increase in securities sold under agreements to repurchase	13,271,000	15,884,000	6,772,000
Proceeds from Federal Home Loan Bank advances	80,000,000	75,000,000	75,000,000
Pay-off of Federal Home Loan Bank advances	(115,000,000)	(65,000,000)	(45,000,000)
Proceeds from issuance of subordinated debentures	0	0	32,990,000

Pay-off of subordinated debentures	0	0	(16,495,000)
Net increase (decrease) in other borrowed money	1,169,000	(4,662,000)	9,495,000
Cash paid in lieu of fractional shares on stock dividend	(4,000)	(4,000)	(4,000)
Employee stock purchase plan	107,000	97,000	79,000
Dividend reinvestment plan	98,000	159,000	123,000
Stock option exercises, net	229,000	80,000	137,000
Cash dividends	(4,035,000)	(3,185,000)	(2,552,000)
Net cash from financing activities	203,386,000	278,540,000	316,834,000

See accompanying notes to consolidated financial statements.

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MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Years ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Net change in cash and cash equivalents	14,627,000	15,942,000	4,247,000
Cash and cash equivalents at beginning of period	36,753,000	20,811,000	16,564,000
Cash and cash equivalents at end of period	$ 51,380,000	$ 36,753,000	$ 20,811,000
Supplemental disclosures of cash flow information			
Cash paid during the year for			
Interest	$ 67,925,000	$ 40,671,000	$ 25,107,000
Federal income tax	10,875,000	8,657,000	6,125,000
Transfers from loans and leases to foreclosed assets	2,129,000	1,556,000	0

See accompanying notes to consolidated financial statements.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Mercantile Bank Corporation (Mercantile) and its subsidiary, Mercantile Bank of Michigan (Bank), and of Mercantile Bank Mortgage Company, LLC (Mortgage Company), Mercantile Bank Real Estate Co., L.L.C. (Mercantile Real Estate) and Mercantile Insurance Center, Inc. (Mercantile Insurance), subsidiaries of our bank, after elimination of significant intercompany transactions and accounts.

We formed a business trust, Mercantile Bank Capital Trust I (the trust), in 2004 to issue trust preferred securities. We issued subordinated debentures to the trust in return for the proceeds raised from the issuance of the trust preferred securities. In accordance with FASB Interpretation No. 46, the trust is not consolidated, but instead we report the subordinated debentures issued to the trust as a liability.

Nature of Operations: Mercantile was incorporated on July 15, 1997 to establish and own the Bank based in Grand Rapids, Michigan. The Bank is a community-based financial institution. The Bank began operations on December 15, 1997. The Bank s primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial loans, commercial leases, residential mortgage loans, and instalment loans. Substantially all loans and leases are secured by specific items of collateral including business assets, real estate or consumer assets. Commercial loans and leases are expected to be repaid from cash flow from operations of businesses. Real estate loans are secured by commercial or residential real estate. The Bank s loan accounts are primarily with customers located in the Grand Rapids, Holland, Lansing and Ann Arbor metropolitan areas. The Bank s retail deposits are also from customers located within those areas. As an alternative source of funds, the Bank has also issued certificates to depositors outside of the Bank s primary market areas. Substantially all revenues are derived from banking products and services and investment securities.

Mercantile Bank Mortgage Company was formed during 2000. A subsidiary of the Bank, Mercantile Bank Mortgage Company was established to increase the profitability and efficiency of the mortgage loan operations. Mercantile Bank Mortgage Company initiated business on October 24, 2000 via the Bank s contribution of most of its residential mortgage loan portfolio and participation interests in certain commercial mortgage loans. On the same date, the Bank also transferred its residential mortgage origination function to Mercantile Bank Mortgage Company. On January 1, 2004, Mercantile Bank Mortgage Company was reorganized as Mercantile Bank Mortgage Company, LLC, a limited liability company, which is 99% owned by the Bank and 1% owned by Mercantile Insurance. Mortgage loans originated and held by the Mercantile Bank Mortgage Company are serviced by the Bank pursuant to a servicing agreement.

Mercantile Insurance was formed during 2002 through the acquisition of an existing shelf insurance agency. Insurance products are offered through an Agency and Institutions Agreement among Mercantile Insurance, the Bank and Hub International. The insurance products are marketed through a central facility operated by the Michigan Bankers Insurance Association, members of which include the insurance subsidiaries of various Michigan-based financial institutions and Hub International. Mercantile Insurance receives commissions based upon written premiums produced under the Agency and Institutions Agreement.

Mercantile Real Estate was organized on July 21, 2003, principally to develop, construct, and own a new facility in downtown Grand Rapids that serves as our bank s main office and Mercantile s headquarters. This facility was placed into service during the second quarter of 2005.

Mercantile filed an election to become a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act and implementing Federal Reserve Board regulations effective March 23, 2000.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan and lease losses and the fair values of financial instruments are particularly subject to change.

Cash Flow Reporting: Cash and cash equivalents include cash on hand, demand deposits with other financial institutions, short-term investments (including securities with daily put provisions) and federal funds sold. Cash flows are reported net for customer loan and deposit transactions, interest-bearing time deposits with other financial institutions and short-term borrowings with maturities of 90 days or less.

Securities: Debt securities classified as held to maturity are carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold prior to maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. Other securities such as Federal Home Loan Bank stock are carried at cost.

Interest income includes amortization of purchase premiums and discounts. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) our ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Loans and Leases: Loans and leases that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs and an allowance for loan and lease losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on commercial loans and leases and mortgage loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer and credit card loans are typically charged-off no later than 120 days past due. Past due status is based on the contractual terms of the loan or lease. In all cases, loans and leases are placed on nonaccrual or charged-off at an earlier date if collection of principal and interest is considered doubtful.

All interest accrued but not received for loans and leases placed on nonaccrual is reversed against interest income. Interest received on such loans and leases is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans and leases are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Such loans are sold service released. Residential mortgage banking fees include fees on direct brokered mortgage loans and the net gain on sale of mortgage loans originated for sale.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses: The allowance for loan and lease losses is a valuation allowance for probable incurred credit losses. Loan and lease losses are charged against the allowance when management believes the uncollectibility of a loan or lease balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan and lease loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, and economic conditions and other factors. Allocations of the allowance may be made for specific loans and leases, but the entire allowance is available for any loan or lease that, in management s judgment, should be charged-off.

A loan or lease is considered impaired when, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan or lease and the borrower, including the length of delay, the reasons for the delay, the borrower s prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial loans and leases and construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price or the fair value of collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. We do not separately identify individual residential and consumer loans for impairment disclosures.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 33 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 7 years. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized.

Long-term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Foreclosed Assets: Assets acquired through or instead of foreclosure are initially recorded at fair value when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key officers. Bank owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

Repurchase Agreements: Substantially all repurchase agreement liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Instruments and Loan Commitments: Financial instruments include off-balance-sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded. Instruments, such as standby letters of credit that are considered financial guarantees in accordance with FASB Interpretation No. 45, are recorded at fair value.

Stock Compensation: Statement of Financial Accounting Standards (SFAS) no. 123(R), *Share-based Payment,* using the modified prospective transition method, was adopted effective January 1, 2006. Accordingly, stock-based employee compensation cost was recorded starting in 2006 using the fair value method. For 2006, adopting this standard resulted in a reduction in net income before taxes and net income of $242,000 and a decrease in basic and diluted earnings per share of $0.03.

Prior to January 1, 2006, employee compensation expense under stock options was reported using the intrinsic value method; therefore, no stock-based compensation cost is reflected in net income for the years ending December 31, 2005 and 2004, as all options granted had an exercise price equal to or greater than the market price of the underlying common stock at date of grant.

The following table illustrates the effect on net income and earnings per share if expense was measured using the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, for the years ending December 31.

	2005	2004
Net income as reported	$ 17,901,000	$ 13,721,000
Deduct: Stock-based compensation expense determined under fair value based method	861,000	323,000
Pro forma net income	17,040,000	13,398,000
Basic earnings per share as reported	$ 2.25	$ 1.73
Pro forma basic earnings per share	2.14	1.69
Diluted earnings per share as reported	$ 2.20	$ 1.69
Pro forma diluted earnings per share	2.09	1.65

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed separately. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on- and off-balance sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Share: Basic earnings per share is based on weighted average common shares outstanding during the period. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under stock options. Earnings per share are restated for all stock dividends, including the 5% stock dividends paid on May 16, 2006, August 1, 2005 and May 3, 2004. The fair value of shares issued in stock dividends is transferred from retained earnings to common stock to the extent of available retained earnings.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. We do not believe there now are such matters that would have a material effect on the financial statements.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation.

Operating Segments: While we monitor the revenue streams of the various products and services offered, the identifiable segments are not material and operations are managed and financial performance is evaluated on a company-wide basis. Accordingly, all of our financial service operations are aggregated in one reportable operating segment.

Adoption of New Accounting Standards: In September 2006, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), which is effective for fiscal years ending on or after November 15, 2006. SAB 108 provides guidance on how the effects of prior-year uncorrected financial statement misstatements should be considered in quantifying a current year misstatement. SAB 108 requires public companies to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. Adjustments considered immaterial in prior years under the method previously used, but now considered material under the dual approach required by SAB 108, are to be recorded upon initial adoption of SAB 108. The amount so recorded, if any, is shown as a cumulative effect adjustment recorded in opening retained earnings as of January 1, 2006. The adoption of SAB 108 had no effect on the financial statements for the year ending December 31, 2006.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48)*, which prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We have determined that the adoption of FIN 48 will not have a material effect on the financial statements.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Effect of Newly Issued But Not Yet Effective Accounting Standards: New accounting standards have been issued that we do not expect will have a material effect on the financial statements when adopted in future years or for which we have not yet completed its evaluation of the potential effect upon adoption. In general, these standards revise accounting for derivatives embedded in other financial instruments for 2007, revise the recognition and accounting for servicing of financial assets for 2007, establish a hierarchy about the assumptions used to measure fair value for 2008, revise the accrual of post-retirement benefits associated with providing life insurance for 2008 and revise the accounting for cash surrender value for 2007.

NOTE 2 SECURITIES

The fair value of available for sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2006				
U.S. Government agency debt obligations	$ 77,544,000	$ 197,000	$ (905,000)	$ 76,836,000
Mortgage-backed securities	54,039,000	80,000	(1,036,000)	53,083,000
Mutual fund	1,080,000	0	(32,000)	1,048,000
	$ 132,663,000	$ 277,000	$ (1,973,000)	$ 130,967,000
2005				
U.S. Government agency debt obligations	$ 64,665,000	$ 15,000	$ (968,000)	$ 63,712,000
Mortgage-backed securities	49,426,000	39,000	(1,228,000)	48,237,000
Mutual fund	1,035,000	0	(23,000)	1,012,000
	$ 115,126,000	$ 54,000	$ (2,219,000)	$ 112,961,000

The carrying amount, unrecognized gains and losses, and fair value of securities held to maturity were as follows:

	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
2006				
Municipal general obligation bonds	$ 56,870,000	$ 1,098,000	$ (197,000)	$ 57,771,000
Municipal revenue bonds	7,073,000	198,000	(17,000)	7,254,000
	$ 63,943,000	$ 1,296,000	$ (214,000)	$ 65,025,000

2005				
Municipal general obligation bonds	$ 53,685,000	$ 1,859,000	$ (101,000)	$ 55,443,000
Municipal revenue bonds	7,081,000	339,000	(13,000)	7,407,000
	$ 60,766,000	$ 2,198,000	$ (114,000)	$ 62,850,000

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 2 SECURITIES (Continued)

Securities with unrealized losses at year-end 2006 and 2005, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows:

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2006						
U.S. Government agency debt obligations	$ 1,971,000	$ (9,000)	$ 53,939,000	$ (896,000)	$ 55,910,000	$ (905,000)
Mortgage-backed securities	1,831,000	(12,000)	40,784,000	(1,024,000)	42,615,000	(1,036,000)
Mutual fund	0	0	1,048,000	(32,000)	1,048,000	(32,000)
Municipal general obligation bonds	9,097,000	(90,000)	7,771,000	(107,000)	16,868,000	(197,000)
Municipal revenue bonds	620,000	(3,000)	718,000	(14,000)	1,338,000	(17,000)
	$ 13,519,000	$ (114,000)	$ 104,260,000	$ (2,073,000)	$ 117,779,000	$ (2,187,000)
2005						
U.S. Government agency debt obligations	$ 51,082,000	$ (705,000)	$ 5,735,000	$ (263,000)	$ 56,817,000	$ (968,000)
Mortgage-backed securities	32,794,000	(749,000)	13,284,000	(479,000)	46,078,000	(1,228,000)
Mutual fund	1,012,000	(23,000)	0	0	1,012,000	(23,000)
Municipal general obligation bonds	7,156,000	(65,000)	1,565,000	(36,000)	8,721,000	(101,000)
Municipal revenue bonds	0	0	723,000	(13,000)	723,000	(13,000)
	$ 92,044,000	$ (1,542,000)	$ 21,307,000	$ (791,000)	$ 113,351,000	$ (2,333,000)

We evaluate securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability we have to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer s financial condition, we may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer s financial condition.

At December 31, 2006, $117.7 million in debt securities and a mutual fund have unrealized losses with aggregate depreciation of 1.1% from the amortized cost basis of total securities. After we considered whether the securities were issued by the federal government or its agencies and whether downgrades by bond rating agencies had occurred, we determined that unrealized losses were due to an increasing interest rate environment. As we have the ability to hold debt securities until maturity, or for the foreseeable future if

classified as available for sale, no declines are deemed to be other than temporary.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 2 SECURITIES (Continued)

The amortized cost and fair values of debt securities at year-end 2006, by contractual maturity, are shown below. The contractual maturity is utilized below for U.S. Government agency debt obligations and municipal bonds. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage backed securities, are shown separately.

The maturities of securities and their weighted average yields at December 31, 2006 are shown in the following table. The yields for municipal securities are shown at their tax equivalent yield.

	Held-to-Maturity			Available-for-Sale		
	Weighted Average Yield	Carrying Amount	Fair Value	Weighted Average Yield	Amortized Cost	Fair Value
Due in one year or less	7.11%	$ 2,593,000	$ 2,606,000	NA	$ 0	$ 0
Due from one to five years	6.87	8,798,000	9,060,000	4.72%	17,864,000	17,647,000
Due from five to ten years	6.38	11,533,000	11,789,000	5.21	59,680,000	59,189,000
Due after ten years	6.39	41,019,000	41,570,000	NA	0	0
Mortgage-backed	NA	0	0	5.03	54,039,000	53,083,000
Mutual fund	NA	0	0	4.36	1,080,000	1,048,000
	6.48%	$ 63,943,000	$ 65,025,000	5.06%	$ 132,663,000	$ 130,967,000

During 2006 and 2005, there were no securities sold. During 2004, securities with an aggregate amortized cost basis of $1.7 million were sold, resulting in a gross realized gain of $78,000.

At year-end 2006 and 2005, the amortized cost of securities issued by the state of Michigan and all its political subdivisions totaled $63.9 million and $60.8 million, with an estimated market value of $65.0 million and $62.9 million, respectively. Total securities of any other specific issuer, other than the U.S. Government and its agencies, did not exceed 10% of shareholders equity.

The carrying value of securities that are pledged to repurchase agreements and other deposits was $92.2 million and $81.7 million at December 31, 2006 and 2005, respectively.

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NOTE 3 LOANS AND LEASES AND ALLOWANCE FOR LOAN AND LEASE LOSSES

Year-end loans and leases are as follows:

	December 31, 2006		December 31, 2005		Percent Increase/
	Balance	%	Balance	%	(Decrease)
Real Estate:					
Construction and land development	$ 293,656,000	16.8%	$ 226,544,000	14.5%	29.6%
Secured by 1 4 family properties	131,644,000	7.5	128,111,000	8.2	2.8
Secured by multi family properties	31,003,000	1.8	30,114,000	2.0	3.0
Secured by nonresidential properties	808,259,000	46.3	714,963,000	45.8	13.0
Commercial	471,272,000	27.0	454,911,000	29.1	3.6
Leases	1,388,000	0.1	1,786,000	0.1	(22.3)
Consumer	8,256,000	0.5	5,383,000	0.3	53.4
	$ 1,745,478,000	100.0%	$ 1,561,812,000	100.0%	11.8%

Activity in the allowance for loan and lease losses is as follows:

	2006	2005	2004
Beginning balance	$ 20,527,000	$ 17,819,000	$ 14,379,000
Provision for loan and lease losses	5,775,000	3,790,000	4,674,000
Charge-offs	(5,389,000)	(1,392,000)	(1,405,000)
Recoveries	498,000	310,000	171,000
Ending balance	$ 21,411,000	$ 20,527,000	$ 17,819,000

Impaired loans and leases were as follows:

	2006	2005
Year-end loans with no allocated allowance for loan and lease losses	$ 558,000	$ 1,390,000
Year-end loans with allocated allowance for loan and lease losses	3,999,000	965,000
	$ 4,557,000	$ 2,355,000
Amount of the allowance for loan and lease losses allocated	$ 1,149,000	$ 399,000
Average of impaired loans during the year	6,142,000	2,460,000

The Bank recognized no interest income on impaired loans during 2006, 2005 or 2004. Nonperforming loans includes both smaller balance homogenous loans that are collectively evaluated for impairment and individually classified impaired loans.

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3 LOANS AND LEASES AND ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

Nonperforming loans and leases were as follows:

	2006	2005
Loans and leases past due over 90 days still accruing interest	$ 819,000	$ 394,000
Nonaccrual loans and leases	7,752,000	3,601,000
	$ 8,571,000	$ 3,995,000

Concentrations within the loan portfolio were as follows at year-end:

	2006		2005	
	Balance	Percentage of Loan Portfolio	Balance	Percentage of Loan Portfolio
Commercial real estate loans to lessors of non-residential buildings	$471,222,000	27.0%	$417,470,000	26.7%

NOTE 4 PREMISES AND EQUIPMENT, NET

Year-end premises and equipment are as follows:

	2006	2005
Land and improvements	$ 8,021,000	$ 7,135,000
Buildings and leasehold improvements	23,036,000	18,450,000
Furniture and equipment	10,773,000	10,351,000
	41,830,000	35,936,000
Less: accumulated depreciation	8,291,000	5,730,000
	$ 33,539,000	$ 30,206,000

Depreciation expense in 2006, 2005 and 2004 totaled $2,578,000, $2,043,000 and $1,248,000, respectively.

We entered into lease arrangements for our banking facilities in East Lansing and Ann Arbor, Michigan during 2005. Rent expense for these two facilities totaled $276,000 and $144,000 during 2006 and 2005, respectively. Minimum rent commitments under the operating leases were as follows, before considering renewal options that generally are present:

2007	$ 207,000
2008	160,000
2009	164,000
2010	83,000
Total	$ 614,000

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NOTE 5 DEPOSITS

Deposits at year-end are summarized as follows:

	December 31, 2006		December 31, 2005		Percent Increase/
	Balance	%	Balance	%	(Decrease)
Noninterest-bearing demand	$ 133,197,000	8.1%	$ 120,828,000	8.5%	10.2%
Interest-bearing checking	39,943,000	2.4	39,792,000	2.8	0.4
Money market	9,409,000	0.6	10,344,000	0.7	(9.0)
Savings	92,370,000	5.6	106,247,000	7.5	(13.1)
Time, under $100,000	47,840,000	2.9	23,906,000	1.7	100.1
Time, $100,000 and over	310,326,000	18.8	155,401,000	11.0	99.7
	633,085,000	38.4	456,518,000	32.2	38.7
Out-of-area time, under $100,000	82,330,000	5.0	80,048,000	5.6	2.9
Out-of-area time, $100,000 and over	931,488,000	56.6	882,786,000	62.2	5.5
	1,013,818,000	61.6	962,834,000	67.8	5.3
	$ 1,646,903,000	100.0%	$ 1,419,352,000	100.0%	16.0%

Out-of-area certificates of deposit consist of certificates obtained from depositors outside of the primary market area. As of December 31, 2006, out-of-area certificates of deposit totaling $987.0 million were obtained through deposit brokers, with the remaining $26.8 million obtained directly from the depositors. The following table depicts the maturity distribution for certificates of deposit at year-end.

	2006	2005
In one year or less	$ 1,027,309,000	$ 787,954,000
In one to two years	258,692,000	243,652,000
In two to three years	54,988,000	68,467,000
In three to four years	11,111,000	33,649,000
In four to five years	19,884,000	8,419,000
	$ 1,371,984,000	$ 1,142,141,000

The following table depicts the maturity distribution for certificates of deposit with balances of $100,000 or more at year-end.

	2006	2005
Up to three months	$ 351,745,000	$ 255,351,000
Three months to six months	246,357,000	186,830,000

Six months to twelve months	341,461,000	278,189,000
Over twelve months	302,251,000	317,817,000
	$ 1,241,814,000	$ 1,038,187,000

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MERCANTILE BANK CORPORATION
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NOTE 6 SHORT-TERM BORROWINGS

Information regarding securities sold under agreements to repurchase at year-end is summarized below:

	2006	2005
Outstanding balance at year-end	$85,472,000	$72,201,000
Weighted average interest rate at year-end	3.88%	3.31%
Average daily balance during the year	72,228,000	60,743,000
Weighted average interest rate during the year	3.71%	2.63%
Maximum month end balance during the year	85,472,000	74,639,000

Securities sold under agreements to repurchase (repurchase agreements) generally have original maturities of less than one year. Repurchase agreements are treated as financings and the obligations to repurchase securities sold are reflected as liabilities. Securities involved with the repurchase agreements are recorded as assets of the Bank and are primarily held in safekeeping by correspondent banks. Repurchase agreements are offered principally to certain large deposit customers as uninsured deposit equivalent investments. Repurchase agreements were secured by securities with a market value of $91.2 million and $80.7 million at year-end 2006 and 2005, respectively.

NOTE 7 FEDERAL HOME LOAN BANK ADVANCES

At year-end, advances from the Federal Home Loan Bank were as follows.

	2006	2005
Maturities January 2007 through May 2008, fixed rates from 3.70% to 5.69%, averaging 4.90%	$ 95,000,000	$ 0
Maturities January 2006 through May 2008, fixed rates from 2.13% to 4.92%, averaging 3.68%	0	120,000,000
Maturities in May 2006, floating rates tied to Libor indices, averaging 4.42%	0	10,000,000
	$ 95,000,000	$ 130,000,000

Each advance is payable at its maturity date, and is subject to a prepayment fee if paid prior to the maturity date. The advances are collateralized by residential mortgage loans, first mortgage liens on multi-family residential property loans, first mortgage liens on commercial real estate property loans, and substantially all other assets of the Bank, under a blanket lien arrangement. Our borrowing line of credit as of December 31, 2006 totaled $322.6 million.

Maturities over the next five years are:

2007	$80,000,000
2008	15,000,000
2009	0
2010	0
2011	0

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NOTE 8 FEDERAL INCOME TAXES

The consolidated provision for income taxes is as follows:

	2006	2005	2004
Current	$ 9,438,000	$ 9,124,000	$ 5,981,000
Deferred benefit	(474,000)	(979,000)	(845,000)
Tax expense	$ 8,964,000	$ 8,145,000	$ 5,136,000

Income tax expense was less than the amount computed by applying the statutory federal income tax rate to income before income taxes. The reasons for the difference are as follows:

	2006	2005	2004
Statutory rates	$ 10,084,000	$ 9,116,000	$ 6,600,000
Increase (decrease) from			
Tax-exempt interest	(795,000)	(792,000)	(708,000)
Life insurance	(408,000)	(349,000)	(257,000)
Rehabilitation tax credits	0	0	(429,000)
Other	83,000	170,000	(70,000)
Tax expense	$ 8,964,000	$ 8,145,000	$ 5,136,000

The net deferred tax asset recorded includes the following amounts of deferred tax assets and liabilities:

	2006	2005
Deferred tax assets		
Allowance for loan and lease losses	$ 7,494,000	$ 7,184,000
Unrealized loss on securities available for sale	594,000	758,000
Deferred loan fees	231,000	307,000
Deferred compensation	1,181,000	821,000
Other	234,000	239,000
	9,734,000	9,309,000
Deferred tax liabilities		
Depreciation	1,052,000	947,000
Other	525,000	515,000
	1,577,000	1,462,000
Net deferred tax asset	$ 8,157,000	$ 7,847,000

A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefits related to such assets will not be realized. Management has determined that no valuation allowance was required at year-end 2006 or 2005.

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NOTE 9 STOCK-BASED COMPENSATION

Stock-based compensation plans are used to provide directors and employees with an increased incentive to contribute to the long-term performance and growth of Mercantile, to join the interests of directors and employees with the interests of Mercantile s shareholders through the opportunity for increased stock ownership and to attract and retain directors and employees. From 1997 through 2005, stock option grants were provided to directors and certain employees through several stock option plans, including the 1997 Employee Stock Option Plan, 2000 Employee Stock Option Plan, 2004 Employee Stock Option Plan and Independent Director Stock Option Plan. During 2006, stock option and restricted stock grants were provided to certain employees through the Stock Incentive Plan of 2006.

Under our 1997 Employee Stock Option Plan, 2000 Employee Stock Option Plan and 2004 Employee Stock Option Plan, stock options granted to employees were granted at the market price on the date of grant, generally fully vest after one year and expire ten years from the date of grant. Stock options granted to non-executive officers during 2005 vested about three weeks after being granted. Under our Independent Director Stock Option Plan, stock options granted to non-employee directors are at 125% of the market price on the date of grant, fully vest after five years and expire ten years from the date of grant. The Stock Incentive Plan of 2006, approved by our shareholders at the annual meeting on April 27, 2006, replaced all of our outstanding stock option plans for stock options not previously granted. Under the Stock Incentive Plan of 2006, incentive awards may include, but are not limited to, stock options, restricted stock, stock appreciation rights and stock awards. Incentive awards that are stock options or stock appreciation rights are granted with an exercise price not less than the closing price of Mercantile stock on the day before the date of grant, with price, vesting and expiration date parameters determined by Mercantile s Compensation Committee on a grant-by-grant basis. Generally, the stock options granted to employees during 2006 fully vest after two years and expire after seven years. The restricted stock awards granted to certain employees during 2006, totaling 20,190 shares and having a fair value per share of $39.84, fully vest after four years. No payments were required from employees for the restricted stock awards. At year-end 2006, there were 550,884 shares authorized for future incentive awards.

As of December 31, 2006, there was $300,000 of total unrecognized compensation cost related to unvested stock options granted under our various stock-based compensation plans. The compensation cost is expected to be recognized over a weighted-average period of 1.5 years. As of December 31, 2006, there was $690,000 of total unrecognized compensation cost related to unvested restricted stock granted under our Stock Incentive Plan of 2006. The compensation cost is expected to be recognized over a period of 3.9 years.

A summary of stock option activity is as follows.

	2006		2005		2004	
	Shares	Weighted Average Price	Shares	Weighted Average Price	Shares	Weighted Average Price
Outstanding at beginning of year	314,830	$ 21.81	310,495	$ 17.77	321,203	$ 13.56
Granted	24,640	39.84	47,540	37.68	46,303	36.43
Exercised	(61,897)	13.14	(41,885)	9.45	(57,011)	9.19
Forfeited or expired	(2,204)	33.55	(1,320)	35.36	0	0.00
Outstanding at end of year	275,369	$ 25.28	314,830	$ 21.81	310,495	$ 17.77

Options exercisable at year-end	223,505	$	22.63	269,700	$	20.17	241,658	$	13.62

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NOTE 9 STOCK-BASED COMPENSATION (Continued)

The fair value of each stock option award is estimated on the date of grant using a closed option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities on our common stock. Historical data is used to estimate stock option expense and post-vesting termination behavior. The expected term of stock options granted is based on historical data and represents the period of time that stock options granted are expected to be outstanding, which takes into account that the stock options are not transferable. The risk-free interest rate for the expected term of the stock option is based on the U.S. Treasury yield curve in effect at the time of the stock option grant.

The fair value of stock options granted was determined using the following weighted-average assumptions as of grant date.

	2006	2005	2004
Risk-free interest rate	4.60%	4.12%	3.45%
Expected option life	5 Years	7 Years	7 Years
Expected stock price volatility	26%	26%	22%
Dividend yield	1%	1%	1%

Options outstanding at year-end 2006 were as follows:

		Outstanding		Exercisable	
Range of Exercise Prices	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
$4.00 - $8.00	8,952	0.6 Years	$ 7.46	8,952	$ 7.46
$8.01 - $12.00	42,208	3.0 Years	9.20	42,208	9.20
$12.01 - $16.00	29,306	4.8 Years	13.07	29,306	13.07
$16.01 - $20.00	37,907	5.6 Years	16.84	37,907	16.84
$20.01 - $24.00	7,272	5.8 Years	21.19	0	NA
$24.01 - $28.00	30,592	6.8 Years	27.94	30,592	27.94
$32.01 - $36.00	41,783	7.7 Years	35.29	34,847	35.36
$36.01 - $40.00	70,186	8.2 Years	38.44	39,693	37.68
$40.01 - $44.00	7,163	7.8 Years	42.29	0	NA
Outstanding at year end	275,369	6.1 Years	$ 25.28	223,505	$ 22.63

The weighted-average remaining contractual life of the 223,505 stock options exercisable as of December 31, 2006 was 5.8 years.

Options outstanding at year-end 2006, 2005 and 2004 were as follows:

	2006	2005	2004
Minimum exercise price	$ 7.46	$ 7.46	$ 7.46
Maximum exercise price	42.29	42.29	42.29
Average remaining option term	6.1 Years	6.5 Years	6.5 Years

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NOTE 9 STOCK-BASED COMPENSATION (Continued)

Information related to stock option grants and exercises during 2006, 2005 and 2004 follows:

	2006	2005	2004
Intrinsic value of stock options exercised	$1,616,000	$1,243,000	$1,310,000
Cash received from stock option exercises	229,000	80,000	137,000
Tax benefit realized from stock option exercises	0	0	0
Weighted average fair value of stock options granted	11.44	13.51	9.82

The aggregate intrinsic value of all stock options outstanding at December 31, 2006 was $3,507,000. The aggregate intrinsic value of all stock options exercisable at December 31, 2006 was $3,367,000. Shares issued as a result of the exercise of stock option grants are new shares as provided for under our stock-based compensation plans.

NOTE 10 RELATED PARTIES

Certain directors and executive officers of the Bank, including their immediate families and companies in which they are principal owners, were loan customers of the Bank. At year-end 2006 and 2005, the Bank had $18.3 million and $14.0 million in loan commitments to directors and executive officers, of which $8.8 million and $8.9 million were outstanding at year-end 2006 and 2005, respectively, as reflected in the following table.

	2006	2005
Beginning balance	$ 8,865,000	$ 10,210,000
New loans	2,356,000	761,000
Repayments	(2,424,000)	(2,106,000)
Ending balance	$ 8,797,000	$ 8,865,000

Related party deposits and repurchase agreements totaled $15.7 million and $13.3 million at year-end 2006 and 2005, respectively.

NOTE 11 COMMITMENTS AND OFF-BALANCE-SHEET RISK

We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. Loan 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. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. 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.

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NOTE 11 COMMITMENTS AND OFF-BALANCE-SHEET RISK (Continued)

These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized, if any, in the balance sheet. Our maximum exposure to loan 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 notional amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments. Collateral, such as accounts receivable, securities, inventory, property and equipment, is generally obtained based on management s credit assessment of the borrower. If required, estimated loss exposure resulting from these instruments is expensed and recorded as a liability. The balance of the liability account related to loan commitments was $0.5 million at year-end 2006 and 2005.

At year-end 2006 and 2005, the rates on existing off-balance sheet instruments were substantially equivalent to current market rates, considering the underlying credit standing of the counterparties.

Our maximum exposure to credit losses for loan commitments and standby letters of credit outstanding at year-end was as follows:

	2006	2005
Commercial unused lines of credit	$ 345,195,000	$ 303,115,000
Unused lines of credit secured by 1 4 family residential properties	29,314,000	27,830,000
Credit card unused lines of credit	8,510,000	7,971,000
Other consumer unused lines of credit	7,197,000	10,791,000
Commitments to make loans	60,850,000	83,280,000
Standby letters of credit	73,241,000	59,058,000
	$ 524,307,000	$ 492,045,000

Commitments to make loans generally reflect our binding obligations to existing and prospective customers to extend credit, including line of credit facilities secured by accounts receivable and inventory, and term debt secured by either real estate or equipment. In most instances, line of credit facilities are for a one year term and are at a floating rate tied to the prime rate. For term debt secured by real estate, customers are generally offered a floating rate tied to the prime rate and a fixed rate currently ranging from 7.25% to 8.25%. These credit facilities generally balloon within five years, with payments based on amortizations ranging from 10 to 25 years. For term debt secured by non-real estate collateral, customers are generally offered a floating rate tied to the prime rate and a fixed rate currently ranging from 7.25% to 8.25%. These credit facilities generally mature and fully amortize within five years.

The following instruments are considered financial guarantees under FASB Interpretation 45. These instruments are carried at fair value.

	2006		2005	
	Contract Amount	Carrying Value	Contract Amount	Carrying Value
Standby letters of credit	$73,241,000	$279,000	$59,058,000	$205,000

We were required to have $8.9 million and $8.6 million of cash on hand or on deposit with the Federal Reserve Bank of Chicago to meet regulatory reserve and clearing requirements at year-end 2006 and 2005, respectively. These balances do not earn interest.

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NOTE 12 BENEFIT PLANS

We have a 401(k) benefit plan that covers substantially all of our employees. Our 2006, 2005 and 2004 matching 401(k) contribution charged to expense was $674,000, $554,000 and $413,000, respectively. The percent of our matching contributions to the 401(k) is determined annually by the Board of Directors. The 401(k) benefit plan allows employee contributions up to 15% of their compensation, which are matched at 100% of the first 5% of the compensation contributed. Matching contributions are immediately vested.

We have a deferred compensation plan in which all persons serving on the Board of Directors may defer all or portions of their annual retainer and meeting fees, with distributions to be paid only upon termination of service as a director. The deferred amounts are categorized on our financial statements as other borrowed money. The deferred balances are paid interest at a rate equal to the prime rate, adjusted at the beginning of each calendar quarter. Interest expense for the plan during 2006, 2005 and 2004 was $81,000, $43,000 and $21,000, respectively.

We have a non-qualified deferred compensation program in which selected officers may defer all or portions of salary and bonus payments. The deferred amounts are categorized on our financial statements as other borrowed money. The deferred balances are paid interest at a rate equal to the prime rate, adjusted at the beginning of each calendar quarter. Interest expense for the plan during 2006, 2005 and 2004 was $148,000, $79,000 and $38,000, respectively.

The Mercantile Bank Corporation Employee Stock Purchase Plan of 2002 (Stock Purchase Plan) is a non-compensatory plan intended to encourage full- and part-time employees of Mercantile and its subsidiaries to promote our best interests and to align employees interests with the interests of our shareholders by permitting employees to purchase shares of our common stock through regular payroll deductions. Shares are purchased on the last business day of each calendar quarter at a price equal to the average, rounded to the nearest whole cent, of the highest and lowest sales prices of our common stock reported on The Nasdaq Stock Market. Originally, 25,000 shares of common stock may be issued under the Stock Purchase Plan; however, the number of shares has been and may continue to be adjusted in the future to reflect stock dividends and other changes in our capitalization. The numbers of shares issued under the Stock Purchase Plan totaled 2,774 and 2,491 in 2006 and 2005, respectively. As of December 31, 2006, there were 20,820 shares available under the Stock Purchase Plan.

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NOTE 13 FAIR VALUES OF FINANCIAL INSTRUMENTS

Carrying amount and estimated fair values of financial instruments were as follows at year-end.

	2006		2005	
	Carrying Values	Fair Values	Carrying Values	Fair Values
Financial assets				
Cash and cash equivalents	$ 51,380,000	$ 51,380,000	$ 36,753,000	$ 36,753,000
Securities available for sale	130,967,000	130,967,000	112,961,000	112,961,000
Securities held to maturity	63,943,000	65,025,000	60,766,000	62,850,000
Federal Home Loan Bank stock	7,509,000	7,509,000	7,887,000	7,887,000
Loans, net	1,724,067,000	1,707,039,000	1,541,285,000	1,540,183,000
Bank owned life insurance policies	30,858,000	30,858,000	28,071,000	28,071,000
Accrued interest receivable	10,287,000	10,287,000	8,274,000	8,274,000
Financial liabilities				
Deposits	1,646,903,000	1,654,798,000	1,419,352,000	1,425,606,000
Securities sold under agreements to repurchase	85,472,000	85,472,000	72,201,000	72,201,000
Federal funds purchased	9,800,000	9,800,000	9,600,000	9,600,000
Federal Home Loan Bank advances	95,000,000	94,801,000	130,000,000	129,942,000
Accrued interest payable	20,213,000	20,213,000	12,465,000	12,465,000
Subordinated debentures	32,990,000	32,984,000	32,990,000	32,990,000

Carrying amount is the estimated fair value for cash and cash equivalents, Federal Home Loan Bank stock, accrued interest receivable and payable, bank owned life insurance policies, demand deposits, securities sold under agreements to repurchase, and variable rate loans or deposits that reprice frequently and fully. Security fair values are based on market prices or dealer quotes, and if no such information is available, on the rate and term of the security and information about the issuer. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of subordinated debentures and Federal Home Loan Bank advances is based on current rates for similar financing. Fair value of off balance sheet items is estimated to be nominal.

(Continued)

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 14 EARNINGS PER SHARE

The factors used in the earnings per share computation follow.

	2006	2005	2004
Basic			
Net income	$ 19,847,000	$ 17,901,000	$ 13,721,000
Weighted average common shares outstanding	8,003,013	7,959,338	7,909,687
Basic earnings per common share	$ 2.48	$ 2.25	$ 1.73
Diluted			
Net income	$ 19,847,000	$ 17,901,000	$ 13,721,000
Weighted average common shares outstanding for basic earnings per common share	8,003,013	7,959,338	7,909,687
Add: Dilutive effects of assumed exercises of stock options	109,342	177,826	198,110
Average shares and dilutive potential common shares	8,112,355	8,137,163	8,107,797
Diluted earnings per common share	$ 2.45	$ 2.20	$ 1.69

Stock options for 10,268, 7,166 and 50,767 shares of common stock were not considered in computing diluted earnings per common share for 2006, 2005 and 2004, respectively, because they were antidilutive.

NOTE 15 SUBORDINATED DEBENTURES

Mercantile Trust, a business trust formed by the company, was incorporated in 2004 for the purpose of issuing Series A and Series B Preferred Securities. On September 16, 2004, Mercantile Trust sold the Series A Preferred Securities in a private sale for $16.0 million, and also sold $495,000 of Series A Common Securities to Mercantile. The proceeds of the Series A Preferred Securities and the Series A Common Securities were used by Mercantile Trust to purchase $16,495,000 of Series A Floating Rate Notes that were issued by Mercantile on September 16, 2004. Mercantile used the proceeds of the Series A Floating Rate Notes to finance the redemption on September 17, 2004 of the $16.0 million of 9.60% Cumulative Preferred Securities issued in 1999 by MBWM Capital Trust I. On December 10, 2004, Mercantile Trust sold the Series B Preferred Securities in a private sale for $16.0 million, and also sold $495,000 of Series B Common Securities to Mercantile. The proceeds of the Series B Preferred Securities and the Series B Common Securities were used by Mercantile Trust to purchase $16,495,000 of Series B Floating Rate Notes that were issued by Mercantile on December 10, 2004. Substantially all of the net proceeds of the Series B Floating Rate Notes were contributed to our bank as capital to provide support for asset growth, fund investments in loans and

securities and for general corporate purposes.
The only significant assets of Mercantile Trust are the Series A and Series B Floating Rate Notes, and the only significant liabilities of Mercantile Trust are the Series A and Series B Preferred Securities. The Series A and Series B Floating Rate Notes are categorized on our consolidated balance sheet as subordinated debentures and the interest expense is recorded on our consolidated statement of income under interest expense on long-term borrowings.

(Continued)

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 16 REGULATORY MATTERS

Mercantile and the Bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors, and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements.

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If an institution is adequately capitalized, regulatory approval is required to accept brokered deposits. Subject to limited exceptions, no institution may make a capital distribution if, after making the distribution, it would be undercapitalized. If an institution is undercapitalized, it is subject to being closely monitored by its principal federal regulator, its asset growth and expansion are restricted, and plans for capital restoration are required. In addition, further specific types of restrictions may be imposed on the institution in the discretion of the federal regulator. At year-end 2006 and 2005, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that we believe has changed the Bank s category.

At year end, actual capital levels (in thousands) and minimum required levels for Mercantile and the Bank were:

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2006						
Total capital (to risk weighted assets)						
Consolidated	$226,428	11.5%	$158,196	8.0%	$ NA	NA
Bank	222,812	11.3	158,019	8.0	197,524	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	205,017	10.4	79,098	4.0	NA	NA
Bank	201,401	10.2	79,010	4.0	118,514	6.0
Tier 1 capital (to average assets)						
Consolidated	205,017	10.0	81,682	4.0	NA	NA
Bank	201,401	9.9	81,623	4.0	102,029	5.0

(Continued)

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 16 REGULATORY MATTERS (Continued)

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2005						
Total capital (to risk weighted assets)						
Consolidated	$209,060	12.0%	$139,337	8.0%	$ NA	NA
Bank	205,642	11.8	139,158	8.0	173,947	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	188,533	10.8	69,669	4.0	NA	NA
Bank	185,115	10.6	69,579	4.0	104,368	6.0
Tier 1 capital (to average assets)						
Consolidated	188,533	10.5	72,163	4.0	NA	NA
Bank	185,115	10.3	72,100	4.0	90,124	5.0

Federal and state banking laws and regulations place certain restrictions on the amount of dividends the Bank can transfer to Mercantile and on the capital levels that must be maintained. At year-end 2006, under the most restrictive of these regulations (to remain well capitalized), the Bank could distribute approximately $22.5 million to Mercantile as dividends without prior regulatory approval.

The capital levels as of year-end 2006 and 2005 include $32.0 million of trust preferred securities issued by Mercantile Trust in September 2004 and December 2004 subject to certain limitations. Federal Reserve guidelines limit the amount of trust preferred securities which can be included in Tier 1 capital of Mercantile to 25% of total Tier 1 capital. At year-end 2006 and 2005, all $32.0 million of the trust preferred securities were included as Tier 1 capital of Mercantile.

NOTE 17 OTHER COMPREHENSIVE INCOME/(LOSS)

Other comprehensive income/(loss) components and related taxes were as follows.

	2006	2005	2004
Unrealized holding gains and losses on available-for-sale securities	$ 470,000	$ (2,368,000)	$ (208,000)
Reclassification adjustments for gains and losses later recognized in income	0	0	(78,000)
Net unrealized gains and losses	470,000	(2,368,000)	(130,000)
Tax effect of unrealized holding gains and losses on available-for-sale securities	(164,000)	828,000	70,000
Tax effect of reclassification adjustments for gains and losses later recognized in income	0	0	(28,000)

Other comprehensive income/(loss)	$ 306,000	$ (1,540,000)	$ (88,000)

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 18 QUARTERLY FINANCIAL DATA (UNAUDITED)

	Interest Income	Net Interest Income	Net Income	Earnings per Share Basic	Earnings per Share Fully Diluted
2006					
First quarter	$31,099,000	$15,099,000	$4,929,000	$0.62	$0.61
Second quarter	33,746,000	15,646,000	5,111,000	0.64	0.63
Third quarter	35,675,000	15,547,000	5,202,000	0.65	0.64
Fourth quarter	36,740,000	15,295,000	4,605,000	0.57	0.57
2005					
First quarter	$21,705,000	$12,655,000	$4,362,000	$0.58	$0.56
Second quarter	24,346,000	13,608,000	4,690,000	0.62	0.61
Third quarter	26,764,000	14,072,000	4,300,000	0.57	0.56
Fourth quarter	29,315,000	14,957,000	4,549,000	0.60	0.59
2004					
First quarter	$15,354,000	$ 9,489,000	$2,973,000	$0.40	$0.39
Second quarter	16,130,000	10,000,000	3,146,000	0.42	0.41
Third quarter	17,819,000	10,856,000	3,114,000	0.41	0.40
Fourth quarter	19,719,000	12,082,000	4,488,000	0.59	0.58

NOTE 19 MERCANTILE BANK CORPORATION (PARENT COMPANY ONLY) CONDENSED FINANCIAL STATEMENTS

Following are condensed parent company only financial statements.

CONDENSED BALANCE SHEETS

	2006	2005
ASSETS		
Cash and cash equivalents	$ 2,323,000	$ 2,045,000
Investment in bank subsidiary	200,300,000	183,707,000
Other assets	2,890,000	2,898,000
Total assets	$ 205,513,000	$ 188,650,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities	$ 608,000	$ 535,000
Subordinated debentures	32,990,000	32,990,000
Shareholders equity	171,915,000	155,125,000
Total liabilities and shareholders equity	$ 205,513,000	$ 188,650,000

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 19 MERCANTILE BANK CORPORATION (PARENT COMPANY ONLY) CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENTS OF INCOME

	2006	2005	2004
Income			
Dividends from subsidiaries	$ 6,440,000	$ 4,832,000	$ 4,032,000
Other	73,000	46,000	25,000
Total income	6,513,000	4,878,000	4,057,000
Expenses			
Interest expense	2,429,000	1,837,000	1,402,000
Other operating expenses	1,917,000	942,000	1,666,000
Total expenses	4,346,000	2,779,000	3,068,000
Income before income tax benefit and equity in undistributed net income of subsidiary	2,167,000	2,099,000	989,000
Federal income tax benefit	(1,392,000)	(936,000)	(1,051,000)
Equity in undistributed net income of subsidiary	16,288,000	14,866,000	11,681,000
Net income	$ 19,847,000	$ 17,901,000	$ 13,721,000

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MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 19 MERCANTILE BANK CORPORATION (PARENT COMPANY ONLY) CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENT OF CASH FLOWS

	2006	2005	2004
Cash flows from operating activities			
Net income	$ 19,847,000	$ 17,901,000	$ 13,721,000
Adjustments to reconcile net income to net cash from operating activities			
Equity in undistributed income of subsidiary	(16,288,000)	(14,866,000)	(11,681,000)
Equity compensation expense	242,000	0	0
Change in other assets	9,000	(98,000)	553,000
Change in other liabilities	73,000	317,000	(140,000)
Net cash from operating activities	3,883,000	3,254,000	2,453,000
Cash flows from investing activities			
Net capital investment into subsidiaries	0	0	(16,495,000)
Net cash from investing activities	0	0	(16,495,000)
Cash flows from financing activities			
Proceeds from the issuance of subordinated debentures	0	0	32,990,000
Pay-off of subordinated debentures	0	0	(16,495,000)
Stock option exercises, net	229,000	80,000	137,000
Employee stock purchase plan	107,000	97,000	79,000
Dividend reinvestment plan	98,000	159,000	123,000
Cash dividends	(4,035,000)	(3,185,000)	(2,552,000)
Fractional shares paid	(4,000)	(4,000)	(4,000)
Net cash from financing activities	(3,605,000)	(2,853,000)	14,278,000
Net change in cash and cash equivalents	278,000	401,000	236,000
Cash and cash equivalents at beginning of period	2,045,000	1,644,000	1,408,000
Cash and cash equivalents at end of period	$ 2,323,000	$ 2,045,000	$ 1,644,000

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on February 22, 2007.

MERCANTILE BANK CORPORATION

/s/ Gerald R. Johnson, Jr.
Gerald R. Johnson, Jr.
Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 22, 2007.

/s/ Betty S. Burton	/s/ Susan K. Jones
Betty S. Burton, Director	Susan K. Jones, Director
/s/ David M. Cassard	/s/ Lawrence W. Larsen
David M. Cassard, Director	Lawrence W. Larsen, Director
/s/ Edward J. Clark	/s/ Calvin D. Murdock
Edward J. Clark, Director	Calvin D. Murdock, Director
/s/ Peter A. Cordes	/s/ Michael H. Price
Peter A. Cordes, Director	Michael H. Price, Director, President and Chief Operating Officer
/s/ C. John Gill	/s/ Merle J. Prins
C. John Gill, Director	Merle J. Prins, Director
/s/ Doyle A. Hayes	/s/ Dale J. Visser
Doyle A. Hayes, Director	Dale J. Visser, Director
/s/ David M. Hecht	/s/ Donald Williams, Sr.
David M. Hecht, Director	Donald Williams, Sr., Director
/s/ Gerald R. Johnson, Jr.	/s/ Charles E. Christmas
Gerald R. Johnson, Jr., Chairman of the Board and	Charles E. Christmas, Senior Vice President, Chief Financial Officer and Treasurer (principal

Chief Executive Officer (principal executive officer)	financial and accounting officer)

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EXHIBIT INDEX

EXHIBIT NO.	EXHIBIT DESCRIPTION
3.1	Our Articles of Incorporation are incorporated by reference to exhibit 3.1 of our Form 10-Q for the quarter ended June 30, 2004
3.2	Our Amended and Restated Bylaws dated as of January 16, 2003 are incorporated by reference to exhibit 3.2 of our Registration Statement on Form S-3 (Commission File No. 333-103376) that became effective on February 21, 2003
10.1	Our 1997 Employee Stock Option Plan is incorporated by reference to exhibit 10.1 of our Registration Statement on Form SB-2 (Commission File No. 333-33081) that became effective on October 23, 1997 *
10.2	Our 2000 Employee Stock Option Plan is incorporated by reference to exhibit 10.14 of our Form 10-K for the year ended December 31, 2000 *
10.3	Our 2004 Employee Stock Option Plan is incorporated by reference to exhibit 10.1 of our Form 10-Q for the quarter ended September 30, 2004 *
10.4	Form of Stock Option Agreement for options under the 2004 Employee Stock Option Plan is incorporated by reference to exhibit 10.2 of our Form 10-Q for the quarter ended September 30, 2004 *
10.5	Our Independent Director Stock Option Plan is incorporated by reference to exhibit 10.26 of our Form 10-K for the year ended December 31, 2002 *
10.6	Form of Stock Option Agreement for options under the Independent Director Stock Option Plan is incorporated by reference to exhibit 10.1 of our Form 8-K dated October 21, 2004 *
10.7	Nonlender Bonus Plan is incorporated by reference to exhibit 10.3 of our Form 10-Q for the quarter ended September 30, 2004 *
10.8	Mercantile Bank of West Michigan Deferred Compensation Plan for Members of the Board of Directors (1999) is incorporated by reference to Exhibit 10.6 of the Registration Statement of the company and our trust on Form SB-2 (Commission File Nos. 333-84313 and 333-84313-01) that became effective on September 13, 1999 *
10.9	Agreement between Fiserv Solutions, Inc. and our bank dated September 10, 1997, is incorporated by reference to exhibit 10.3 of our Registration Statement on Form SB-2 (Commission File No. 333-33081) that became effective on October 23, 1997
10.10	Extension Agreement of Data Processing Contract between Fiserv Solutions, Inc. and our bank dated May 12, 2000 extending the agreement between Fiserv Solutions, Inc. and our bank dated September 10, 1997, is incorporated by reference to exhibit 10.15 of our Form 10-K for the year ended December 31, 2000
10.11	

Extension Agreement of Data Processing Contract between Fiserv Solutions, Inc. and our bank dated November 22, 2002 extending the agreement between Fiserv Solutions, Inc. and our bank dated September 10, 1997, is incorporated by reference to exhibit 10.5 of our Form 10-K for the year ended December 31, 2002

EXHIBIT NO.	EXHIBIT DESCRIPTION
10.12	Amended and Restated Employment Agreement dated as of October 18, 2001, among the company, our bank and Gerald R. Johnson, Jr., is incorporated by reference to exhibit 10.21 of our Form 10-K for the year ended December 31, 2001 *
10.13	Amended and Restated Employment Agreement dated as of October 18, 2001, among the company, our bank and Michael H. Price, is incorporated by reference to exhibit 10.22 of our Form 10-K for the year ended December 31, 2001 *
10.14	Employment Agreement dated as of October 18, 2001, among the company, our bank and Robert B. Kaminski, Jr., is incorporated by reference to exhibit 10.23 of our Form 10-K for the year ended December 31, 2001 *
10.15	Employment Agreement dated as of October 18, 2001, among the company, our bank and Charles E. Christmas, is incorporated by reference to exhibit 10.23 of our Form 10-K for the year ended December 31, 2001 *
10.16	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Gerald R. Johnson, Jr., is incorporated by reference to exhibit 10.21 of our Form 10-K for the year ended December 31, 2002 *
10.17	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Michael H. Price, is incorporated by reference to exhibit 10.22 of our Form 10-K for the year ended December 31, 2002 *
10.18	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Robert B. Kaminski, Jr., is incorporated by reference to exhibit 10.23 of our Form 10-K for the year ended December 31, 2002 *
10.19	Amendment to Employment Agreement dated as of October 17, 2002, among the company, our bank and Charles E. Christmas, is incorporated by reference to exhibit 10.24 of our Form 10-K for the year ended December 31, 2002 *
10.20	Amendment to Employment Agreement dated as of October 28, 2004, among the company, our bank and Robert B. Kaminski, Jr., is incorporated by reference to exhibit 10.21 of our Form 10-K for the year ended December 31, 2004 *
10.21	Junior Subordinated Indenture between us and Wilmington Trust Company dated September 16, 2004 providing for the issuance of the Series A and Series B Floating Rate Junior Subordinated Notes due 2034 is incorporated by reference to exhibit 10.1 of our Form 8-K dated December 15, 2004
10.22	Amended and Restated Trust Agreement dated September 16, 2004 for Mercantile Bank Capital Trust I is incorporated by reference to exhibit 10.2 of our Form 8-K dated December 15, 2004
10.23	

	Placement Agreement between us, Mercantile Bank Capital Trust I, and SunTrust Capital Markets, Inc. dated September 16, 2004 is incorporated by reference to exhibit 10.3 of our Form 8-K dated December 15, 2004
10.24	Guarantee Agreement dated September 16, 2004 between Mercantile as Guarantor and Wilmington Trust Company as Guarantee Trustee is incorporated by reference to exhibit 10.4 of our Form 8-K dated December 15, 2004
10.25	Non-Lender Bonus Plan 2006, is incorporated by reference to exhibit 10.1 of our Form 8-K dated November 22, 2005 *

EXHIBIT NO.	EXHIBIT DESCRIPTION
10.26	Form of Agreement Amending Stock Option Agreement, dated November 17, 2005 issued under our 2004 Employee Stock Option Plan, is incorporated by reference to exhibit 10.1 of our Form 8-K dated December 12, 2005 *
10.27	Second Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Gerald R. Johnson, Jr. is incorporated by reference to exhibit 10.28 of our Form 10-K for the year ended December 31, 2005 *
10.28	Second Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Michael H. Price is incorporated by reference to exhibit 10.29 of our Form 10-K for the year ended December 31, 2005 *
10.29	Third Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Robert B. Kaminski, Jr. is incorporated by reference to exhibit 10.30 of our Form 10-K for the year ended December 31, 2005 *
10.30	Second Amendment to Employment Agreement dated as of November 17, 2005, among the company, our bank and Charles E. Christmas is incorporated by reference to exhibit 10.31 of our Form 10-K for the year ended December 31, 2005 *
10.31	Form of Mercantile Bank of Michigan Executive Deferred Compensation Agreement, that has been entered into between our bank and each of Gerald R. Johnson, Jr., Michael H. Price, Robert B. Kaminski, Jr., Charles E. Christmas, and certain other officers of our bank is incorporated by reference to exhibit 10.32 of our Form 10-K for the year ended December 31, 2005 *
10.32	Form of Mercantile Bank of Michigan Split Dollar Agreement that has been entered into between our bank and each of Gerald R. Johnson, Jr., Michael H. Price, Robert B. Kaminski, Jr., Charles E. Christmas, and certain other officers of our bank is incorporated by reference to exhibit 10.33 of our Form 10-K for the year ended December 31, 2005 *
10.33	Director Fee Summary *
10.34	Lease Agreement between our bank and Joe D. Pentecost Trust dated April 29, 2005 for our East Lansing, Michigan office is incorporated by reference to exhibit 10.35 of our Form 10-K for the year ended December 31, 2005
10.35	Lease Agreement between our bank and The Conlin Company dated July 12, 2005 for our Ann Arbor, Michigan office is incorporated by reference to exhibit 10.36 of our Form 10-K for the year ended December 31, 2005
10.36	Stock Incentive Plan of 2006 is incorporated by reference to Appendix A of our proxy statement for our April 27, 2006 annual meeting of shareholders that was filed with the Securities and Exchange Commission *
10.37	

Form of Notice of Grant of Incentive Stock Option and Stock Option Agreement for incentive stock options granted under our Stock Incentive Plan of 2006 is incorporated by reference to exhibit 10.1 of our Form 8-K dated November 22, 2006 *

EXHIBIT NO.	EXHIBIT DESCRIPTION
10.38	Form of Restricted Stock Award Agreement Notification of Award and Terms and Conditions of Award for restricted stock under our Stock Incentive Plan of 2006 is incorporated by reference to exhibit 10.2 of our Form 8-K dated November 22, 2006 *
10.39	Executive Officer Bonus Plan for 2007 is incorporated by reference to exhibit 10.1 of our Form 8-K dated January 29, 2007 *
21	Subsidiaries of the company
23	Consent of Independent Registered Public Accounting Firm
31	Rule 13a-14(a) Certifications
32.1	Section 1350 Chief Executive Officer Certification
32.2	Section 1350 Chief Financial Officer Certification

* Management contract or compensatory plan