ALCOA INC
Form 8-K
March 17, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Date of Report (Date of earliest event reported): March 17, 2009

ALCOA INC.

(Exact name of Registrant as specified in its charter)

Pennsylvania	**1-3610**	**25-0317820**
(State or Other Jurisdiction of Incorporation)	**(Commission File Number)**	**(I.R.S. Employer Identification Number)**

390 Park Avenue, New York, New York	**10022-4608**
(Address of Principal Executive Offices)	**(Zip Code)**

Office of Investor Relations 212-836-2674

Office of the Secretary 212-836-2732

(Registrant s telephone number, including area code)

(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the Registrant under any of the following provisions:

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 7.01. Regulation FD Disclosure.
The presentation attached as Exhibit 99 was prepared by Alcoa Inc. and is available on its Internet website at http://www.alcoa.com under Invest.

* * * * *

The information in this Current Report on Form 8-K is being furnished in accordance with the provisions of General Instruction B.2 of Form 8-K.

Forward-Looking Statements

Certain statements in the presentation attached as Exhibit 99 relate to future events and expectations and as such constitute forward-looking statements involving known and unknown risks and uncertainties that may cause actual results, performance or achievements of Alcoa to be different from those expressed or implied in the forward-looking statements. Forward-looking statements include those containing such words as anticipates, believes, estimates, expects, goal, hopes, intends, plans, targets, should, will, will likely result, forecast, words of similar meaning. Alcoa disclaims any obligation to update publicly any forward-looking statements, whether in response to new information, future events or otherwise, except as required by applicable law. Important factors that could cause actual results to differ materially from those in the forward-looking statements include: (a) material adverse changes in economic or aluminum industry conditions generally, including global supply and demand conditions and fluctuations in London Metal Exchange-based prices for primary aluminum, alumina and other products; (b) material adverse changes in the markets served by Alcoa, including automotive and commercial transportation, aerospace, building and construction, distribution, packaging, and industrial gas turbine markets; (c) Alcoa s inability to achieve the level of cost reductions, cash generation or conservation, return on capital improvement, improvement in profitability and margins, or strengthening of operations anticipated by management in connection with its restructuring, portfolio streamlining and liquidity strengthening actions; (d) continued volatility or deterioration in the financial markets, including disruptions in the commercial paper, capital and credit markets; (e) Alcoa s inability to mitigate impacts from increased energy, transportation and raw materials costs, including caustic soda, calcined petroleum coke and natural gas, or from other cost inflation; (f) Alcoa s inability to complete its Brazilian growth and portfolio streamlining projects or achieve efficiency improvements at newly constructed or acquired facilities as planned and by targeted completion dates; (g) unfavorable changes in laws, governmental regulations or policies, foreign currency exchange rates or competitive factors in the countries in which Alcoa operates; (h) significant legal proceedings or investigations adverse to Alcoa, including environmental, product liability, safety and health and other claims; and (i) the other risk factors summarized in Alcoa s Form 10-K for the year ended December 31, 2008 and other reports filed with the Securities and Exchange Commission.

Item 9.01. Financial Statements and Exhibits.

(d) Exhibits.
The following is furnished as an exhibit to this report:

99 Alcoa Inc. Presentation dated March 2009.

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 hereunto duly authorized.

ALCOA INC.

By: /s/ J. Michael Schell
Name: J. Michael Schell
Title: Executive Vice President

Business Development and Law

Date: March 17, 2009

EXHIBIT INDEX

Exhibit No.	**Description**
99	Alcoa Inc. Presentation dated March 2009.

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Total originated loans

$1,186,713,000 100.0% $1,053,243,000 100.0% 12.7%

	September 30, 2014		December 31, 2013		Percent Increase
	Balance	%	Balance	%	(Decrease)
Acquired loans					
Commercial:					
Commercial and industrial	$179,476,000	20.4 %	$0	NA	NM
Vacant land, land development, and residential construction	21,972,000	2.5	0	NA	NM
Real estate – owner occupied	145,398,000	16.5	0	NA	NM
Real estate – non-owner occupied	182,660,000	20.7	0	NA	NM
Real estate – multi-family and residential rental	53,256,000	6.0	0	NA	NM
Total commercial	582,762,000	66.1	0	NA	NM
Retail:					
Home equity and other	119,033,000	13.5	0	NA	NM
1-4 family mortgages	179,757,000	20.4	0	NA	NM
Total retail	298,790,000	33.9	0	NA	NM
Total acquired loans	$881,552,000	100.0%	$0	NA	NM

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	September 30, 2014 Balance	%	December 31, 2013 Balance	%	Percent Increase (Decrease)
Total loans					
Commercial:					
Commercial and industrial	$541,805,000	26.2 %	$286,373,000	27.2 %	89.2 %
Vacant land, land development, and residential construction	52,218,000	2.5	36,741,000	3.5	42.1
Real estate – owner occupied	412,470,000	19.9	261,877,000	24.9	57.5
Real estate – non-owner occupied	584,422,000	28.3	364,066,000	34.6	60.5
Real estate – multi-family and residential rental	95,649,000	4.6	37,639,000	3.5	154.1
Total commercial	1,686,564,000	81.5	986,696,000	93.7	70.9
Retail:					
Home equity and other	163,950,000	7.9	35,080,000	3.3	367.4
1-4 family mortgages	217,751,000	10.6	31,467,000	3.0	592.0
Total retail	381,701,000	18.5	66,547,000	6.3	473.6
Total loans	$2,068,265,000	100.0%	$1,053,243,000	100.0%	96.4 %

The total outstanding balance and carrying value of acquired impaired loans was $34.4 million and $23.7 million, respectively, as of September 30, 2014. Changes in the accretable yield for acquired impaired loans for the three and nine months ended September 30, 2014 were as follows:

Balance at June 30, 2014	$2,411,000
Additions	0
Accretion	(285,000)
Net reclassification from nonaccretable to accretable	0
Disposals	(48,000)
Ending balance	$2,078,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Balance at December 31, 2013	$0
Additions	2,514,000
Accretion	(388,000)
Net reclassification from nonaccretable to accretable	0
Disposals	(48,000)
Ending balance	$2,078,000

Nonperforming originated loans as of September 30, 2014 and December 31, 2013 were as follows:

	September 30, 2014	December 31, 2013
Loans past due 90 days or more still accruing interest	$0	$0
Nonaccrual loans	4,856,000	6,718,000
Total nonperforming originated loans	$4,856,000	$6,718,000

Nonperforming acquired loans as of September 30, 2014 and December 31, 2013 were as follows:

	September 30, 2014	December 31, 2013
Loans past due 90 days or more still accruing interest	$81,000	$ NA

Nonaccrual loans	1,134,000	NA
Total nonperforming aquired loans	$1,215,000	$ NA

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES
(Continued)

The recorded principal balance of nonperforming loans was as follows:

	September 30, 2014	December 31, 2013
Commercial:		
Commercial and industrial	$350,000	$1,501,000
Vacant land, land development, and residential construction	222,000	785,000
Real estate – owner occupied	733,000	389,000
Real estate – non-owner occupied	329,000	168,000
Real estate – multi-family and residential rental	331,000	208,000
Total commercial	1,965,000	3,051,000
Retail:		
Home equity and other	914,000	788,000
1-4 family mortgages	3,192,000	2,879,000
Total retail	4,106,000	3,667,000
Total nonperforming loans	$6,071,000	$6,718,000

Acquired impaired loans are not subject to individual evaluation for impairment and are not reported as nonperforming loans based on acquired impaired loan accounting. Acquired non-impaired loans are placed on nonaccrual status and reported as nonperforming or past due using the same criteria applied to the originated loan portfolio.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. **LOANS AND ALLOWANCE FOR LOAN LOSSES**
(Continued)

An age analysis of past due loans is as follows as of September 30, 2014:

	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Recorded Balance > 89 Days and Accruing
Originated loans							
Commercial:							
Commercial and industrial	$0	$ 0	$0	$0	$362,329,000	$362,329,000	$ 0
Vacant land, land development, and residential construction	0	0	0	0	30,246,000	30,246,000	0
Real estate – owner occupied	0	0	217,000	217,000	266,855,000	267,072,000	0
Real estate – non-owner occupied	201,000	0	0	201,000	401,561,000	401,762,000	0
Real estate – multi-family and residential rental	0	0	0	0	42,393,000	42,393,000	0
Total commercial	201,000	0	217,000	418,000	1,103,384,000	1,103,802,000	0
Retail:							
Home equity and other	67,000	0	0	67,000	44,850,000	44,917,000	0
1-4 family mortgages	33,000	0	344,000	377,000	37,617,000	37,994,000	0
Total retail	100,000	0	344,000	444,000	82,467,000	82,911,000	0
Total past due loans	$301,000	$ 0	$561,000	$862,000	$1,185,851,000	$1,186,713,000	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Recorded Balance > 89 Days and Accruing
Acquired loans							
Commercial:							
Commercial and industrial	$66,000	$11,000	$23,000	$100,000	$179,376,000	$179,476,000	$0
Vacant land, land development, and residential construction	0	0	0	0	21,972,000	21,972,000	0
Real estate – owner occupied	112,000	0	1,914,000	2,026,000	143,372,000	145,398,000	0
Real estate – non-owner occupied	0	0	2,732,000	2,732,000	179,928,000	182,660,000	0
Real estate – multi-family and residential rental	0	0	81,000	81,000	53,175,000	53,256,000	0
Total commercial	178,000	11,000	4,750,000	4,939,000	577,823,000	582,762,000	0
Retail:							
Home equity and other	405,000	122,000	103,000	630,000	118,403,000	119,033,000	3,000
1-4 family mortgages	1,684,000	504,000	844,000	3,032,000	176,725,000	179,757,000	238,000
Total retail	2,089,000	626,000	947,000	3,662,000	295,128,000	298,790,000	241,000
Total past due loans	$2,267,000	$637,000	$5,697,000	$8,601,000	$872,951,000	$881,552,000	$241,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

An age analysis of past due loans is as follows as of December 31, 2013:

	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Recorded Balance > 89 Days and Accruing
Originated loans							
Commercial:							
Commercial and industrial	$0	$0	$309,000	$309,000	$286,064,000	$286,373,000	$ 0
Vacant land, land development, and residential construction	0	0	0	0	36,741,000	36,741,000	0
Real estate –owner occupied	65,000	0	50,000	115,000	261,762,000	261,877,000	0
Real estate –non-owner occupied	0	0	0	0	364,066,000	364,066,000	0
Real estate –multi-family and residential rental	0	0	64,000	64,000	37,575,000	37,639,000	0
Total commercial	65,000	0	423,000	488,000	986,208,000	986,696,000	0
Retail:							
Home equity and other	14,000	0	0	14,000	35,066,000	35,080,000	0
1-4 family mortgages	21,000	44,000	375,000	440,000	31,027,000	31,467,000	0
Total retail	35,000	44,000	375,000	454,000	66,093,000	66,547,000	0
Total past due loans	$100,000	$44,000	$798,000	$942,000	$1,052,301,000	$1,053,243,000	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired loans as of September 30, 2014, and average impaired loans for the three and nine months ended September 30, 2014, were as follows:

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Third Quarter Average Recorded Principal Balance	Year-To-Date Average Recorded Principal Balance
With no related allowance recorded					
Commercial:					
Commercial and industrial	$1,250,000	$1,250,000		$691,000	$525,000
Vacant land, land development and residential construction	545,000	222,000		111,000	232,000
Real estate – owner occupied	19,499,000	17,815,000		9,227,000	4,981,000
Real estate – non-owner occupied	575,000	575,000		576,000	911,000
Real estate – multi-family and residential rental	0	0		0	0
Total commercial	21,869,000	19,862,000		10,605,000	6,649,000
Retail:					
Home equity and other	707,000	639,000		642,000	598,000
1-4 family mortgages	1,102,000	547,000		553,000	591,000
Total retail	1,809,000	1,186,000		1,195,000	1,189,000
Total with no related allowance recorded	$23,678,000	$21,048,000		$11,800,000	$7,838,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Third Quarter Average Recorded Principal Balance	Year-To-Date Average Recorded Principal Balance
With an allowance recorded					
Commercial:					
Commercial and industrial	$5,404,000	$5,363,000	$2,251,000	$3,087,000	$2,142,000
Vacant land, land development and residential construction	2,798,000	2,798,000	318,000	3,049,000	3,536,000
Real estate – owner occupied	2,218,000	2,016,000	628,000	2,238,000	1,869,000
Real estate – non-owner occupied	17,023,000	17,023,000	6,489,000	17,377,000	18,819,000
Real estate – multi-family and residential rental	1,861,000	1,808,000	799,000	1,679,000	1,783,000
Total commercial	29,304,000	29,008,000	10,485,000	27,430,000	28,149,000
Retail:					
Home equity and other	117,000	87,000	87,000	88,000	139,000
1-4 family mortgages	2,206,000	2,073,000	792,000	2,093,000	2,144,000
Total retail	2,323,000	2,160,000	879,000	2,181,000	2,283,000
Total with an allowance recorded	$31,627,000	$31,168,000	$11,364,000	$29,611,000	$30,432,000
Total impaired loans:					
Commercial	$51,173,000	$48,870,000	$10,485,000	$38,035,000	$34,798,000
Retail	4,132,000	3,346,000	879,000	3,376,000	3,472,000
Total impaired loans	$55,305,000	$52,216,000	$11,364,000	$41,411,000	$38,270,000

Acquired impaired loans are not subject to individual evaluation for impairment and are not reported as impaired loans based on acquired impaired loan accounting. Acquired non-impaired loans are placed on nonaccrual status and reported as impaired using the same criteria applied to the originated loan portfolio. In accordance with purchase accounting rules, acquired loans were recorded at fair value at the Merger Date and the prior allowance was eliminated. No allowance has been established on these acquired loans through September 30, 2014. Interest income of $0.6 million and $1.3 million was recognized on impaired loans during the third quarter and first nine months of

2014, respectively.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired loans as of December 31, 2013, and average impaired loans for the three and nine months ended September 30, 2013, were as follows:

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Third Quarter Average Recorded Principal Balance	Year-To-Date Average Recorded Principal Balance
With no related allowance recorded					
Commercial:					
Commercial and industrial	$2,229,000	$511,000		$1,170,000	$1,378,000
Vacant land, land development and residential construction	475,000	362,000		907,000	1,148,000
Real estate – owner occupied	1,270,000	785,000		865,000	1,159,000
Real estate – non-owner occupied	895,000	733,000		4,651,000	4,878,000
Real estate – multi-family and residential rental	41,000	1,000		425,000	487,000
Total commercial	4,910,000	2,392,000		8,018,000	9,050,000
Retail:					
Home equity and other	507,000	461,000		466,000	474,000
1-4 family mortgages	1,272,000	647,000		715,000	746,000
Total retail	1,779,000	1,108,000		1,181,000	1,220,000
Total with no related allowance recorded	$6,689,000	$3,500,000		$9,199,000	$10,270,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Third Quarter Average Recorded Principal Balance	Year-To-Date Average Recorded Principal Balance
With an allowance recorded					
Commercial:					
Commercial and industrial	$1,517,000	$1,440,000	$792,000	$1,764,000	$1,990,000
Vacant land, land development and residential construction	4,436,000	4,139,000	844,000	4,466,000	3,158,000
Real estate – owner occupied	1,513,000	1,513,000	528,000	2,330,000	2,810,000
Real estate – non-owner occupied	21,088,000	21,072,000	7,969,000	28,789,000	30,216,000
Real estate – multi-family and residential rental	3,219,000	2,684,000	1,127,000	2,639,000	2,973,000
Total commercial	31,773,000	30,848,000	11,260,000	39,988,000	41,147,000
Retail:					
Home equity and other	320,000	289,000	96,000	309,000	339,000
1-4 family mortgages	2,274,000	2,231,000	1,030,000	2,480,000	1,477,000
Total retail	2,594,000	2,520,000	1,126,000	2,789,000	1,816,000
Total with an allowance recorded	$34,367,000	$33,368,000	$12,386,000	$42,777,000	$42,963,000
Total impaired loans:					
Commercial	$36,683,000	$33,240,000	$11,260,000	$48,006,000	$50,197,000
Retail	4,373,000	3,628,000	1,126,000	3,970,000	3,036,000
Total impaired loans	$41,056,000	$36,868,000	$12,386,000	$51,976,000	$53,233,000

Interest income of $0.7 million and $2.2 million was recognized on impaired loans during the third quarter and first nine months of 2013, respectively.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Indicators. We utilize a comprehensive grading system for our commercial loans. All commercial loans are graded on a ten grade rating system. The rating system utilizes standardized grade paradigms that analyze several critical factors such as cash flow, operating performance, financial condition, collateral, industry condition and management. All commercial loans are graded at inception and reviewed and, if appropriate, re-graded at various intervals thereafter. The risk assessment for retail loans is primarily based on the type of collateral and payment activity.

Credit quality indicators were as follows as of September 30, 2014:

Originated Loans

Commercial credit exposure - credit risk profiled by internal credit risk grades:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Internal credit risk grade groupings:					
Grades 1 – 4	$248,213,000	$7,451,000	$169,127,000	$270,074,000	$17,812,000
Grades 5 – 7	107,038,000	19,774,000	78,049,000	118,498,000	22,758,000
Grades 8 – 9	7,078,000	3,021,000	19,896,000	13,190,000	1,823,000
Total commercial	$362,329,000	$30,246,000	$267,072,000	$401,762,000	$42,393,000

Retail credit exposure - credit risk profiled by collateral type:

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Total retail	$44,917,000	$37,994,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Acquired loans

Commercial credit exposure – credit risk profiled by internal credit risk grades:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Internal credit risk grade groupings:					
Grades 1 – 4	$72,928,000	$4,931,000	$35,824,000	$69,611,000	$24,144,000
Grades 5 – 7	102,862,000	15,711,000	100,845,000	105,564,000	28,654,000
Grades 8 – 9	3,686,000	1,330,000	8,729,000	7,485,000	458,000
Total commercial	$179,476,000	$21,972,000	$145,398,000	$182,660,000	$53,256,000

Retail credit exposure – credit risk profiled by collateral type:

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Total retail	$119,033,000	$179,757,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit quality indicators were as follows as of December 31, 2013:

Originated loans

Commercial credit exposure – credit risk profiled by internal credit risk grades:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Internal credit risk grade groupings:					
Grades 1 – 4	$208,151,000	$6,973,000	$156,230,000	$219,325,000	$15,465,000
Grades 5 – 7	76,237,000	25,535,000	103,066,000	122,717,000	19,469,000
Grades 8 – 9	1,985,000	4,233,000	2,581,000	22,024,000	2,705,000
Total commercial	$286,373,000	$36,741,000	$261,877,000	$364,066,000	$37,639,000

Retail credit exposure – credit risk profiled by collateral type:

Retail Home Equity and Other	Retail 1-4 Family Mortgages

Total retail	$35,080,000	$31,467,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

All commercial loans are graded using the following criteria:

Grade 1.	Excellent credit rating that contain very little, if any, risk of loss.
Grade 2.	Strong sources of repayment and have low repayment risk.
Grade 3.	Good sources of repayment and have limited repayment risk.
Grade 4.	Adequate sources of repayment and acceptable repayment risk; however, characteristics are present that render the credit more vulnerable to a negative event.
Grade 5.	Marginally acceptable sources of repayment and exhibit defined weaknesses and negative characteristics.
Grade 6.	Well defined weaknesses which may include negative current cash flow, high leverage, or operating losses. Generally, if the credit does not stabilize or if further deterioration is observed in the near term, the loan will likely be downgraded and placed on the Watch List (i.e., list of lending relationships that receive increased scrutiny and review by the Board of Directors and senior management).
Grade 7.	Defined weaknesses or negative trends that merit close monitoring through Watch List status.
Grade 8.	Inadequately protected by current sound net worth, paying capacity of the obligor, or pledged collateral, resulting in a distinct possibility of loss requiring close monitoring through Watch List status.
Grade 9.	Vital weaknesses exist where collection of principal is highly questionable.

Grade 10. Considered uncollectable and of such little value that continuance as an asset is not warranted.

The primary risk elements with respect to commercial loans are the financial condition of the borrower, the sufficiency of collateral, and timeliness of scheduled payments. We have a policy of requesting and reviewing periodic financial statements from commercial loan customers and employ a disciplined and formalized review of the existence of collateral and its value. The primary risk element with respect to each residential real estate loan and consumer loan is the timeliness of scheduled payments. We have a reporting system that monitors past due loans and have adopted policies to pursue creditor's rights in order to preserve our collateral position.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Activity in the allowance for loan losses and the recorded investments in originated loans as of and during the three and nine months ended September 30, 2014 are as follows:

	Commercial Loans	Retail Loans	Unallocated	Total
Allowance for loan losses:				
Balance at June 30, 2014	$19,107,000	$1,774,000	$(25,000)	$20,856,000
Provision for loan losses	(473,000)	63,000	10,000	(400,000)
Charge-offs	(24,000)	(321,000)	0	(345,000)
Recoveries	102,000	161,000	0	263,000
Ending balance	$18,712,000	$1,677,000	$(15,000)	$20,374,000
Allowance for loan losses:				
Balance at December 31, 2013	$20,455,000	$2,358,000	$8,000	$22,821,000
Provision for loan losses	(2,251,000)	(726,000)	(23,000)	(3,000,000)
Charge-offs	(708,000)	(328,000)	0	(1,036,000)
Recoveries	1,216,000	373,000	0	1,589,000
Ending balance	$18,712,000	$1,677,000	$(15,000)	$20,374,000
Ending balance: individually evaluated for impairment	$10,485,000	$879,000	$0	$11,364,000
Ending balance: collectively evaluated for impairment	$8,227,000	$798,000	$(15,000)	$9,010,000
Total loans:				
Ending balance	$1,103,802,000	$82,911,000		$1,186,713,000
Ending balance: individually evaluated for impairment	$48,870,000	$3,346,000		$52,216,000

Ending balance: collectively evaluated for impairment	$1,054,932,000	$79,565,000	$1,134,497,000

In accordance with purchase accounting rules, acquired loans were recorded at fair value at the Merger Date and the prior allowance was eliminated. No allowance has been established on these acquired loans through September 30, 2014.

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(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Activity in the allowance for loan losses and the recorded investments in originated loans as of and during the three and nine months ended September 30, 2013 are as follows:

	Commercial Loans	Retail Loans	Unallocated	Total
Allowance for loan losses:				
Balance at June 30, 2013	$22,382,000	$2,559,000	$ 6,000	$ 24,947,000
Provision for loan losses	(1,730,000)	(7,000)	37,000	(1,700,000)
Charge-offs	0	(85,000)	0	(85,000)
Recoveries	2,002,000	31,000	0	2,033,000
Ending balance	$22,654,000	$2,498,000	$ 43,000	$ 25,195,000
Allowance for loan losses:				
Balance at December 31, 2012	$26,043,000	$2,645,000	$ (11,000)	$ 28,677,000
Provision for loan losses	(4,375,000)	(379,000)	54,000	(4,700,000)
Charge-offs	(2,774,000)	(107,000)	0	(2,881,000)
Recoveries	3,760,000	339,000	0	4,099,000
Ending balance	$22,654,000	$2,498,000	$ 43,000	$ 25,195,000
Ending balance: individually evaluated for impairment	$13,860,000	$1,203,000	$ 0	$ 15,063,000
Ending balance: collectively evaluated for impairment	$8,794,000	$1,295,000	$ 43,000	$ 10,132,000
Total loans:				
Ending balance	$1,007,763,000	$67,724,000		$ 1,075,487,000
Ending balance: individually evaluated for impairment	$46,426,000	$3,851,000		$ 50,277,000

Ending balance: collectively evaluated for impairment	$961,337,000	$63,873,000	$ 1,025,210,000

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(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Loans modified as troubled debt restructurings during the three months ended September 30, 2014 were as follows:

	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance
Originated loans			
Commercial:			
Commercial and industrial	2	$5,994,000	$6,094,000
Vacant land, land development and residential construction	0	0	0
Real estate – owner occupied	2	16,787,000	16,787,000
Real estate – non-owner occupied	0	0	0
Real estate – multi-family and residential rental	0	0	0
Total originated commercial	4	22,781,000	22,881,000
Retail:			
Home equity and other	0	0	0
1-4 family mortgages	0	0	0
Total originated retail	0	0	0
Total originated loans	4	$22,781,000	$22,881,000
Acquired loans			
Commercial:			
Commercial and industrial	0	$0	$0
Vacant land, land development and residential construction	0	0	0
Real estate – owner occupied	0	0	0
Real estate – non-owner occupied	0	0	0
Real estate – multi-family and residential rental	0	0	0
Total acquired commercial	0	0	0

Retail:			
Home equity and other	0	0	0
1-4 family mortgages	0	0	0
Total acquired retail	0	0	0
Total acquired loans	0	$0	$0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance
Total loans			
Commercial:			
Commercial and industrial	2	$5,994,000	$6,094,000
Vacant land, land development and residential construction	0	0	0
Real estate – owner occupied	2	16,787,000	16,787,000
Real estate – non-owner occupied	0	0	0
Real estate – multi-family and residential rental	0	0	0
Total commercial	4	22,781,000	22,881,000
Retail:			
Home equity and other	0	0	0
1-4 family mortgages	0	0	0
Total retail	0	0	0
Total loans	4	$22,781,000	$22,881,000

Loans modified as troubled debt restructurings during the nine months ended September 30, 2014 were as follows:

	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance
Originated loans			
Commercial:			

Commercial and industrial	2	$5,994,000	$6,094,000
Vacant land, land development and residential construction	0	0	0
Real estate – owner occupied	3	17,783,000	17,783,000
Real estate – non-owner occupied	1	146,000	146,000
Real estate – multi-family and residential rental	0	0	0
Total originated commercial	6	23,923,000	24,023,000
Retail:			
Home equity and other	0	0	0
1-4 family mortgages	0	0	0
Total originated retail	0	0	0
Total originated loans	6	$23,923,000	$24,023,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance
Acquired loans			
Commercial:			
Commercial and industrial	0	$0	$0
Vacant land, land development and residential construction	0	0	0
Real estate – owner occupied	0	0	0
Real estate – non-owner occupied	0	0	0
Real estate – multi-family and residential rental	0	0	0
Total acquired commercial	0	0	0
Retail:			
Home equity and other	0	0	0
1-4 family mortgages	0	0	0
Total acquired	0	0	0
Total acquired loans	0	$0	$0
Total loans			
Commercial:			
Commercial and industrial	2	$5,994,000	$6,094,000
Vacant land, land development and residential construction	0	0	0
Real estate – owner occupied	3	17,783,000	17,783,000
Real estate – non-owner occupied	1	146,000	146,000
Real estate – multi-family and residential rental	0	0	0
Total commercial	6	23,923,000	24,023,000
Retail:			
Home equity and other	0	0	0
1-4 family mortgages	0	0	0
Total retail	0	0	0

Total loans	6	$23,923,000	$24,023,000

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Loans modified as troubled debt restructurings during the three months ended September 30, 2013 were as follows:

	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance
Originated loans			
Commercial:			
Commercial and industrial	1	$ 553,000	$ 553,000
Vacant land, land development and residential construction	0	0	0
Real estate – owner occupied	0	0	0
Real estate – non-owner occupied	2	171,000	171,000
Real estate – multi-family and residential rental	2	346,000	346,000
Total originated commercial	5	1,070,000	1,070,000
Retail:			
Home equity and other	0	0	0
1-4 family mortgages	0	0	0
Total originated retail	0	0	0
Total originated loans	5	$ 1,070,000	$ 1,070,000

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Loans modified as troubled debt restructurings during the nine months ended September 30, 2013 were as follows:

	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance
Originated loans			
Commercial:			
Commercial and industrial	2	$ 613,000	$ 613,000
Vacant land, land development and residential construction	2	3,247,000	3,247,000
Real estate – owner occupied	3	909,000	909,000
Real estate – non-owner occupied	4	2,239,000	2,239,000
Real estate – multi-family and residential rental	2	346,000	346,000
Total originated commercial	13	7,354,000	7,354,000
Retail:			
Home equity and other	0	0	0
1-4 family mortgages	1	1,879,000	1,879,000
Total originated retail	1	1,879,000	1,879,000
Total originated loans	14	$ 9,233,000	$ 9,233,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following originated loans, modified as troubled debt restructurings within the previous twelve months, became over 30 days past due within the three months ended September 30, 2014 (amounts as of period end):

	Number of Contracts	Recorded Principal Balance
Commercial:		
Commercial and industrial	0	$ 0
Vacant land, land development and residential construction	0	0
Real estate – owner occupied	0	0
Real estate – non-owner occupied	0	0
Real estate – multi-family and residential rental	0	0
Total commercial	0	0
Retail:		
Home equity and other	0	0
1-4 family mortgages	0	0
Total retail	0	0
Total	0	$ 0

The following originated loans, modified as troubled debt restructurings within the previous twelve months, became over 30 days past due within the nine months ended September 30, 2014 (amounts as of period end):

	Number of Contracts	Recorded Principal Balance
Commercial:		

Commercial and industrial	0	$ 0
Vacant land, land development and residential construction	0	0
Real estate – owner occupied	0	0
Real estate – non-owner occupied	0	0
Real estate – multi-family and residential rental	0	0
Total commercial	0	0
Retail:		
Home equity and other	0	0
1-4 family mortgages	0	0
Total retail	0	0
Total	0	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following originated loans, modified as troubled debt restructurings within the previous twelve months, became over 30 days past due within the three months ended September 30, 2013 (amounts as of period end):

	Number of Contracts	Recorded Principal Balance
Commercial:		
Commercial and industrial	0	$ 0
Vacant land, land development and residential construction	0	0
Real estate – owner occupied	0	0
Real estate – non-owner occupied	0	0
Real estate – multi-family and residential rental	0	0
Total commercial	0	0
Retail:		
Home equity and other	0	0
1-4 family mortgages	0	0
Total retail	0	0
Total	0	$ 0

The following originated loans, modified as troubled debt restructurings within the previous twelve months, became over 30 days past due within the nine months ended September 30, 2013 (amounts as of period end):

	Number of Contracts	Recorded Principal Balance
Commercial:		

Commercial and industrial	0	$ 0
Vacant land, land development and residential construction	0	0
Real estate – owner occupied	0	0
Real estate – non-owner occupied	0	0
Real estate – multi-family and residential rental	0	0
Total commercial	0	0
Retail:		
Home equity and other	0	0
1-4 family mortgages	0	0
Total retail	0	0
Total	0	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Activity for originated loans categorized as troubled debt restructurings during the three months ended September 30, 2014 is as follows:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Commercial Loan Portfolio:					
Beginning Balance	$ 1,176,000	$ 3,786,000	$ 2,711,000	$ 18,664,000	$ 719,000
Charge-Offs	0	0	0	0	0
Payments	(205,000)	(287,000)	(91,000)	(655,000)	(130,000)
Transfers to ORE	(21,000)	0	0	0	0
Net Additions/Deletions	6,315,000	0	16,748,000	0	0
Ending Balance	$ 7,265,000	$ 3,499,000	$ 19,368,000	$ 18,009,000	$ 589,000

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Retail Loan Portfolio:		
Beginning Balance	$ 0	$ 2,077,000
Charge-Offs	0	0
Payments	0	(51,000)
Transfers to ORE	0	0
Net Additions/Deletions	0	0

Ending Balance	$ 0	$2,026,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Activity for originated loans categorized as troubled debt restructurings during the nine months ended September 30, 2014 is as follows:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Commercial Loan Portfolio:					
Beginning Balance	$ 1,656,000	$ 4,501,000	$ 1,816,000	$ 22,311,000	$ 2,620,000
Charge-Offs	(67,000)	0	(11,000)	0	(420,000)
Payments	(632,000)	(3,901,000)	(181,000)	(4,621,000)	(1,611,000)
Transfers to ORE	(21,000)	0	0	0	0
Net Additions/Deletions	6,329,000	2,899,000	17,744,000	319,000	0
Ending Balance	$ 7,265,000	$ 3,499,000	$ 19,368,000	$ 18,009,000	$ 589,000

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Retail Loan Portfolio:		
Beginning Balance	$ 0	$ 2,191,000
Charge-Offs	0	0
Payments	0	(165,000)
Transfers to ORE	0	0
Net Additions/Deletions	0	0

Ending Balance	$ 0	$2,026,000

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Activity for originated loans categorized as troubled debt restructurings during the three months ended September 30, 2013 is as follows:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Commercial Loan Portfolio:					
Beginning Balance	$ 2,266,000	$ 5,440,000	$ 3,580,000	$ 34,424,000	$ 2,775,000
Charge-Offs	0	0	0	0	0
Payments	(324,000)	(303,000)	(271,000)	(1,690,000)	(295,000)
Transfers to ORE	0	0	0	(350,000)	0
Net Additions/Deletions	466,000	0	(652,000)	68,000	343,000
Ending Balance	$ 2,408,000	$ 5,137,000	$ 2,657,000	$ 32,452,000	$ 2,823,000

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Retail Loan Portfolio:		
Beginning Balance	$ 2,029,000	$ 0
Charge-Offs	0	0
Payments	(16,000)	0
Transfers to ORE	0	0
Net Additions/Deletions	0	0
Ending Balance	$ 2,013,000	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Activity for originated loans categorized as troubled debt restructurings during the nine months ended September 30, 2013 is as follows:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Commercial Loan Portfolio:					
Beginning Balance	$2,721,000	$3,071,000	$4,116,000	$37,672,000	$3,026,000
Charge-Offs	(35,000)	(725,000)	(70,000)	(716,000)	(15,000)
Payments	(1,902,000)	(456,000)	(1,310,000)	(5,475,000)	(530,000)
Transfers to ORE	(74,000)	0	(363,000)	(1,153,000)	0
Net Additions/Deletions	1,698,000	3,247,000	284,000	2,124,000	342,000
Ending Balance	$2,408,000	$5,137,000	$2,657,000	$32,452,000	$2,823,000

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Retail Loan Portfolio:		
Beginning Balance	$155,000	$ 0
Charge-Offs	0	0
Payments	(21,000)	0
Transfers to ORE	0	0
Net Additions/Deletions	1,879,000	0
Ending Balance	$2,013,000	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The allowance related to originated loans categorized as troubled debt restructurings was as follows:

	September 30, 2014	December 31, 2013
Commercial:		
Commercial and industrial	$514,000	$187,000
Vacant land, land development, and residential construction	1,672,000	798,000
Real estate – owner occupied	1,419,000	528,000
Real estate – non-owner occupied	1,773,000	7,828,000
Real estate – multi-family and residential rental	5,855,000	1,010,000
Total commercial	11,233,000	10,351,000
Retail:		
Home equity and other	0	0
1-4 family mortgages	0	0
Total retail	0	0
Total related allowance	$11,233,000	$10,351,000

In general, our policy dictates that a renewal or modification of an 8- or 9-rated commercial loan meets the criteria of a troubled debt restructuring, although we review and consider all renewed and modified loans as part of our troubled debt restructuring assessment procedures. Loan relationships rated 8 contain significant financial weaknesses, resulting in a distinct possibility of loss, while relationships rated 9 reflect vital financial weaknesses, resulting in a highly questionable ability on our part to collect principal; we believe borrowers warranting such ratings would have difficulty obtaining financing from other market participants. Thus, due to the lack of comparable market rates for loans with similar risk characteristics, we believe 8- or 9-rated loans renewed or modified were done so at below market rates. Loans that are identified as troubled debt restructurings are considered impaired and are individually evaluated for impairment when assessing these credits in our allowance for loan losses calculation.

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(Unaudited)

5. PREMISES AND EQUIPMENT, NET

Premises and equipment are comprised of the following:

	September 30, 2014	December 31, 2013
Land, buildings and improvements	$55,286,000	$33,289,000
Furniture and equipment	15,610,000	12,718,000
	70,896,000	46,007,000
Less: accumulated depreciation	22,326,000	21,109,000
Premises and equipment, net	$48,570,000	$24,898,000

Depreciation expense totaled $0.7 million during the third quarter of 2014, compared to $0.3 million during the third quarter of 2013. Depreciation expense totaled $1.5 million during the first nine months of 2014, compared to $1.0 million during the first nine months of 2013.

6. DEPOSITS

Our total deposits at September 30, 2014 totaled $2.27 billion compared to $1.12 billion at December 31, 2013, an increase of $1.15 billion, or 103.0%. A vast majority of the increase reflects the consummation of the merger with Firstbank effective June 1, 2014. The components of our outstanding balances at September 30, 2014 and December 31, 2013, and percentage change in deposits from the end of 2013 to the end of the third quarter of 2014, are as follows:

	September 30, 2014	December 31, 2013	Percent Increase

	Balance	%	Balance	%	(Decrease)
Noninterest-bearing checking	$535,101,000	23.5 %	$224,580,000	20.1 %	138.3 %
Interest-bearing checking	403,600,000	17.8	197,388,000	17.6	104.5
Money market	241,365,000	10.6	133,369,000	11.9	81.0
Savings	334,343,000	14.7	52,606,000	4.7	535.6
Time, under $100,000	188,174,000	8.3	43,251,000	3.9	335.1
Time, $100,000 and over	385,830,000	17.0	254,600,000	22.8	51.5
	2,088,413,000	91.9	905,794,000	81.0	130.6
Out-of-area time, under $100,000	2,805,000	0.1	4,078,000	0.4	(31.2)
Out-of-area time, $100,000 and over	180,490,000	8.0	209,039,000	18.6	(13.7)
	183,295,000	8.1	213,117,000	19.0	(14.0)
Total deposits	$2,271,708,000	100.0%	$1,118,911,000	100.0%	103.0 %

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MERCANTILE BANK CORPORATION

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(Unaudited)

7. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase ("repurchase agreements") are offered principally to certain large deposit customers. Information relating to our repurchase agreements follows:

	Nine Months Ended September 30, 2014	Twelve Months Ended December 31, 2013
Outstanding balance at end of period	$142,869,000	$69,305,000
Average interest rate at end of period	0.10 %	0.12 %
Average daily balance during the period	$93,855,000	$65,939,000
Average interest rate during the period	0.12 %	0.12 %
Maximum daily balance during the period	$148,700,000	$78,960,000

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 agreements are recorded as assets of our bank and are held in safekeeping by a correspondent bank. Repurchase agreements are secured by securities with an aggregate market value equal to the aggregate outstanding balance.

8. FEDERAL HOME LOAN BANK ADVANCES

Federal Home Loan Bank advances totaled $57.0 million at September 30, 2014, and mature at varying dates from October 2014 through September, 2017, with fixed rates of interest from 0.41% to 1.51% and averaging 1.21%.

Federal Home Loan Bank advances totaled $45.0 million at December 31, 2013, maturing at varying dates from March 2017 through September 2017, with fixed rates of interest from 1.22% to 1.51% and averaging 1.34%. The $12.0 million increase during the first nine months of 2014 reflects the consummation of the merger with Firstbank effective June 1, 2014.

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 our bank, under a blanket lien arrangement. Our borrowing line of credit as of September 30, 2014 totaled about $570 million, with availability based on collateral approximating $511 million.

Maturities of currently outstanding FHLB advances are as follows:

2014	$3,000,000
2015	6,000,000
2016	3,033,000
2017	45,000,000
2018	0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

9. COMMITMENTS AND OFF-BALANCE SHEET RISK

Our bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. 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 our 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.

These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized, if any, in the balance sheet. Our bank's 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. Our bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Collateral, such as accounts receivable, securities, inventory, and property and equipment, is generally obtained based on our credit assessment of the borrower. If required, estimated loss exposure resulting from these instruments is expensed and is generally recorded as a liability. There was no reserve or liability balance for these instruments as of September 30, 2014 and December 31, 2013.

A summary of the contractual amounts of our financial instruments with off-balance sheet risk at September 30, 2014 and December 31, 2013 follows:

	September 30, 2014	December 31, 2013
Commercial unused lines of credit	$553,734,000	$257,937,000
Unused lines of credit secured by 1 – 4 family residential properties	59,991,000	23,429,000
Credit card unused lines of credit	11,303,000	9,013,000
Other consumer unused lines of credit	9,681,000	5,695,000

Commitments to make loans	128,196,000	58,799,000
Standby letters of credit	37,482,000	19,670,000
	$800,387,000	$374,543,000

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9. COMMITMENTS AND OFF-BALANCE SHEET RISK (Continued)

Certain of our commercial loan customers have entered into interest rate swap agreements directly with our correspondent banks. To assist our commercial loan customers in these transactions, and to encourage our correspondent banks to enter into the interest rate swap transactions with minimal credit underwriting analyses on their part, we have entered into risk participation agreements with the correspondent banks whereby we agree to make payments to the correspondent banks owed by our commercial loan customers under the interest rate swap agreement in the event that our commercial loan customers do not make the payments. We are not a party to the interest rate swap agreements under these arrangements. As of September 30, 2014, the total notional amount of the underlying interest rate swap agreements was $17.0 million, with a net fair value from our commercial loan customers' perspective of negative $2.4 million. These risk participation agreements are considered financial guarantees in accordance with applicable accounting guidance and are therefore recorded as liabilities at fair value, generally equal to the fees collected at the time of their execution. These liabilities are accreted into income during the term of the interest rate swap agreements, generally ranging from four to fifteen years.

10. HEDGING ACTIVITIES

Our interest rate risk policy includes guidelines for measuring and monitoring interest rate risk. Within these guidelines, parameters have been established for maximum fluctuations in net interest income. Possible fluctuations are measured and monitored using net interest income simulation. Our policy provides for the use of certain derivative instruments and hedging activities to aid in managing interest rate risk to within the policy parameters. To help mitigate the negative impact to our net interest income in an increasing interest rate environment resulting from our cost of funds likely increasing at a higher rate than the yield on our assets, we may periodically enter into derivative financial instruments.

In February 2012, we entered into an interest rate swap agreement with a correspondent bank to hedge the floating rate on our subordinated debentures, which became effective in January 2013 and matures in January 2018. Our $32.0 million of subordinated debentures have a rate equal to the 90-Day Libor Rate plus a fixed spread of 218 basis points, and are subject to repricing quarterly. The interest rate swap agreement provides for us to pay our correspondent bank a fixed rate, while our correspondent bank will pay us the 90-Day Libor Rate on a $32.0 million notional amount. The

quarterly re-set dates for the floating rate on the interest rate swap agreement are the same as the re-set dates for the floating rate on the subordinated debentures. The interest rate swap agreement does qualify for hedge accounting; therefore, monthly fluctuations in the present value of the interest rate swap agreement, net of tax effect, are recorded to other comprehensive income. As of September 30, 2014 and December 31, 2013, the present value of the interest rate swap agreement was recorded as a liability in the amount of $0.1 million and $0.3 million, respectively.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

11. FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amounts, estimated fair values and level within the fair value hierarchy of financial instruments were as follows as of September 30, 2014 and December 31, 2013 (dollars in thousands):

	Level in Fair Value Hierarchy	September 30, 2014		December 31, 2013	
		Carrying Values	Fair Values	Carrying Values	Fair Values
Financial assets:					
Cash	Level 1	$14,296	$14,296	$1,464	$1,464
Cash equivalents	Level 2	117,956	117,956	145,501	145,501
Securities available for sale	(1)	454,009	454,009	131,178	131,178
FHLB stock	(2)	19,226	19,226	11,961	11,961
Loans, net	Level 3	2,047,891	2,042,291	1,030,422	1,027,300
Bank owned life insurance	Level 2	55,992	55,992	51,377	51,377
Accrued interest receivable	Level 2	8,292	8,292	3,649	3,649
Financial liabilities:					
Deposits	Level 2	2,271,708	2,258,113	1,118,911	1,120,576
Repurchase agreements	Level 2	142,869	142,869	69,305	69,305
FHLB advances	Level 2	57,033	57,418	45,000	45,139
Subordinated debentures	Level 2	54,301	54,301	32,990	32,974
Accrued interest payable	Level 2	1,832	1,832	2,041	2,041
Interest rate swap	(1)	135	135	264	264

(1) See Note 12 for a description of the fair value hierarchy as well as a disclosure of levels for classes of financial assets and liabilities.

(2) It is not practical to determine the fair value of FHLB stock due to transferability restrictions.

Carrying amount is the estimated fair value for cash and cash equivalents, accrued interest receivable and payable, bank owned life insurance, noninterest checking deposits, securities sold under agreements to repurchase, and variable rate loans and 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 and deposits and for variable rate loans and 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 the interest rate swap is determined primarily utilizing market-consensus forecasted yield curves. Fair value of off-balance sheet items is estimated to be nominal.

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12. FAIR VALUES

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market for the asset or liability. The price of the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

We are required to use valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from independent sources, or unobservable, meaning those that reflect our own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances. In that regard, we utilize a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that we have the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or

other inputs that are observable or can be derived from or corroborated by observable market data by correlation or other means.

Level 3: Significant unobservable inputs that reflect our own conclusions about the assumptions that market participants would use in pricing an asset or liability.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

12. FAIR VALUES (Continued)

The following is a description of our valuation methodologies used to measure and disclose the fair values of our financial assets and liabilities that are recorded at fair value on a recurring or nonrecurring basis:

Securities available for sale. Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based on quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models. Level 2 securities include U.S. Government agency bonds, mortgage-backed securities issued or guaranteed by U.S. Government agencies, municipal general obligation and revenue bonds and mutual funds. Level 3 securities include bonds issued by certain relatively small municipalities located within our markets that have very limited marketability due to their size and lack of ratings from a recognized rating service. We carry these bonds at historical cost, which we believe approximates fair value, unless our periodic financial analysis or other information becomes known which necessitates a valuation allowance. There was no such valuation allowance as of September 30, 2014 or December 31, 2013. We have no Level 1 securities available for sale.

Derivatives. The interest rate swap is measured at fair value on a recurring basis. We measure fair value utilizing models that use primarily market observable inputs, such as forecasted yield curves, and accordingly, the interest rate swap agreement is classified as Level 2.

Mortgage 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, and are measured on a nonrecurring basis. Fair value is based on independent quoted market prices, where applicable, or the prices for other mortgage whole loans with similar characteristics. As of September 30, 2014 and December 31, 2013, we determined that the fair value of our mortgage loans held for sale approximated the recorded cost of $2.1 million and $1.1 million, respectively.

Loans. We do not record loans at fair value on a recurring basis. However, from time to time, we record nonrecurring fair value adjustments to collateral dependent loans to reflect partial write-downs or specific reserves that are based on the observable market price or current estimated value of the collateral. These loans are reported in the nonrecurring

table below at initial recognition of impairment and on an ongoing basis until recovery or charge-off.

Foreclosed Assets. At time of foreclosure or repossession, foreclosed and repossessed assets are adjusted to fair value less costs to sell upon transfer of the loans to foreclosed and repossessed assets, establishing a new cost basis. We subsequently adjust estimated fair value of foreclosed assets on a nonrecurring basis to reflect write-downs based on revised fair value estimates.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

12. FAIR VALUES (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The balances of assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
U.S. Government agency debt obligations	$204,477,000	$ 0	$204,477,000	$0
Mortgage-backed securities	100,258,000	0	100,258,000	0
Municipal general obligation bonds	136,250,000	0	125,889,000	10,361,000
Municipal revenue bonds	11,117,000	0	11,117,000	0
Other investments	1,907,000	0	1,907,000	0
Interest rate swap	(135,000)	0	(135,000)	0
Total	$453,874,000	$ 0	$443,513,000	$10,361,000

There were no transfers in or out of Level 1, Level 2 or Level 3 during the first nine months of 2014.

The balances of assets and liabilities measured at fair value on a recurring basis as of December 31, 2013 are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
U.S. Government agency debt obligations	$98,477,000	$ 0	$98,477,000	$ 0
Mortgage-backed securities	13,558,000	0	13,558,000	0
Municipal general obligation bonds	16,872,000	0	16,872,000	0
Municipal revenue bonds	916,000	0	916,000	0
Other investments	1,355,000	0	1,355,000	0
Interest rate swap	(264,000)	0	(264,000)	0
Total	$130,914,000	$ 0	$130,914,000	$ 0

There were no transfers in or out of Level 1, Level 2 or Level 3 during 2013.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

12. FAIR VALUES (Continued)

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The balances of assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2014 are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans [1]	$39,444,000	$ 0	$ 0	$39,444,000
Foreclosed assets [1]	2,659,000	0	0	2,659,000
Total	$42,103,000	$ 0	$ 0	$42,103,000

The balances of assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2013 are as follows:

Quoted Prices in Active	Significant Other	Significant

	Total	Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Impaired loans [1]	$23,405,000	$ 0	$ 0	$23,405,000
Foreclosed assets [1]	2,851,000	0	0	2,851,000
Total	$26,256,000	$ 0	$ 0	$26,256,000

[1] Represents carrying value and related write-downs for which adjustments are based on the estimated value of the property or other assets.

13. REGULATORY MATTERS

We 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 our financial statements.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

13. REGULATORY MATTERS (Continued)

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 not well 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 close monitoring 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 at the discretion of the federal regulator. At September 30, 2014 and December 31, 2013, our bank was in the well capitalized category under the regulatory framework for prompt corrective action. There are no conditions or events since September 30, 2014 that we believe have changed our bank's categorization. Our actual capital levels (dollars in thousands) and the minimum levels required to be categorized as adequately and well capitalized 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
September 30, 2014						
Total capital (to risk weighted assets)						
Consolidated	$327,936	14.0 %	$186,848	8.0 %	$NA	NA
Bank	325,909	14.0	186,608	8.0	233,259	10.0 %
Tier 1 capital (to risk weighted assets)						
Consolidated	307,562	13.2	93,424	4.0	NA	NA
Bank	305,535	13.1	93,304	4.0	139,956	6.0
Tier 1 capital (to average assets)						
Consolidated	307,562	11.0	111,775	4.0	NA	NA
Bank	305,535	10.9	111,764	4.0	139,704	5.0

December 31, 2013						
Total capital (to risk weighted assets)						
Consolidated	$193,925	15.9 %	$97,498	8.0 %	$NA	NA
Bank	190,493	15.7	97,329	8.0	121,662	10.0 %
Tier 1 capital (to risk weighted assets)						
Consolidated	178,598	14.7	48,749	4.0	NA	NA
Bank	175,192	14.4	48,665	4.0	72,997	6.0
Tier 1 capital (to average assets)						
Consolidated	178,598	12.5	57,006	4.0	NA	NA
Bank	175,192	12.3	56,860	4.0	71,075	5.0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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13. REGULATORY MATTERS (Continued)

Our consolidated capital levels as of September 30, 2014 and December 31, 2013 include $52.2 million and $32.0 million, respectively, of trust preferred securities subject to certain limitations. Under applicable Federal Reserve guidelines, the trust preferred securities constitute a restricted core capital element. The guidelines provide that the aggregate amount of restricted core elements that may be included in our Tier 1 capital must not exceed 25% of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Our ability to include the trust preferred securities in Tier 1 capital in accordance with the guidelines is not affected by the provision of the Dodd-Frank Act generally restricting such treatment, because (i) the trust preferred securities were issued before May 19, 2010, and (ii) our total consolidated assets as of December 31, 2009 were less than $15.0 billion. As of September 30, 2014 and December 31, 2013, all $52.2 million and $32.0 million, respectively, of the trust preferred securities were included in our consolidated Tier 1 capital.

Our and our bank's ability to pay cash and stock dividends is subject to limitations under various laws and regulations and to prudent and sound banking practices. On January 16, 2014, our Board of Directors declared a cash dividend on our common stock in the amount of $0.12 per share that was paid on March 10, 2014 to shareholders of record as of February 10, 2014. On May 9, 2014, our Board of Directors declared a cash dividend on our common stock in the amount of $0.12 per share that was paid on June 25, 2014 to shareholders of record as of June 13, 2014. On July 17, 2014, our Board of Directors declared a cash dividend on our common stock in the amount of $0.12 per share that was paid on September 24, 2014 to shareholders of record as of September 12, 2014. On October 16, 2014, our Board of Directors declared a cash dividend on our common stock in the amount of $0.12 per share that will be paid on December 24, 2014 to shareholders of record as of December 12, 2014. In addition, on May 9, 2014, our Board of Directors declared a special cash dividend on our common stock in the amount of $2.00 per share that was paid on May 29, 2014 to shareholders of record as of May 22, 2014. The special cash dividend, in contemplation of the plan of merger with Firstbank, was paid to Mercantile shareholders prior to the effective date of the merger with Firstbank and before the issuance of Mercantile shares in exchange for Firstbank shares.

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MERCANTILE BANK CORPORATION

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

Forward Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and our company. Words such as "anticipates," "believes," "estimates," "expects," "forecasts," "intends," "is likely," "plans," "projects," and variations words and similar 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, among others, 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 or actions by bank regulators; changes in tax laws; changes in prices, levies, and assessments; our ability to successfully integrate the operations of Mercantile and Firstbank and their respective subsidiary banks; the ability of the combined company to compete in the highly competitive banking and financial services industry; 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 local real estate values; changes in the national and local economies; and risk factors described in our annual report on Form 10-K for the year ended December 31, 2013 or in this report. These are representative of the Future Factors that could cause a difference between an ultimate actual outcome and a forward-looking statement.

Introduction

The following discussion compares the financial condition of Mercantile Bank Corporation and its consolidated subsidiaries, including Mercantile Bank of Michigan ("our bank") and our bank's two subsidiaries, Mercantile Bank Real Estate Co., LLC ("our real estate company") and Mercantile Insurance Center, Inc. ("our insurance company"), at September 30, 2014 and December 31, 2013 and the results of operations for the three months and nine months ended September 30, 2014 and September 30, 2013. This discussion should be read in conjunction with the interim consolidated financial statements and footnotes included in this report. Unless the text clearly suggests otherwise, references in this report to "us," "we," "our" or "the company" include Mercantile Bank Corporation and its consolidated subsidiaries referred to above.

Critical Accounting Policies

Accounting principles generally accepted in the United States of America are complex and require us to apply significant judgment to various accounting, reporting and disclosure matters. We must use assumptions and estimates to apply these principles where actual measurements are not possible or practical. Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our unaudited financial statements included in this report. For a discussion of our significant accounting policies, see Note 1 of the Notes to our Consolidated Financial Statements included on pages F-48 through F-53 in our Form 10-K for the fiscal year ended December 31, 2013 (Commission file number 000-26719). Our allowance for loan losses policy and accounting for income taxes are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements, and actual results may differ from those estimates. We have reviewed the application of these policies with the Audit Committee of our Board of Directors.

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MERCANTILE BANK CORPORATION

Allowance for Loan Losses: The allowance for loan losses ("allowance") is maintained at a level we believe is adequate to absorb probable incurred losses identified and inherent in the originated loan portfolio. Our evaluation of the adequacy of the allowance is an estimate based on past loan loss experience, the nature and volume of the loan portfolio, information about specific borrower situations and estimated collateral values, guidance from bank regulatory agencies, and assessments of the impact of current and anticipated economic conditions on the loan portfolio. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in our judgment, should be charged-off. Loan losses are charged against the allowance when we believe the uncollectability of a loan is likely. The balance of the allowance represents our best estimate, but significant downturns in circumstances relating to loan quality or economic conditions could result in a requirement for an increased allowance in the future. Likewise, an upturn in loan quality or improved economic conditions may result in a decline in the required allowance in the future. In either instance, unanticipated changes could have a significant impact on the allowance and operating results.

The allowance is increased through a provision charged to operating expense. Uncollectable loans are charged-off through the allowance. Recoveries of loans previously charged-off are added to the allowance. 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. Impairment is evaluated in aggregate for smaller-balance loans of similar nature such as residential mortgage, consumer and credit card loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. The timing of obtaining outside appraisals varies, generally depending on the nature and complexity of the property being evaluated, general breadth of activity within the marketplace and the age of the most recent appraisal. For collateral dependent impaired loans, in most cases we obtain and use the "as is" value as indicated in the appraisal report, adjusting for any expected selling costs. In certain circumstances, we may internally update outside appraisals based on recent information impacting a particular or similar property, or due to identifiable trends (e.g., recent sales of similar properties) within our markets. The expected future cash flows exclude potential cash flows from certain guarantors. To the extent these guarantors provide repayments, a recovery would be recorded upon receipt. Loans are evaluated for impairment when payments are delayed, typically 30 days or more, or when serious deficiencies are identified within the credit relationship. Our policy for recognizing income on impaired loans is to accrue interest unless a loan is placed on nonaccrual status. We put loans into nonaccrual status when the full collection of principal and interest is not expected.

Income Tax Accounting: Current income tax assets and liabilities are established for the amount of taxes payable or refundable for the current year. In the preparation of income tax returns, tax positions are taken based on interpretation of federal and state income tax laws for which the outcome may be uncertain. We periodically review and evaluate the status of our tax positions and make adjustments as necessary. Deferred income tax assets and liabilities are also

established for the future tax consequences of events that have been recognized in our financial statements or tax returns. A deferred income tax asset or liability is recognized for the estimated future tax effects attributable to temporary differences that can be carried forward (used) in future years. The valuation of our net deferred income tax asset is considered critical as it requires us to make estimates based on provisions of the enacted tax laws. The assessment of the realizability of the net deferred income tax asset involves the use of estimates, assumptions, interpretations and judgments concerning accounting pronouncements, federal and state tax codes and the extent of future taxable income. There can be no assurance that future events, such as court decisions, positions of federal and state tax authorities, and the extent of future taxable income will not differ from our current assessment, the impact of which could be significant to the consolidated results of operations and reported earnings.

Accounting guidance requires that we assess whether a valuation allowance should be established against our deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard. In making such judgments, we consider both positive and negative evidence and analyze changes in near-term market conditions as well as other factors which may impact future operating results. Significant weight is given to evidence that can be objectively verified. During 2011, we returned to pre-tax profitability for four consecutive quarters. Additionally, we experienced lower provision expense, continued declines in nonperforming assets and problem asset administration costs, a higher net interest margin, a further strengthening of our regulatory capital ratios and additional reductions in wholesale funding. This positive evidence allowed us to conclude that, as of December 31, 2011, it was more likely than not that we returned to sustainable profitability in amounts sufficient to allow for realization of our deferred tax assets in future years. Consequently, we reversed the valuation allowance that we had previously determined necessary to carry against our entire net deferred tax asset starting on December 31, 2009.

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MERCANTILE BANK CORPORATION

Securities and Other Financial Instruments: Securities available for sale consist of bonds and notes which might be sold prior to maturity due to changes in interest rate, prepayment risks, yield and availability of alternative investments, liquidity needs or other factors. Securities classified as available for sale are reported at their fair value. 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 carrying value (2) the financial condition and near term prospects of the issuer and (3) the Company's ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. Fair values for securities available for sale are obtained from outside sources and applied to individual securities within the portfolio. The difference between the amortized cost and the current fair value of securities is recorded as a valuation adjustment and reported in other comprehensive income.

Mortgage Servicing Rights: Mortgage servicing rights are recognized as assets based on the allocated fair value of retained servicing rights on loans sold. Servicing rights are carried at the lower of amortized cost or fair value and are expensed in proportion to, and over the period of, estimated net servicing income. We utilize a discounted cash flow model to determine the value of our servicing rights. The valuation model utilizes mortgage prepayment speeds, the remaining life of the mortgage pool, delinquency rates, our cost to service loans, and other factors to determine the cash flow that we will receive from serving each grouping of loans. These cash flows are then discounted based on current interest rate assumptions to arrive at the fair value of the right to service those loans. Impairment is evaluated quarterly based on the fair value of the servicing rights, using groupings of the underlying loans classified by interest rates. Any impairment of a grouping is reported as a valuation allowance.

Goodwill: Generally accepted accounting principles require us to determine the fair value of all of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. We employ a variety of means in determination of the fair value, including the use of discounted cash flow analysis, market comparisons, and projected future revenue streams. For certain items that we believe we have the appropriate expertise to determine the fair value, we may choose to use our own calculation of the value. In other cases, where the value is not easily determined, we consult with outside parties to determine the fair value of the asset or liability. Once valuations have been adjusted, the net difference between the price paid for the acquired company and the value of its balance sheet is recorded as goodwill.

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Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment is recognized in the period identified. A more frequent assessment is performed if conditions in the market place or changes in the company's organizational structure occur. We use a discounted income approach and a market valuation model, which compares the inherent value of our company to valuations of recent transactions in the market place to determine if our goodwill has been impaired.

Firstbank Merger

We completed the merger of Firstbank Corporation ("Firstbank"), a Michigan corporation with approximately $1.5 billion in total assets and 46 branch locations, into Mercantile Bank Corporation as of June 1, 2014 ("Merger Date"). The results of operations due to the Firstbank transaction have been included in Mercantile's financial results since the Merger Date. All of Firstbank's common stock was converted into the right to receive one share of Mercantile common stock for each share of Firstbank common stock. The conversion of Firstbank's common stock into Mercantile's common stock resulted in Mercantile issuing 8,087,272 shares of its common stock. In conjunction with the completion of the merger, Mercantile assumed the obligations of four business trusts that were formed by Firstbank to issue trust preferred securities.

The Firstbank transaction was accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the Merger Date. In accordance with the applicable accounting guidance for business combinations, these fair values are preliminary and subject to refinement for up to one year after the closing date of the transaction as additional information relative to closing date fair value may become available.

In most instances, determining the fair value of the acquired assets and assumed liabilities required us to estimate cash flows expected to result from those assets and liabilities and to discount those cash flows at appropriate rates of interest. The most significant of those determinations relates to the valuation of acquired loans. For such loans, the excess of cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the impact of estimated credit losses and other factors, such as prepayments. In accordance with the applicable accounting guidance for business combinations, there was no carry-over of Firstbank's previously established allowance for loan losses. The acquired loans were divided into loans with evidence of credit quality deterioration, which are accounted for under ASC 310-30 ("acquired impaired"), and loans that do not meet this criteria, which are accounted for under ASC 310-20 ("acquired non-impaired").

Our operating results include the operating results of the acquired assets and assumed liabilities for the 122 days subsequent to the Merger Date. The operations of the former Firstbank organization provided approximately $13.5 million and $18.0 million in net interest income for the third quarter and nine months ended September 30, 2014, respectively, and are included in our consolidated financial statements for those periods. Firstbank's results of operations prior to the Merger Date are not included in our consolidated statements of income or comprehensive income.

We recorded merger-related expenses of $1.3 million and $5.1 million during the three month and nine month periods ended September 30, 2014, respectively. Such expenses were generally for professional services, costs related to termination of existing contractual arrangements for various services, retention and severance compensation costs, marketing and promotional expenses, travel costs, and printing and supplies costs. Virtually all of Mercantile and Firstbank's operating systems are now integrated.

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Financial Overview

We reported net income of $5.9 million, or $0.35 per diluted share, for the third quarter of 2014, and net income of $11.0 million, or $0.89 per diluted share, during the first nine months of 2014.

Our third quarter and year-to-date earnings results have been significantly impacted by the Firstbank merger. In addition to our earnings results reflecting four months of operations as a combined organization, we recorded relatively large merger-related costs during the first nine months of 2014, especially during the second and third quarters. Merger-related costs totaled $1.3 million during the third quarter and $5.1 million during the first nine months of 2014. On an after-tax basis, that equated to $0.9 million, or $0.05 per diluted share, during the third quarter, and $3.6 million, or $0.29 per diluted share, during the first nine months of 2014. We expect to record additional merger-related costs totaling approximately $0.4 million during the fourth quarter of 2014, and then nominal amounts during the first and second quarters of 2015.

The quality of our loan portfolio remains strong, which when combined with recoveries of prior loan charge-offs and the eliminations of and reductions in specific reserves, have produced a positive impact on our allowance calculations and allowed us to make negative provisions in seven consecutive quarters and in nine of the last ten quarters. We have recorded a net loan recovery during seven out of the last ten quarters. In addition, the level of problem asset administration costs remains low.

New term loan originations totaled approximately $47 million during the third quarter of 2014 and about $168 million during the first nine months of 2014. We have also experienced net increases in commercial lines of credit, in large part reflecting lines that are part of new commercial lending relationships established during recent quarterly periods. The new loan pipeline remains strong, and at September 30, 2014, we had over $140 million in unfunded loan commitments on commercial construction and development loans that are in the construction phase. We believe our loan portfolio is well diversified post-merger, with commercial real estate non-owner occupied loans comprising 28% of total loans, commercial and industrial loans equaling 26%, commercial real estate owner occupied loans comprising 20% and residential mortgage and consumer loans aggregating 18% of total loans at September 30, 2014. As a percent of total commercial loans, commercial and industrial loans and commercial real estate owner occupied loans equal 57%.

The merger with Firstbank also had a significant positive impact on our funding structure, resulting in a well diversified funding mix. As of September 30, 2014, noninterest-bearing checking accounts comprised 22% of total funds, interest-bearing checking and sweep accounts combined for 22%, savings deposits and money market accounts aggregated to 23% and local time deposits accounted for 23%. Wholesale funds, comprised of brokered deposits and FHLB advances, represented 10% of total funds.

Financial Condition

Primarily reflecting the merger with Firstbank, our total assets increased $1.44 billion during the first nine months of 2014, and totaled $2.86 billion as of September 30, 2014. Total loans increased $1.02 billion and securities available for sale were up $323 million, while cash and cash equivalents decreased $14.7 million. Total deposits increased $1.15 billion and securities sold under agreements to repurchase (“repurchase agreements”) were up $73.6 million during the first nine months of 2014.

Our loan portfolio has historically been primarily comprised of commercial loans, although less so now with the Firstbank merger. Commercial loans increased $700 million during the first nine months of 2014, and at September 30, 2014 totaled $1.69 billion, or 81.5% of the loan portfolio. As of December 31, 2013, the commercial loan portfolio comprised 93.7% of total loans. The increase in commercial loans during the first nine months of 2014 includes about $168 million in new commercial term loans to existing and new borrowers, with the remainder generally reflecting the Firstbank merger. Commercial and industrial loans were up $255 million, non-owner occupied commercial real estate ("CRE") loans increased $220 million, owner occupied CRE loans increased $151 million, multi-family and residential rental loans increased $58 million and vacant land, land development and residential construction loans were up $15 million. As a percent of total commercial loans, commercial and industrial loans and commercial real estate owner occupied loans equal 56.6%.

We significantly enhanced our commercial loan sales efforts over the past couple of years. We are very pleased with the approximately $572 million in new commercial term loan fundings since the beginning of 2012, and our current pipeline reports indicate continued strong commercial loan funding opportunities in future periods. Also, as of September 30, 2014, availability on existing construction and development loans totaled over $140 million, with most of those funds expected to be drawn over the next twelve months. In addition, we have made additional lending commitments totaling about $128 million, a majority of which we expect to be accepted and funded over the next 12 to 18 months. Our commercial lenders also report substantial additional opportunities they are currently discussing with existing and potentially new borrowers.

We continue to experience some commercial loan principal paydowns and payoffs. A majority of these principal paydowns and payoffs received thus far have been welcomed, such as on stressed loan relationships; however, we have also experienced instances where well-performing relationships have been refinanced at other financial institutions and other situations where the borrower has sold the underlying asset, paying off the loan. In many of those cases where the loans were refinanced elsewhere, we believed the terms and conditions of the new lending arrangements were too aggressive, generally reflecting the very competitive banking environment in our markets. We remain committed to prudent underwriting standards that provide for an appropriate yield and risk relationship. In addition, we continue to receive accelerated principal paydowns from certain borrowers who have elevated deposit balances generally resulting from profitable operations and an apparent unwillingness to expand their businesses and/or replace equipment primarily due to economic- and tax-related uncertainties. Usage of existing commercial lines of credit has remained relatively steady.

Reflecting the Firstbank merger, one-to-four family mortgage loans increased $186 million and other consumer loans were up $129 million during the first nine months of 2014, and at September 30, 2014, totaled a combined $382

million, or 18.5% of total loans. One-to-four family mortgage loans and other consumer loans equated to 6.3% of total loans as of December 31, 2013.

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The following table summarizes our loan portfolio at September 30, 2014:

	9/30/14	6/30/14	3/31/14	12/31/13	9/30/13
Commercial:					
Commercial & Industrial	$541,805,000	$538,791,000	$289,009,000	$286,373,000	$286,887,000
Land Development & Construction	52,218,000	55,948,000	37,190,000	36,741,000	40,741,000
Owner Occupied Commercial RE	412,470,000	411,116,000	264,299,000	261,877,000	258,656,000
Non-Owner Occupied Commercial RE	584,422,000	588,752,000	378,034,000	364,066,000	368,301,000
Multi-Family & Residential Rental	95,649,000	93,939,000	35,686,000	37,639,000	53,178,000
Total Commercial	1,686,564,000	1,688,546,000	1,004,218,000	986,696,000	1,007,763,000
Retail:					
1-4 Family Mortgages	217,751,000	215,908,000	30,800,000	31,467,000	36,575,000
Home Equity & Other Consumer Loans	163,950,000	169,028,000	31,778,000	35,080,000	31,149,000
Total Retail	381,701,000	384,936,000	62,578,000	66,547,000	67,724,000
Total	$2,068,265,000	$2,073,482,000	$1,066,796,000	$1,053,243,000	$1,075,487,000

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 an internal watch list. Senior management and the Board of Directors review this list regularly. Market value estimates of collateral on impaired loans, as well as on foreclosed and repossessed assets, are reviewed periodically; however, we have a process in place to monitor whether value estimates at each quarter-end are reflective of current market conditions. Our credit policies establish criteria for obtaining appraisals and determining internal value estimates. We may also adjust outside and internal valuations based on identifiable trends within our markets, such as recent sales of similar properties or assets, listing prices and offers received. In addition, we may discount certain appraised and internal value estimates to address distressed market conditions.

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Nonperforming assets, comprised of nonaccrual loans, loans past due 90 days or more and accruing interest and foreclosed properties, totaled $8.7 million (0.3% of total assets) as of September 30, 2014, compared to $9.6 million (0.7% of total assets) as of December 31, 2013. The volume of nonperforming assets has generally been on a declining trend since the peak of $117.6 million on March 31, 2010, and is currently at its lowest level since year-end 2006. Reductions in nonperforming assets during the first nine months of 2014 primarily reflect principal payments on nonaccrual loans and sales proceeds on foreclosed properties. Loans placed into nonaccrual status totaled $1.6 million during the first nine months of 2014, while foreclosed properties at the time of the Firstbank merger totaled $1.2 million and another $0.8 million was transferred from acquired loans to foreclosed properties during the third quarter of 2014. Acquired loans are recorded at fair value with no allowance brought forward in accordance with acquisition accounting. Acquired impaired loans are considered performing due to the application of the accretion method under acquisition accounting.

The following tables provide a breakdown of nonperforming assets by collateral type:

NONPERFORMING LOANS

	9/30/14	6/30/14	3/31/14	12/31/13	9/30/13
Residential Real Estate:					
Land Development	$107,000	$36,000	$38,000	$40,000	$43,000
Construction	0	0	0	0	0
Owner Occupied / Rental	4,350,000	3,898,000	4,026,000	4,219,000	2,859,000
	4,457,000	3,934,000	4,064,000	4,259,000	2,902,000
Commercial Real Estate:					
Land Development	222,000	235,000	361,000	389,000	627,000
Construction	0	0	0	0	0
Owner Occupied	733,000	1,176,000	784,000	885,000	718,000
Non-Owner Occupied	330,000	129,000	335,000	169,000	3,251,000
	1,285,000	1,540,000	1,480,000	1,443,000	4,596,000
Non-Real Estate:					
Commercial Assets	296,000	267,000	798,000	1,016,000	1,111,000
Consumer Assets	33,000	0	0	0	0
	329,000	267,000	798,000	1,016,000	1,111,000

Total	$6,071,000	$5,741,000	$6,342,000	$6,718,000	$8,609,000

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OTHER REAL ESTATE OWNED & REPOSSESSED ASSETS

	9/30/14	6/30/14	3/31/14	12/31/13	9/30/13
Residential Real Estate:					
Land Development	$329,000	$427,000	$427,000	$427,000	$495,000
Construction	0	22,000	22,000	22,000	89,000
Owner Occupied / Rental	902,000	968,000	186,000	207,000	219,000
	1,231,000	1,417,000	635,000	656,000	803,000
Commercial Real Estate:					
Land Development	0	92,000	92,000	92,000	6,000
Construction	0	0	0	0	0
Owner Occupied	173,000	300,000	75,000	164,000	501,000
Non-Owner Occupied	1,255,000	1,069,000	1,548,000	1,939,000	2,239,000
	1,428,000	1,461,000	1,715,000	2,195,000	2,746,000
Non-Real Estate:					
Commercial Assets	0	0	0	0	0
Consumer Assets	0	0	0	0	0
	0	0	0	0	0
Total	$2,659,000	$2,878,000	$2,350,000	$2,851,000	$3,549,000

The following tables provide a reconciliation of nonperforming assets:

NONPERFORMING LOANS RECONCILIATION

	3rd Qtr 2014	2nd Qtr 2014	1st Qtr 2014	4th Qtr 2013	3rd Qtr 2013

Beginning balance	$5,741,000	$6,342,000	$6,718,000	$8,609,000	$10,526,000
Additions, net of transfers to ORE	1,194,000	(11,000)	174,000	1,734,000	502,000
Principal payments	(864,000)	(523,000)	(449,000)	(3,072,000)	(2,363,000)
Loan charge-offs	0	(67,000)	(101,000)	(553,000)	(56,000)
Total	$6,071,000	$5,741,000	$6,342,000	$6,718,000	$8,609,000

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OTHER REAL ESTATE OWNED & REPOSSESSED ASSETS RECONCILIATION

	3rd Qtr 2014	2nd Qtr 2014	1st Qtr 2014	4th Qtr 2013	3rd Qtr 2013
Beginning balance	$2,878,000	$2,350,000	$2,851,000	$3,549,000	$3,916,000
Additions - originated loans	21,000	175,000	0	134,000	350,000
Additions - merger ORE	830,000	1,187,000	0	0	0
Sale proceeds	(910,000)	(790,000)	(501,000)	(797,000)	(527,000)
Valuation write-downs	(160,000)	(44,000)	0	(35,000)	(190,000)
Total	$2,659,000	$2,878,000	$2,350,000	$2,851,000	$3,549,000

During the first nine months of 2014, loan charge-offs totaled $1.0 million while recoveries of prior period charge-offs aggregated to $1.6 million, resulting in a net recovery $0.6 million. We recorded a net recovery of prior period charge-offs of $1.3 million during all of 2013.

The following table provides a breakdown of net loan charge-offs (recoveries) by collateral type:

	3rd Qtr 2014	2nd Qtr 2014	1st Qtr 2014	4th Qtr 2013	3rd Qtr 2013
Residential Real Estate:					
Land Development	$34,000	$(4,000)	$(1,000)	$(78,000)	$(387,000)
Construction	0	0	0	0	0
Owner Occupied / Rental	95,000	(572,000)	(139,000)	(144,000)	(105,000)
	129,000	(576,000)	(140,000)	(222,000)	(492,000)
Commercial Real Estate:					
Land Development	(57,000)	(11,000)	0	0	0
Construction	0	0	0	0	0
Owner Occupied	4,000	98,000	37,000	47,000	(74,000)
Non-Owner Occupied	3,000	(70,000)	336,000	1,206,000	(1,215,000)

	(50,000)	17,000	373,000	1,253,000	(1,289,000)
Non-Real Estate:					
Commercial Assets	(49,000)	(45,000)	(267,000)	(1,154,000)	(172,000)
Consumer Assets	52,000	2,000	1,000	(4,000)	5,000
	3,000	(43,000)	(266,000)	(1,158,000)	(167,000)
Total	$82,000	$(602,000)	$(33,000)	$(127,000)	$(1,948,000)

In each accounting period, we adjust the allowance to the amount we believe is necessary to maintain the allowance at an adequate level. Through the loan review and credit departments, we establish portions of the allowance based on specifically identifiable problem loans. The evaluation of the allowance is further based on, but not limited to, consideration of the internally prepared Allowance Analysis, loan loss migration analysis, composition of the loan portfolio, third party analysis of the loan administration processes and portfolio, and general economic conditions.

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The Allowance Analysis applies reserve allocation factors to non-impaired outstanding loan balances, the result of which is combined with specific reserves to calculate an overall allowance dollar amount. For non-impaired commercial loans, reserve allocation factors are based on the loan ratings as determined by our standardized grade paradigms and by loan purpose. Our commercial loan portfolio is segregated into five classes: 1) commercial and industrial loans; 2) vacant land, land development and residential construction loans; 3) owner occupied real estate loans; 4) non-owner occupied real estate loans; and 5) multi-family and residential rental property loans. The reserve allocation factors are primarily based on the historical trends of net loan charge-offs through a migration analysis whereby net loan losses are tracked via assigned grades over various time periods, with adjustments made for environmental factors reflecting the current status of, or recent changes in, items such as: lending policies and procedures; economic conditions; nature and volume of the loan portfolio; experience, ability and depth of management and lending staff; volume and severity of past due, nonaccrual and adversely classified loans; effectiveness of the loan review program; value of underlying collateral; loan concentrations; and other external factors such as competition and regulatory environment. Adjustments for specific lending relationships, particularly impaired loans, are made on a case-by-case basis. Non-impaired retail loan reserve allocations are determined in a similar fashion as those for non-impaired commercial loans, except that retail loans are segmented by type of credit and not a grading system. We regularly review the Allowance Analysis and make needed adjustments based upon identifiable trends and experience.

A migration analysis is completed quarterly to assist us in determining appropriate reserve allocation factors for non-impaired commercial loans. Our migration analysis takes into account various time periods, with most weight placed on a twelve-quarter time frame. We believe the twelve-quarter period represents an appropriate range of economic conditions, and that it provides for an appropriate basis in determining reserve allocation factors given current economic conditions and the general consensus of economic conditions in the near future.

Although the migration analysis provides a historical accounting of our net loan losses, it is not able to fully account for environmental factors that will also very likely impact the collectability of our commercial loans as of any quarter-end date. Therefore, we incorporate the environmental factors as adjustments to the historical data. Environmental factors include both internal and external items. We believe the most significant internal environmental factor is our credit culture and the relative aggressiveness in assigning and revising commercial loan risk ratings, with the most significant external environmental factor being the assessment of the current economic environment and the resulting implications on our commercial loan portfolio.

The primary risk elements with respect to commercial loans are the financial condition of the borrower, the sufficiency of collateral, and timeliness of scheduled payments. We have a policy of requesting and reviewing

periodic financial statements from commercial loan customers, and we have a disciplined and formalized review of the existence of collateral and its value. The primary risk element with respect to each residential real estate loan and consumer loan is the timeliness of scheduled payments. We have a reporting system that monitors past due loans and have adopted policies to pursue creditor's rights in order to preserve our collateral position.

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The allowance equaled $20.4 million as of September 30, 2014, or 1.7% of total originated loans outstanding, compared to 2.2% as of December 31, 2013. A large portion of the decline in the level of the allowance during the first nine months of 2014 reflects elimination and reduction of specific reserves due to successful collection efforts, while the remainder of the decline is primarily associated with commercial loan upgrades and reductions in most reserve allocation factors on non-impaired commercial loans resulting from the impact of lower net loan charge-offs in recent periods on our migration calculations. The allowance equaled 335.6% of nonperforming loans as of September 30, 2014, compared to 339.7% as of December 31, 2013. This particular allowance measurement has increased significantly during the past several years primarily due to total nonperforming loans declining at a faster rate than the balance of the allowance and certain accruing higher-balance commercial loan relationships having been categorized as troubled debt restructurings resulting in higher specific reserve allocations.

As of September 30, 2014, the allowance was comprised of $9.1 million in general reserves relating to non-impaired loans, $1.2 million in specific reserve allocations relating to nonaccrual loans, and $10.1 million in specific reserves on other loans, primarily accruing loans designated as troubled debt restructurings. Troubled debt restructurings totaled $50.8 million at September 30, 2014, consisting of $3.4 million that are on nonaccrual status and $47.4 million that are on accrual status. The latter, while considered and accounted for as impaired loans in accordance with accounting guidelines, is not included in our nonperforming loan totals. The increase during the third quarter of 2014 primarily reflects one stressed commercial loan relationship that was restructured to obtain additional collateral and personal guarantees, and to adjust the loan rate to better reflect the credit risk. Impaired loans with an aggregate carrying value of $1.3 million as of September 30, 2014 had been subject to previous partial charge-offs aggregating $2.3 million. Those partial charge-offs were recorded as follows: $0.1 million during the first nine months of 2014, $0.5 million in 2013, $1.0 million in 2012, $0.5 million in 2011 and $0.2 million in 2010. As of September 30, 2014, there were no specific reserves allocated to impaired loans that had been subject to a previous partial charge-off.

The following table provides a breakdown of our originated loans categorized as troubled debt restructurings:

	9/30/14	6/30/14	3/31/14	12/31/13	9/30/13
Performing	$47,385,000	$24,900,000	$27,093,000	$30,247,000	$41,708,000
Nonperforming	3,371,000	4,232,000	4,800,000	4,645,000	5,782,000
Total	$50,756,000	$29,132,000	$31,893,000	$34,892,000	$47,490,000

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

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In large part reflecting the merger with Firstbank, securities increased $323 million during the first nine months of 2014, totaling $454 million as of September 30, 2014. Purchases during the first nine months of 2014, generally consisting of U.S. Government agency and municipal bonds, totaled $14.4 million. Proceeds from matured and called U.S. Government agency bonds and municipal bonds during the first nine months of 2014 totaled $20.4 million and $14.7 million, respectively, with another $11.1 million from principal paydowns on mortgage-backed securities. At September 30, 2014, the portfolio was primarily comprised of U.S. Government agency bonds (45%), municipal bonds (33%) and U.S. Government agency issued or guaranteed mortgage-backed securities (22%). All of our securities are currently designated as available for sale, and are therefore stated at fair value. The fair value of securities designated as available for sale at September 30, 2014 totaled $454 million, including a net unrealized loss of $3.4 million. We maintain the securities portfolio at levels to provide adequate pledging and secondary liquidity for our daily operations. In addition, the securities portfolio serves a primary interest rate risk management function.

FHLB stock totaled $19.2 million as of September 30, 2014, an increase of $7.3 million from the balance at December 31, 2013 resulting from the Firstbank merger. Our investment in FHLB stock is necessary to engage in their advance and other financing programs. We have received regularly quarterly cash dividends, and we expect a cash dividend will continue to be paid in future quarterly periods.

Market values on our U.S. Government agency bonds, mortgage-backed securities issued or guaranteed by U.S. Government agencies and municipal bonds are generally determined on a monthly basis with the assistance of a third party vendor. Evaluated pricing models that vary by type of security and incorporate available market data are utilized. Standard inputs include issuer and type of security, benchmark yields, reported trades, broker/dealer quotes and issuer spreads. We believe our valuation methodology provides for a reasonable estimation of market value, and that it is consistent with the requirements of accounting guidelines.

Federal funds sold, consisting of excess funds sold overnight to a correspondent bank, along with investments in interest-bearing deposits at correspondent and other banks, are used to manage daily liquidity needs and interest rate sensitivity. During the first nine months of 2014, the average balance of these funds equaled $90.0 million, or 4.7% of average earning assets. We expect the level of these funds to average approximately 1% to 2% of average earning assets in future quarters.

Net premises and equipment equaled $48.6 million at September 30, 2014, an increase of $23.7 million during the first nine months of 2014. The merger with Firstbank accounts for virtually the entire increase.

Primarily reflecting the merger with Firstbank, total deposits increased $1.15 billion during the first nine months of 2014, totaling $2.27 billion at September 30, 2014. Out-of-area deposits decreased $29.8 million during the first nine months of 2014, and as a percent of total deposits, equaled 8.1% as of September 30, 2014, compared to 19.0% as of December 31, 2013.

Noninterest-bearing checking accounts increased $311 million during the first nine months of 2014. While the growth is primarily due to the Firstbank merger, noninterest-bearing checking accounts also increased due to deposit account openings as part of new commercial lending relationships. Also reflecting the impact of the Firstbank merger, interest-bearing checking accounts increased $206 million, money market deposit accounts grew $108 million, savings deposits increased $282 million and local time deposits grew $276 million during the first nine months of 2014.

Repurchase agreements increased $73.6 million during the first nine months of 2014, totaling $143 million as of September 30, 2014. The increase is primarily due to the merger with Firstbank. As part of our sweep account program, collected funds from certain business noninterest-bearing checking accounts and savings deposits are invested into over-night interest-bearing repurchase agreements. Such repurchase agreements are not deposit accounts and are not afforded federal deposit insurance.

Reflecting the merger with Firstbank, FHLB advances increased $12.0 million during the first nine months of 2014. As of September 30, 2014, FHLB advances totaled $57.0 million. The 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 as of September 30, 2014 totaled about $570 million, with availability approximating $511 million.

Liquidity

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

To assist in providing needed funds, we have regularly obtained monies from wholesale funding sources. Wholesale funds, primarily comprised of deposits from customers outside of our market areas and advances from the FHLB, totaled $240 million, or 9.7% of combined deposits and borrowed funds, as of September 30, 2014, compared to $258 million, or 20.9% of combined deposits and borrowed funds, as of December 31, 2013.

As part of our sweep account program, collected funds from certain business noninterest-bearing checking accounts and savings deposits are invested into over-night interest-bearing repurchase agreements. Such repurchase agreements are not deposit accounts and are not afforded federal deposit insurance. Repurchase agreements increased $73.6 million during the first nine months of 2014, totaling $143 million as of September 30, 2014. The increase is primarily attributable to the merger with Firstbank. Information regarding our repurchase agreements as of September 30, 2014

and during the first nine months of 2014 is as follows:

Outstanding balance at September 30, 2014	$142,869,000
Weighted average interest rate at September 30, 2014	0.10 %
Maximum daily balance nine months ended September 30, 2014	$148,700,000
Average daily balance for nine months ended September 30, 2014	$93,855,000
Weighted average interest rate for nine months ended September 30, 2014	0.12 %

As a member of the FHLB, we have access to the FHLB advance borrowing programs. FHLB advances increased $12.0 million during the first nine months of 2014, reflecting the merger with Firstbank. As of September 30, 2014, FHLB advances totaled $57.0 million. Based on available collateral at September 30, 2014, we could borrow an additional $511 million.

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We also have the ability to borrow up to $63.0 million on a daily basis through correspondent banks using established unsecured federal funds purchased lines of credit. We did not access these lines of credit during first nine months of 2014; in fact, we have not accessed the lines of credit since January of 2010. In contrast, federal funds sold averaged $61.4 million during the first nine months of 2014. We have a line of credit through the Discount Window of the Federal Reserve Bank of Chicago. Using certain municipal bonds as collateral, we could have borrowed up to $12.1 million as of September 30, 2014. We did not utilize this line of credit during the first nine months of 2014 or at any time during the previous five fiscal years, and do not plan to access this line of credit in future periods.

The following table reflects, as of September 30, 2014, significant fixed and determinable contractual obligations to third parties by payment date, excluding accrued interest:

	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	$1,514,409,000	$0	$0	$0	$1,514,409,000
Certificates of deposit	372,023,000	283,603,000	101,673,000	0	757,299,000
Short-term borrowings	142,869,000	0	0	0	142,869,000
Federal Home Loan Bank advances	9,000,000	48,033,000	0	0	57,033,000
Subordinated debentures	0	0	0	54,301,000	54,301,000
Other borrowed money	724,000	1,276,000	0	3,514,000	5,514,000
Property leases	301,000	923,000	297,000	71,000	1,592,000

In addition to normal loan funding and deposit flow, we must maintain liquidity to meet the demands of certain unfunded loan commitments and standby letters of credit. As of September 30, 2014, we had a total of $763 million in unfunded loan commitments and $37.5 million in unfunded standby letters of credit. Of the total unfunded loan commitments, $635 million were commitments available as lines of credit to be drawn at any time as customers' cash needs vary, and $128 million were for loan commitments generally expected to close and become funded within the next twelve months. We regularly monitor fluctuations in loan balances and commitment levels, and include such data in our overall liquidity management.

We monitor our liquidity position and funding strategies on an ongoing basis, but recognize that unexpected events, changes in economic or market conditions, a reduction in earnings performance, declining capital levels or situations beyond our control could cause liquidity challenges. While we believe it is unlikely that a funding crisis of any

significant degree is likely to materialize, we have developed a comprehensive contingency funding plan that provides a framework for meeting liquidity disruptions.

Capital Resources

Shareholders' equity was $321 million at September 30, 2014, compared to $153 million at December 31, 2013. The $168 million increase during the first nine months of 2014 was primarily due to the merger with Firstbank. We issued 8,087,272 shares of common stock, valued at $173 million, in connection with the merger. Net income during the first nine months of 2014 totaled $11.0 million. Negatively impacting shareholder's equity during the first nine months of 2014 were cash dividends on common shares totaling $22.4 million. In accordance with the plan of merger with Firstbank, we declared and paid a special $2.00 per share cash dividend to Mercantile shareholders prior to the effective date of the merger and before the issuance of Mercantile shares in exchange for Firstbank shares. In addition, we declared and paid a $0.12 per share cash dividend in the first, second and third quarters of 2014.

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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. As of September 30, 2014, our bank's total risk-based capital ratio was 14.0%, with our bank's total regulatory capital equaling $326 million, or approximately $93 million in excess of the 10.0% minimum which is among the requirements to be categorized as "well capitalized." Our and our bank's capital ratios as of September 30, 2014 and December 31, 2013 are disclosed in Note 13 of the Notes to Condensed Consolidated Financial Statements.

Results of Operations

We recorded net income of $5.9 million for the third quarter of 2014 ($0.35 per basic and diluted share), compared to net income of $3.5 million ($0.40 per basic and diluted share) recorded during the third quarter of 2013. We recorded net income of $11.0 million ($0.89 per basic and diluted share) for the first nine months of 2014, compared to net income of $11.9 million ($1.36 per basic and diluted share) recorded during the first nine months of 2013. The results for the third quarter and the first nine months of 2014 were impacted by the merger with Firstbank, which was consummated on June 1, 2014; operating results for the first nine months of 2014 include four months of operations as a combined organization. After-tax merger-related costs totaled $0.9 million, or $0.05 per diluted share, during the third quarter of 2014 and $3.6 million, or $0.29 per diluted share, during the first nine months of 2014. After-tax merger-related expenses totaled $0.7 million, or $0.07 per diluted share, during the third quarter of 2013 and $0.7 million, or $0.08 per diluted share, during the first nine months of 2013. We expect to record merger-related costs totaling approximately $0.4 million during the fourth quarter of 2014; in addition, we expect to record nominal merger-related costs during the first and second quarters of 2015.

The improved earnings performance in the third quarter of 2014 compared to the prior-year third quarter primarily resulted from increased net interest income, which more than offset increased overhead costs. The decline in earnings performance in the first nine months of 2014 compared to the respective 2013 period mainly resulted from increased overhead costs, which more than offset higher net interest income. Various nonmerger-related costs necessary to operate the combined company, along with a higher level of merger-related costs, resulted in the increase in overhead costs. The increased net interest income primarily resulted from the higher level of average earning assets associated with the completion of the merger.

Interest income during the third quarter of 2014 was $28.9 million, an increase of $14.2 million, or 97.0%, from the $14.7 million earned during the third quarter of 2013. Interest income during the first nine months of 2014 was $61.0 million, an increase of $18.1 million, or 42.2%, from the $42.9 million earned during the first nine months of 2013.

The increase in interest income in the 2014 periods compared to the respective 2013 periods is attributable to an increase in earning assets, which more than offset a declining yield on earning assets. Average earning assets include Firstbank's assets from the date of acquisition. The decreased yield on earning assets in the third quarter and first nine months of 2014 was mainly attributable to a lower yield on average securities and a change in earning asset mix; a lower yield on average loans also contributed to the decreased yield on earning assets in the first nine months of 2014. Accretion of acquired loans totaled $1.2 million during the third quarter of 2014 and $1.7 million during the first nine months of 2014.

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Interest expense during the third quarter of 2014 was $2.9 million, an increase of $0.2 million, or 8.9%, from the $2.7 million expensed during the third quarter of 2013. Interest expense during the first nine months of 2014 was $8.4 million, an increase of $0.3 million, or 3.2%, from the $8.1 million expensed during the first nine months of 2013. The increase in interest expense in the 2014 periods compared to the respective 2013 periods is attributable to an increase in the volume of average interest-bearing liabilities. Average interest-bearing liabilities include Firstbank's liabilities from the date of acquisition. The impact of the higher volume of average interest-bearing liabilities on interest expense was substantially offset by a decrease in the weighted average cost of interest-bearing liabilities. Maturing fixed-rate certificates of deposit were renewed at lower rates, replaced by lower-costing funds, or allowed to runoff during 2013 and the first nine months of 2014. In addition, the lowering of interest rates on certain non-certificate of deposit accounts in the latter part of the fourth quarter of 2013 and the absorption of Firstbank's lower-costing interest-bearing liability base positively impacted the cost of funds in the 2014 periods.

Net interest income during the third quarter of 2014 was $26.0 million, an increase of $14.0 million, or 116.7%, from the $12.0 million earned during the third quarter of 2013. Net interest income during the first nine months of 2014 was $52.6 million, an increase of $17.8 million, or 51.3%, from the $34.8 million earned during the first nine months of 2013. The increase in net interest income in the 2014 periods compared to the respective 2013 periods was primarily due to an increase in earning assets. The net interest margin during the third quarter of 2014 was 3.95%, compared to 3.76% during the third quarter of 2013. During the first nine months of 2014, the net interest margin was 3.73%, compared to 3.69% during the same time period in 2013. The higher net interest margin in the 2014 periods reflects the reduction in the cost of funds, which more than offset the decreased yield on earning assets.

The following table sets forth certain information relating to our consolidated average interest-earning assets and interest-bearing liabilities and reflects the average yield on assets and average cost of liabilities for the third quarter of 2014 and 2013. Such yields and costs are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the period presented. Tax-exempt 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 $165,000 and $87,000 in the third quarter of 2014 and 2013, respectively, for this adjustment.

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	Quarters ended September 30,					
	2014			2013		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	(dollars in thousands)					
ASSETS						
Loans	$ 2,075,087	$ 26,323	5.03 %	$ 1,072,199	$ 13,411	4.96 %
Investment securities	484,345	2,710	2.24	136,455	1,301	3.81
Federal funds sold	11,447	7	0.25	59,674	38	0.25
Interest-bearing deposits	54,760	25	0.18	6,204	4	0.27
Total interest - earning assets	2,625,639	29,065	4.39	1,274,532	14,754	4.59
Allowance for loan losses	(20,802)			(25,278)		
Other assets	257,512			129,158		
Total assets	$ 2,862,349			$ 1,378,412		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest-bearing deposits	$ 1,757,162	$ 1,971	0.45 %	$ 881,851	$ 2,190	0.99 %
Short-term borrowings	123,075	34	0.11	61,705	19	0.12
Federal Home Loan Bank advances	57,038	166	1.14	41,196	141	1.34
Other borrowings	65,409	740	4.43	34,501	323	3.66
Total interest-bearing liabilities	2,002,684	2,911	0.58	1,019,253	2,673	1.04
Noninterest-bearing deposits	532,997			204,402		
Other liabilities	10,257			4,973		
Shareholders' equity	316,411			149,784		
Total liabilities and shareholders' equity	$ 2,862,349			$ 1,378,412		

Net interest income	$ 26,154	$ 12,081
Net interest rate spread	3.81 %	3.55 %
Net interest spread on average assets	3.63 %	3.48 %
Net interest margin on earning assets	3.95 %	3.76 %

A negative loan loss provision expense of $0.4 million was recorded during the third quarter of 2014, compared to a negative provision expense of $1.7 million during the third quarter of 2013. A negative loan loss provision expense of $3.0 million was recorded during the first nine months of 2014, compared to a negative provision expense of $4.7 million during the first nine months of 2013. The negative provision expense reflects recoveries of previously charged-off loans, reversals of specific reserves, a reduced level of loan-rating downgrades, and ongoing loan-rating upgrades as the quality of the loan portfolio continued to improve. Continued progress in the stabilization of economic and real estate market conditions and resulting collateral valuations also positively impacted provision expense.

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Net loan charge-offs of $0.1 million were recorded during the third quarter of 2014, compared to net loan recoveries of $1.9 million during the prior-year third quarter. Net loan recoveries of $0.6 million were recorded during the first nine months of 2014, compared to net loan recoveries of $1.2 million during the same time period in 2013. Nonperforming loans totaled $6.1 million, or 0.3% of total loans, as of September 30, 2014, compared to $8.6 million, or 0.8% of total loans, as of September 30, 2013. The allowance equaled 1.7% of total originated loans as of September 30, 2014, compared to 2.3% of total loans as of September 30, 2013.

Noninterest income during the third quarter of 2014 was $2.9 million, an increase of $1.2 million, or 72.3%, from the $1.7 million earned during the prior-year third quarter. Noninterest income during the first nine months of 2014 was $6.7 million, an increase of $1.4 million, or 26.8%, from the $5.3 million earned during the same time period in 2013. The increase in noninterest income in the 2014 periods was mainly due to higher debit and credit card fee income, service charges on deposit accounts, and mortgage referral and sale fees. These categories of noninterest income benefited from the consummation of the merger with Firstbank. An industry-wide slowdown in mortgage banking activity has negatively impacted our mortgage banking income during 2014; although income from this activity has increased in the 2014 periods compared to the respective 2013 periods as a result of the merger, our mortgage banking income in the third quarter of 2014 was less than half of what the two companies combined achieved in the prior-year quarter.

Noninterest expense during the third quarter of 2014 was $20.7 million, an increase of $10.8 million, or 109.0%, from the $9.9 million expensed during the third quarter of 2013. Noninterest expense during the first nine months of 2014 was $46.0 million, an increase of $18.7 million, or 68.4%, from the $27.3 million expensed during the same time period in 2013. The increase in noninterest expense in the third quarter of 2014 and the first nine months of 2014 primarily resulted from higher salary and benefit expenses. Salary and benefit expenses totaled $10.7 million during the third quarter of 2014, an increase of $5.4 million, or 103.3%, from the $5.3 million expensed during the prior-year third quarter. Salary and benefit expenses were $23.4 million during the first nine months of 2014, an increase of $8.3 million, or 55.0%, from the $15.1 million expensed during the first nine months of 2013. The increase in salary and benefit expenses was mainly due to the increase in employees associated with the completion of the merger with Firstbank, along with the hiring of additional staff members over the past year and officer merit pay increases. As of September 30, 2014, full-time equivalent employees numbered 640, up from 239 as of September 30, 2013. Increases in merger-related expenses and other categories of nonmerger-related costs necessary to operate the combined company also contributed to the higher level of overhead costs. Merger-related costs totaled $1.3 million during the third quarter of 2014 and $5.1 million during the first nine months of 2014; these costs totaled $0.7 million and $0.8 million during the respective 2013 periods.

During the third quarter of 2014, we recorded income before federal income tax of $8.5 million and a federal income tax expense of $2.6 million. During the third quarter of 2013, we recorded income before federal income tax of $5.5 million and a federal income tax expense of $2.0 million. The increase in federal income tax expense in the third quarter of 2014 resulted from the higher level of income before federal income tax, which more than offset a decrease in our effective tax rate from 36.7% in the third quarter of 2013 to 30.4% in the third quarter of 2014. The elevated effective tax rate in the third quarter of 2013 primarily resulted from the recording of nondeductible merger-related expenses. During the first nine months of 2014, we recorded income before federal income tax of $16.3 million and a federal income tax expense of $5.2 million. During the first nine months of 2013, we recorded income before federal income tax of $17.4 million and a federal income tax expense of $5.6 million. The decrease in federal income tax expense during the first nine months of 2014 resulted from the lower level of income before federal income tax, which more than offset a slight increase in our effective tax rate from 31.9% in the 2013 period to 32.2% in the 2014 period.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

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 our interest-earning assets over the interest paid on our 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.

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 control procedures 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 our net interest margin during periods of changing market interest rates.

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The following table depicts our GAP position as of September 30, 2014:

	Within Three Months	Three to Twelve Months	One to Five Years	After Five Years	Total
Assets:					
Commercial loans (1)	$300,795,000	$220,427,000	$1,014,072,000	$146,119,000	$1,681,413,000
Residential real estate loans	39,098,000	16,452,000	111,119,000	157,461,000	324,130,000
Consumer loans	3,456,000	1,869,000	44,796,000	12,601,000	62,722,000
Securities (2)	31,928,000	25,849,000	343,946,000	71,512,000	473,235,000
Federal funds sold	10,102,000	0	0	0	10,102,000
Interest-bearing deposits	71,196,000	498,000	749,000	0	72,443,000
Allowance for loan losses	0	0	0	0	(20,374,000)
Other assets	0	0	0	0	259,433,000
Total assets	456,575,000	265,095,000	1,514,682,000	387,693,000	$2,863,104,000
Liabilities:					
Interest-bearing checking	403,600,000	0	0	0	403,600,000
Savings deposits	334,343,000	0	0	0	334,343,000
Money market accounts	241,365,000	0	0	0	241,365,000
Time deposits under $100,000	32,448,000	73,296,000	85,235,000	0	190,979,000
Time deposits $100,000 & over	68,883,000	197,396,000	300,041,000	0	566,320,000
Short-term borrowings	142,869,000	0	0	0	142,869,000
Federal Home Loan Bank advances	3,000,000	6,000,000	48,033,000	0	57,033,000
Other borrowed money	57,996,000	543,000	1,276,000	0	59,815,000
Noninterest-bearing checking	0	0	0	0	535,101,000
Other liabilities	0	0	0	0	10,686,000
Total liabilities	1,284,504,000	277,235,000	434,585,000	0	2,542,111,000
Shareholders' equity	0	0	0	0	320,993,000
Total liabilities & shareholders' equity	1,284,504,000	277,235,000	434,585,000	0	$2,863,104,000
Net asset (liability) GAP	$(827,929,000)	$(12,140,000)	$1,080,097,000	$387,693,000	
Cumulative GAP	$(827,929,000)	$(840,069,000)	$240,028,000	$627,721,000	

Percent of cumulative GAP to total assets	(28.9%)	(29.3%)	8.4%	21.9%

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

(2) Mortgage-backed securities are categorized by average life calculations based upon prepayment trends as of September 30, 2014.

The second interest rate risk measurement we use 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.

MERCANTILE BANK CORPORATION

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.

We conducted multiple simulations as of September 30, 2014, in which it was assumed that changes in market interest rates occurred ranging from up 400 basis points to down 400 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 in comparison to estimated net interest income based on our balance sheet structure, including the balances and interest rates associated with our specific loans, securities, deposits and borrowed funds, as of September 30, 2014. The resulting estimates are 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 400 basis points	$(6,800,000)	(7.2%)
Interest rates down 300 basis points	(5,960,000)	(6.3)
Interest rates down 200 basis points	(5,050,000)	(5.3)
Interest rates down 100 basis points	(3,240,000)	(3.4)
No change in interest rates	115,000	0.1
Interest rates up 100 basis points	1,170,000	1.2
Interest rates up 200 basis points	1,860,000	2.0
Interest rates up 300 basis points	2,460,000	2.6
Interest rates up 400 basis points	2,695,000	2.9

The resulting estimates have been significantly impacted by the current interest rate and economic environments, as adjustments have been made to critical model inputs with regards to traditional interest rate relationships. This is especially important as it relates to floating rate commercial loans, which comprise a sizable portion of our balance sheet.

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; level of nonperforming assets; economic and competitive conditions; potential changes in lending, investing, and deposit gathering strategies; client preferences; and other factors.

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Item 4. Controls and Procedures

As of September 30, 2014, an evaluation was performed under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of September 30, 2014.

There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, we may be involved in various legal proceedings that are incidental to our business. In our opinion, we are not a party to any current legal proceedings that are material to our financial condition, either individually or in the aggregate.

Item 1A. Risk Factors.

There have been no material changes in our risk factors from those previously disclosed in our annual report on Form 10-K for the year ended December 31, 2013, and incorporated therein by reference.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

We made no unregistered sale of equity securities, nor did we purchase our equity securities, during the quarter ended September 30, 2014.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Not applicable.

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Item 6. Exhibits

Exhibit No.	EXHIBIT DESCRIPTION
2.1	Agreement and Plan of Merger dated August 14, 2013, incorporated by reference to Exhibit 2.1 to our Current Report on Form 8-K filed August 15, 2013
2.2	First Amendment to Merger Agreement dated February 20, 2014, incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed February 21, 2014
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, 2009
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
31	Rule 13a-14(a) Certifications
32.1	Section 1350 Chief Executive Officer Certification
32.2	Section 1350 Chief Financial Officer Certification
101	The following financial information from Mercantile's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Changes in Shareholders' Equity, (v) the Condensed Consolidated Statements of Cash Flows, and (vi) the Notes to Condensed Consolidated Financial Statements

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 7, 2014.

MERCANTILE BANK CORPORATION

By: /s/ Michael H. Price
Michael H. Price
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Charles E. Christmas
Charles E. Christmas
Senior Vice President, Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

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32.1	Section 1350 Chief Executive Officer Certification
32.2	Section 1350 Chief Financial Officer Certification
101	The following financial information from Mercantile's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Changes in Shareholders' Equity, (v) the Condensed Consolidated Statements of Cash Flows, and (vi) the Notes to Condensed Consolidated Financial Statements