

MACATAWA BANK CORP
Form 10-Q
August 08, 2008

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

FORM 10-Q

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from _____ to _____

Commission file number: 000-25927

MACATAWA BANK CORPORATION
(Exact name of issuer as specified in its charter)

Michigan
(State of other jurisdiction of
incorporation or organization)

38-3391345
(I.R.S. Employer
Identification No.)

10753 Macatawa Drive, Holland, Michigan 49424
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (616) 820-1444

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes No

Indicate by check whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 17,023,165 shares of the Company's Common Stock (no par value) were outstanding as of August 6, 2008.

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Part I Financial Information**Item 1.**

MACATAWA BANK CORPORATION
 CONSOLIDATED BALANCE SHEETS
 As of June 30, 2008 (unaudited) and December 31, 2007

| (dollars in thousands) | June 30, 2008 | December 31, 2007 |
|--|--------------------------|------------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 41,261 | \$ 49,816 |
| Federal funds sold | 7,759 | --- |
| | 49,020 | 49,816 |
| Cash and cash equivalents | 49,020 | 49,816 |
| Securities available for sale | 169,378 | 201,498 |
| Securities held to maturity | 1,840 | 1,917 |
| Federal Home Loan Bank stock | 12,275 | 12,275 |
| Loans held for sale, at fair value at 6/30/08 | 992 | 3,127 |
| Total loans | 1,765,779 | 1,750,632 |
| Allowance for loan losses | (31,769) | (33,422) |
| | 1,734,010 | 1,717,210 |
| Net loans | 1,734,010 | 1,717,210 |
| Premises and equipment - net | 64,284 | 64,564 |
| Accrued interest receivable | 8,487 | 10,003 |
| Goodwill | 25,919 | 25,919 |
| Acquisition intangibles | 2,803 | 3,023 |
| Bank-owned life insurance | 23,164 | 22,703 |
| Other assets | 26,554 | 17,911 |
| | 2,118,726 | 2,129,966 |
| Total assets | \$ 2,118,726 | \$ 2,129,966 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits | | |
| Noninterest-bearing | \$ 186,688 | \$ 185,681 |
| Interest-bearing | 1,417,324 | 1,337,872 |
| | 1,604,012 | 1,523,553 |
| Total deposits | 1,604,012 | 1,523,553 |
| Federal funds purchased | 8,500 | 46,467 |
| Other borrowed funds | 295,775 | 354,052 |
| Long-term debt | 41,238 | 41,238 |
| Accrued expenses and other liabilities | 8,375 | 4,031 |
| | 1,957,900 | 1,969,341 |
| Total liabilities | 1,957,900 | 1,969,341 |
| Shareholders' equity | | |
| Preferred stock, no par value, 500,000 shares authorized; no shares issued and outstanding | | |
| Common stock, no par value, 40,000,000 shares authorized; 17,021,379 and 16,968,398 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively | 163,964 | 163,522 |
| Retained earnings (deficit) | (4,009) | (4,208) |
| Accumulated other comprehensive income | 871 | 1,311 |

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| (dollars in thousands) | June 30, 2008 | December 31, 2007 |
|--|--------------------------|------------------------------|
| Total shareholders' equity | 160,826 | 160,625 |
| Total liabilities and shareholders' equity | \$ 2,118,726 | \$ 2,129,966 |

See accompanying notes to consolidated financial statements

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three and Six Month Periods Ended June 30, 2008 and 2007
(unaudited)

| (dollars in thousands, except per share data) | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|--|---|---|---|---|
| Interest income | | | | |
| Loans, including fees | \$ 26,934 | \$ 33,105 | 55,899 | \$ 65,563 |
| Securities | 2,040 | 2,192 | 4,225 | 4,408 |
| FHLB Stock | 174 | 123 | 327 | 280 |
| Other | 51 | 263 | 64 | 364 |
| Total interest income | 29,199 | 35,683 | 60,515 | 70,615 |
| Interest expense | | | | |
| Deposits | 10,083 | 15,296 | 21,917 | 30,534 |
| Other | 4,029 | 4,052 | 8,814 | 7,686 |
| Total interest expense | 14,112 | 19,348 | 30,731 | 38,220 |
| Net interest income | 15,087 | 16,335 | 29,784 | 32,395 |
| Provision for loan losses | 3,500 | 965 | 6,200 | 1,840 |
| Net interest income after provision for loan losses | 11,587 | 15,370 | 23,584 | 30,555 |
| Noninterest income | | | | |
| Service charges and fees | 1,322 | 1,306 | 2,563 | 2,448 |
| Gain on sales of loans | 343 | 370 | 819 | 813 |
| Trust fees | 1,164 | 1,209 | 2,334 | 2,406 |
| Gain on sales of securities | 412 | --- | 412 | --- |
| Gain on settlement of interest rate swaps | --- | --- | 832 | --- |
| Other | 1,814 | 1,135 | 3,098 | 2,088 |
| Total noninterest income | 5,055 | 4,020 | 10,058 | 7,755 |
| Noninterest expense | | | | |
| Salaries and benefits | 6,875 | 6,345 | 13,776 | 12,475 |
| Occupancy of premises | 1,114 | 1,020 | 2,339 | 2,075 |
| Furniture and equipment | 992 | 933 | 1,985 | 1,825 |
| Legal and professional fees | 334 | 306 | 637 | 557 |
| Marketing and promotion | 353 | 346 | 710 | 663 |
| Data processing fees | 466 | 471 | 971 | 950 |
| Other | 3,507 | 3,184 | 6,814 | 5,848 |
| Total noninterest expenses | 13,641 | 12,605 | 27,232 | 24,393 |
| Income before income tax expense | 3,001 | 6,785 | 6,410 | 13,917 |
| Income tax expense | 830 | 2,195 | 1,801 | 4,492 |

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| (dollars in thousands, except per share data) | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|---|---|---|---|---|
| Net income | \$ 2,171 | \$ 4,590 | \$ 4,609 | \$ 9,425 |
| Basic earnings per share | \$.13 | \$.27 | \$.27 | \$.55 |
| Diluted earnings per share | .13 | .26 | .27 | .54 |
| Cash dividends per share | .13 | .13 | .26 | .25 |

See accompanying notes to consolidated financial statements

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MACATAWA BANK CORPORATION
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 Three and Six Month Periods Ended June 30, 2008 and 2007
 (unaudited)

| (dollars in thousands) | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|--|---|---|---|---|
| Net income | \$ 2,171 | \$ 4,590 | \$ 4,609 | \$ 9,425 |
| Other comprehensive income (loss), net of tax: | | | | |
| Net change in unrealized gains (losses) on securities available for sale | (2,309) | (1,370) | (440) | (1,200) |
| Net change in unrealized gains (losses) on derivative instruments | --- | (120) | --- | 136 |
| Comprehensive income (loss) | <u>\$ (138)</u> | <u>\$ 3,100</u> | <u>\$ 4,169</u> | <u>\$ 8,361</u> |

See accompanying notes to consolidated financial statements

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Six Month Periods Ended June 30, 2008 and 2007
(unaudited)

| (dollars in thousands, except per share data) | Common Stock | Retained Earnings/ (Deficit) | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|-------------------|------------------------------------|--|----------------------------------|
| Balance, January 1, 2007 | \$ 153,728 | \$ 4,840 | \$ (1,719) | \$ 156,849 |
| Net income for six months ended June 30, 2007 | | 9,425 | | 9,425 |
| Other comprehensive income (loss), net of tax: | | | | |
| Net change in unrealized gain (loss) on securities available for sale | | | (1,200) | (1,200) |
| Net change in unrealized gain (loss) on derivative instruments | | | | 136 |
| Comprehensive income | | | 136 | 8,361 |
| Issued 20,537 shares for stock option exercises (net of 3,485 shares exchanged and including \$18 of tax benefit) | 169 | | | 169 |
| Stock compensation expense | 299 | | | 299 |
| Issued 136,936 shares for acquisition of Smith & Associates | 3,150 | | | 3,150 |
| Issued 819,223 shares in payment of 5% stock dividend | 9,518 | (9,536) | | (18) |
| Repurchased 60,000 shares of stock | (924) | | | (924) |
| Cash dividends at \$.25 per share | | (4,362) | | (4,362) |
| Balance, June 30, 2007 | \$ 165,940 | \$ 367 | \$ (2,783) | \$ 163,524 |
| Balance, January 1, 2008 | \$ 163,522 | \$ (4,208) | \$ 1,311 | \$ 160,625 |
| Net income for six months ended June 30, 2008 | | 4,609 | | 4,609 |
| Other comprehensive income (loss), net of tax: | | | | |
| Net change in unrealized gain (loss) on securities available for sale | | | (440) | (440) |
| Comprehensive income | | | | 4,169 |
| Issued 28,060 shares for stock option exercises (net of 96 shares exchanged and including \$36 of tax benefit) | 141 | | | 141 |
| Stock compensation expense | 301 | | | 301 |
| Cash dividends at \$.26 per share | | (4,410) | | (4,410) |

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| | Common Stock | Retained Earnings/ (Deficit) | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|-------------------------|---|--|---|
| (dollars in thousands, except per share data) | | | | |
| Balance, June 30, 2008 | \$ 163,964 | (4,009) | \$ 871 | \$ 160,826 |

See accompanying notes to consolidated financial statements

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Month Periods Ended June 30, 2008 and 2007
(unaudited)

| (dollars in thousands) | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|--|---|---|
| Cash flows from operating activities | | |
| Net income | \$ 4,609 | \$ 9,425 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 1,924 | 1,724 |
| Stock compensation expense | 301 | 299 |
| Provision for loan losses | 6,200 | 1,840 |
| Origination of loans for sale | (53,789) | (53,259) |
| Proceeds from sales of loans originated for sale | 56,743 | 54,022 |
| Gain on sales of loans | (819) | (813) |
| Gain on sales of securities | (412) | --- |
| Net change in: | | |
| Accrued interest receivable and other assets | (4,605) | 318 |
| Bank-owned life insurance | 461 | (415) |
| Accrued expenses and other liabilities | 4,581 | (176) |
| Net cash from operating activities | 15,194 | 12,965 |
| Cash flows from investing activities | | |
| Loan originations and payments, net | (26,444) | (17,743) |
| Purchases of securities available for sale | (20,509) | (15,335) |
| Maturities and calls of securities available for sale | 30,651 | 17,944 |
| Maturities of securities held to maturity | --- | 715 |
| Sales of securities available for sale | 21,704 | --- |
| Principal paydowns on securities | 92 | 158 |
| Additions to premises and equipment | (1,430) | (5,017) |
| Net cash used in investing activities | 4,064 | (19,278) |
| Cash flows from financing activities | | |
| Net increase (decrease) in deposits | 80,459 | (5,871) |
| Net decrease in short term borrowings | (37,967) | (11,990) |
| Proceeds from other borrowed funds | 228,000 | 85,000 |
| Repayments of other borrowed funds | (286,277) | (32,258) |
| Cash dividends paid | (4,410) | (4,380) |
| Repurchases of stock | --- | (924) |
| Proceeds from exercises of stock options, including tax benefit | 141 | 169 |
| Net cash from financing activities | (20,054) | 29,746 |
| Net change in cash and cash equivalents | (796) | 23,433 |
| Cash and cash equivalents at beginning of period | 49,816 | 39,882 |
| Cash and cash equivalents at end of period | \$ 49,020 | \$ 63,315 |
| Supplemental cash flow information | | |
| Interest paid | \$ 31,574 | \$ 37,864 |
| Income taxes paid | 3,850 | 5,350 |

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| (dollars in thousands) | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|---|---|---|
| Supplemental noncash disclosures: | | |
| Transfers from loans to other real estate | 3,444 | 3,264 |
| Acquisition of Smith & Associates: | | |
| Acquisition intangibles recorded | --- | 3,924 |
| Other liabilities assumed | --- | 774 |
| Common stock issued | --- | 3,150 |

See accompanying notes to consolidated financial statements

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Macatawa Bank, and its wholly-owned subsidiary, Macatawa Bank Mortgage Company. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company also owns all of the common stock of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and are not consolidated with the Company per FASB Interpretation No. 46.

Basis of Presentation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's 2007 Annual Report containing financial statements for the year ended December 31, 2007.

New Accounting Pronouncements: In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position (FSP) 157-2, *Effective Date of FASB Statement No. 157*. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company adopted the standard effective January 1, 2008 and disclosures have been added in the accompanying Notes to the Financial Statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. Effective January 1, 2008, the standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The Company adopted Statement No. 159 for loans originated for sale beginning April 1, 2008. The impact was not material to the Company's financial statements.

MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

On November 5, 2007, the SEC issued Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value through Earnings (SAB 109). Previously, SAB 105, Application of Accounting Principles to Loan Commitments, stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The impact of this standard was not material to the Company.

NOTE 2 SECURITIES

The amortized cost and fair value of securities were as follows (in thousands):

| | <u>Amortized Cost</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> | <u>Fair Value</u> |
|---|---------------------------|---------------------------------------|--|-------------------|
| June 30, 2008 | | | | |
| Available for Sale: | | | | |
| U.S. Treasury and federal agency securities | \$ 117,886 | \$ 725 | \$ (270) | \$ 118,341 |
| State and municipal bonds | 49,152 | 1,029 | (123) | 50,058 |
| Other equity securities | 1,000 | --- | (21) | 979 |
| | <u>\$ 168,038</u> | <u>\$ 1,754</u> | <u>\$ (414)</u> | <u>\$ 169,378</u> |
| Held to Maturity: | | | | |
| State and municipal bonds | \$ 1,840 | \$ 4 | \$ --- | \$ 1,884 |
| | <u>\$ 1,840</u> | <u>\$ 4</u> | <u>\$ ---</u> | <u>\$ 1,884</u> |
| December 31, 2007 | | | | |
| Available for Sale: | | | | |
| U.S. Treasury and federal agency securities | \$ 149,021 | \$ 1,169 | \$ (145) | \$ 150,045 |
| State and municipal bonds | 49,460 | 1,056 | (56) | 50,460 |
| Other equity securities | 1,000 | -- | (7) | 993 |
| | <u>\$ 199,481</u> | <u>\$ 2,225</u> | <u>\$ (208)</u> | <u>\$ 201,498</u> |
| Held to Maturity: | | | | |
| State and municipal bonds | \$ 1,917 | \$ 45 | \$ (1) | \$ 1,961 |
| | <u>\$ 1,917</u> | <u>\$ 45</u> | <u>\$ (1)</u> | <u>\$ 1,961</u> |
| | 9 | | | |

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 2 SECURITIES (Continued)

Securities with unrealized losses at June 30, 2008 and December 31, 2007, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---------------------|-----------------|-------------------|-----------------|------------------|-----------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| <u>June 30, 2008</u> | | | | | | |
| U.S. Treasury and federal agency securities | \$ 19,807 | \$ (270) | \$ --- | \$ --- | \$ 19,807 | \$ (270) |
| State and municipal bonds | 9,411 | (123) | --- | --- | 9,411 | (123) |
| Other equity securities | 979 | (21) | --- | --- | 979 | (21) |
| Total temporarily impaired | \$ 30,197 | \$ (414) | \$ --- | \$ --- | \$ 30,197 | \$ (414) |
| <u>December 31, 2007</u> | | | | | | |
| U.S. Treasury and federal agency securities | \$ -- | \$ --- | \$ 37,104 | \$ (145) | \$ 37,104 | \$ (145) |
| State and municipal bonds | 1,777 | (6) | 4,479 | (51) | 6,256 | (57) |
| Other equity securities | -- | -- | 993 | (7) | 993 | (7) |
| Total temporarily impaired | \$ 1,777 | \$ (6) | \$ 42,576 | \$ (203) | \$ 44,353 | \$ (209) |

For unrealized losses on securities, no loss has been recognized into income because management has the intent and ability to hold these securities for the foreseeable future and the declines are largely due to differences in market interest rates as compared to those of the underlying securities. The declines in fair value are considered temporary and are expected to recover as the bonds approach their maturity date.

Contractual maturities of debt securities at June 30, 2008 were as follows (dollars in thousands):

| | Held-to-Maturity Securities | | Available-for-Sale Securities | |
|----------------------------|-----------------------------|-----------------|-------------------------------|-------------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in one year or less | \$ --- | \$ --- | \$ 45,495 | \$ 45,761 |
| Due from one to five years | 239 | 241 | 79,096 | 79,453 |
| Due from five to ten years | 840 | 866 | 29,067 | 29,657 |
| Due after ten years | 761 | 777 | 13,380 | 13,528 |
| | \$ 1,840 | \$ 1,884 | \$ 167,038 | \$ 168,399 |

Proceeds from the sale of available for sale securities were \$21,704,000 and resulted in gross gains of \$412,000 during the three and six month periods ended June 30, 2008. There were no sales of securities during the three and six month periods ended June 30, 2007.

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 >(Unaudited)

NOTE 3 LOANS

Loans were as follows (in thousands):

| | June 30, 2008 | December 31, 2007 |
|---------------------------|--------------------------|------------------------------|
| Commercial | \$ 441,882 | \$ 438,743 |
| Commercial mortgage | 834,690 | 855,882 |
| Residential mortgage | 302,185 | 266,325 |
| Consumer | 187,022 | 189,682 |
| | <u>1,765,779</u> | <u>1,750,632</u> |
| Allowance for loan losses | (31,769) | (33,422) |
| | <u>\$ 1,734,010</u> | <u>\$ 1,717,210</u> |

Activity in the allowance for loan losses was as follows (in thousands):

| | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|--------------------------------|---|---|---|---|
| Balance at beginning of period | \$ 31,954 | \$ 23,689 | \$ 33,422 | \$ 23,259 |
| Provision for loan losses | 3,500 | 965 | 6,200 | 1,840 |
| Charge-offs | (3,865) | (789) | (8,071) | (1,295) |
| Recoveries | 180 | 78 | 218 | 139 |
| | <u>\$ 31,769</u> | <u>\$ 23,943</u> | <u>\$ 31,769</u> | <u>\$ 23,943</u> |

Impaired loans were as follows at period end (dollars in thousands):

| | June 30, 2008 | December 31, 2007 |
|---|--------------------------|------------------------------|
| Loans with no allocated allowance for loan losses | \$ 39,602 | \$ 17,580 |
| Loans with allocated allowance for loan losses | 72,604 | 81,440 |
| | <u>112,206</u> | <u>99,020</u> |
| Amount of the allowance for loan losses allocated | <u>\$ 12,593</u> | <u>\$ 15,831</u> |

| | Six months ended June 30, 2008 | Six months ended June 30, 2007 |
|--|---|---|
| Average of impaired loans during the period | \$ 109,110 | \$ 14,952 |
| Interest income recognized during impairment | 929 | --- |
| Cash received for interest during impairment | 734 | --- |

Nonperforming loans were as follows at period-end (dollars in thousands):

NOTE 3 LOANS

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| | June 30, 2008 | December 31, 2007 |
|--|--------------------------|------------------------------|
| Loans past due over 90 days still on accrual | \$ 2,801 | \$ 2,872 |
| Nonaccrual loans | 77,362 | 70,999 |
| Renegotiated loans | 30 | 38 |
| | <hr/> | <hr/> |
| | \$ 80,193 | \$ 73,909 |
| | <hr/> | <hr/> |

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 4 DEPOSITS

Deposits are summarized as follows (in thousands):

| | June 30, 2008 | December 31, 2007 |
|----------------------------|--------------------------|------------------------------|
| Noninterest-bearing demand | \$ 186,688 | \$ 185,681 |
| Money market | 350,097 | 337,322 |
| NOW and Super NOW | 237,203 | 273,658 |
| Savings | 47,623 | 40,119 |
| Certificates of deposit | 782,401 | 686,773 |
| | \$ 1,604,012 | \$ 1,523,553 |

Approximately \$544,288,000 and \$457,769,000 in time certificates of deposit were in denominations of \$100,000 or more at June 30, 2008 and December 31, 2007.

Brokered deposits totaled approximately \$241,998,000 and \$202,839,000 at June 30, 2008 and December 31, 2007. At June 30, 2008 and December 31, 2007, brokered deposits had interest rates ranging from 3.50% to 5.15% and 3.65% to 5.20%, respectively. At June 30, 2008, maturities ranged from July, 2008 to May, 2011.

NOTE 5 OTHER BORROWED FUNDS

Other borrowed funds include advances from the Federal Home Loan Bank and securities sold under agreements to repurchase.

Federal Home Loan Bank Advances

Advances from the Federal Home Loan Bank were as follows (dollars in thousands):

| Principal Terms | Advance Amount | Range of Maturities | Weighted Average Interest Rate |
|-------------------------------------|---------------------------|---------------------------------|---|
| <u>June 30, 2008</u> | | | |
| Single maturity fixed rate advances | \$ 155,000 | October 2008 to November 2010 | 4.05% |
| Putable advances | 31,000 | September 2009 to December 2010 | 5.80% |
| Amortizable mortgage advances | 19,775 | October 2008 to July 2018 | 3.81% |
| | \$ 205,775 | | |
| <u>December 31, 2007</u> | | | |
| Single maturity fixed rate advances | \$ 135,000 | March 2008 to November 2010 | 4.77% |
| Daily variable rate advance | 70,000 | June 2008 | 4.32% |
| Putable advances | 31,000 | September 2009 to December 2010 | 5.80% |
| Amortizable mortgage advances | 8,052 | February 2008 to July 2018 | 3.81% |
| | \$ 244,052 | | |

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 5 OTHER BORROWED FUNDS (Continued)

Each advance is payable at its maturity date and contains a prepayment penalty. These advances were collateralized by residential and commercial real estate loans totaling \$638,348,000 and \$611,055,000 under a blanket lien arrangement at June 30, 2008 and December 31, 2007. Maturities as of June 30, 2008 were as follows (in thousands):

| | |
|------------|------------|
| 2008 | \$ 25,319 |
| 2009 | 40,123 |
| 2010 | 121,000 |
| Thereafter | 19,333 |
| | \$ 205,775 |

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase (repo borrowings) are financing arrangements secured by U.S. federal agency securities. These borrowings were collateralized by securities that had a carrying amount of approximately \$97,927,000 and \$120,263,000 at June 30, 2008 and December 31, 2007. At maturity, the securities underlying the arrangements are returned to the company.

These borrowings were as follows (dollars in thousands):

June 30, 2008

| | | | |
|-----------------------|-----------|--------------------------------|-------|
| Fixed rate borrowings | \$ 90,000 | February 2009 to November 2010 | 4.66% |
|-----------------------|-----------|--------------------------------|-------|

December 31, 2007

| | | | |
|--------------------------|------------|--------------------------------|-------|
| Fixed rate borrowings | \$ 90,000 | February 2009 to November 2010 | 4.66% |
| Floating rate borrowings | 20,000 | August 2009 to August 2010 | 5.72% |
| | \$ 110,000 | | |

Maturities as of June 30, 2008 were as follows (in thousands):

| | |
|------|-----------|
| 2009 | \$ 50,000 |
| 2010 | 40,000 |
| | \$ 90,000 |

The Company terminated \$20,000,000 of floating rate borrowings during the second quarter of 2008 resulting in gross gains of \$243,000, which was included in other noninterest income for both the three and six month periods ended June 30, 2008.

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 6 STOCK-BASED COMPENSATION

The Company has stock-based compensation plans for its employees (the Employees Plans) and directors (the Directors Plans). The Employees Plans permit the grant of stock options or the issuance of restricted stock for up to 1,917,210 shares of common stock. The Directors Plans permit the grant of stock options or the issuance of restricted stock for up to 473,278 shares of common stock. There were 638,816 shares under the Employees Plans and 165,375 shares under the Directors Plans available for future issuance as of June 30, 2008. All per share amounts and average shares outstanding have been adjusted for all periods presented to reflect the 5% stock dividend distributed on May 30, 2007. The Company issues new shares under its stock-based compensation plans from its authorized but unissued shares.

Stock Options

Option awards are granted with an exercise price equal to the market price at the date of grant. Option awards have vesting periods ranging from one to three years and have ten year contractual terms. The fair value of each option award is estimated on the grant date using a closed form option valuation (Black-Scholes) model. The fair value of options granted during the three months ended March 31, 2008 was determined using the following weighted-average assumptions as of grant date.

| | |
|--|-------------|
| | 2008 |
| Risk-free interest rate | 3.14% |
| Expected option life | 6.5 years |
| Expected stock price volatility | 30.09% |
| Dividend yield | 6.07% |
| Weighted average fair value of options granted | \$ 1.35 |

A summary of option activity in the plans is as follows (dollars in thousands, except per option data):

| Options | Number Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life in Years | Aggregate Intrinsic Value |
|--------------------------------|-------------------------------|--|---|--|
| Outstanding at January 1, 2008 | 957,765 | \$ 14.66 | | |
| Granted | 114,000 | 8.57 | | |
| Exercised | (28,156) | 5.05 | | |
| Forfeited | (10,273) | 16.11 | | |
| Outstanding at June 30, 2008 | 1,033,336 | \$ 14.24 | 6.11 | \$ 142 |
| Exercisable at June 30, 2008 | 675,658 | \$ 12.57 | 4.90 | \$ 142 |

The total intrinsic value of options exercised during the three months ended June 30, 2008 and 2007 was \$17,000 and \$45,000, respectively. The total intrinsic value of options exercised during the six months ended June 30, 2008 and 2007 was \$128,000 and \$222,000 respectively.

There were no options vested during the three and six months ended June 30, 2008 or June 30, 2007.

For the three and six month periods ended June 30, 2008, the Company recorded compensation cost for stock options of \$113,000, or \$100,000 after tax and \$192,000, or \$167,000 after tax, respectively, each representing \$0.01 per share. For the three and six month periods ended June 30, 2007, the Company recorded compensation cost for stock options of \$110,000, or \$99,000 after tax, and \$227,000, or \$204,000 after tax, each representing \$0.01 per share.

As of June 30, 2008, there was approximately \$400,000 of total unrecognized compensation cost related to nonvested stock options granted under the Company's stock-based compensation plans. The cost is expected to be recognized over a weighted-average period of 1.4 years.

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 6 STOCK-BASED COMPENSATION (Continued)

Restricted Stock Awards

Stock awards have vesting periods of up to four years. A summary of nonvested stock awards activity is as follows (dollars in thousands, except per option data):

| Nonvested Stock Awards | Shares | Weighted-Average Grant-Date Fair Value |
|--------------------------------|---------------|---|
| Outstanding at January 1, 2008 | 24,339 | \$ 18.64 |
| Granted | 26,590 | 8.57 |
| Forfeited | (1,669) | 14.70 |
| Outstanding at June 30, 2008 | 49,260 | \$ 13.34 |

The Company recorded compensation cost of \$54,000 and \$36,000 for restricted stock awards for the three months ended June 30, 2008 and June 30, 2007, respectively. The Company recorded compensation cost of \$109,000 and \$72,000 for restricted stock awards for the six months ended June 30, 2008 and June 30, 2007, respectively.

As of June 30, 2008, there was \$448,000 of total unrecognized compensation cost related to nonvested shares granted under the Company's stock-based compensation plans. The cost is expected to be recognized over a weighted-average period of 2.0 years. There were no shares vested during the three and six months ended June 30, 2008 and 2007.

NOTE 7 EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic and diluted earnings per share for the three and six month periods ended June 30, 2008 and 2007 are as follows (dollars in thousands, except per share data):

| | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|--|---|---|---|---|
| Basic earnings per share | | | | |
| Net income | \$ 2,171 | \$ 4,590 | \$ 4,609 | \$ 9,425 |
| Weighted average common shares outstanding | 16,970,634 | 17,191,063 | 16,960,909 | 17,195,050 |
| Basic earnings per share | \$ 0.13 | \$ 0.27 | \$ 0.27 | \$ 0.55 |
| Diluted earnings per share | | | | |
| Net income | \$ 2,171 | \$ 4,590 | \$ 4,609 | \$ 9,425 |
| Weighted average common shares outstanding | 16,970,634 | 17,191,063 | 16,960,909 | 17,195,050 |
| Add: Dilutive effects of assumed exercise of stock options | 44,573 | 213,955 | 48,619 | 248,050 |

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| | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|---|---|---|---|---|
| Shares outstanding common and dilutive potential common | 17,015,207 | 17,405,018 | 17,009,528 | 17,405,018 |
| Diluted earnings per share | \$ 0.13 | \$ 0.26 | \$ 0.27 | \$ 0.54 |

Stock options and restricted stock awards for 802,542 and 360,963 shares of common stock for both the three and six month periods ended June 30, 2008 and June 30, 2007, respectively were not considered in computing diluted earnings per share because they were antidilutive.

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 8 CONTINGENCIES

The Company and its subsidiaries periodically become defendants in certain claims and legal actions arising in the ordinary course of business.

On July 8, 2003, the Company filed a Form 8-K (dated July 1, 2003) with the Securities and Exchange Commission reporting events related to a former trust customer, Trade Partners, Inc. (Trade Partners), of the former Grand Bank, which the Company acquired effective April 1, 2002. Trade Partners was involved in purchasing and selling interests in viaticals, which are interests in life insurance policies of the terminally ill or elderly. Beginning in 1996, Grand Bank served as a custodian and escrow agent with respect to viaticals purchased by Trade Partners and sold to investors. Two lawsuits were filed, one in December 2002 and another in March 2003, against Trade Partners, Grand Bank and the Company alleging that Grand Bank breached certain escrow agreements related to viatical settlement contracts. Both of these lawsuits have been dismissed although the plaintiffs reserved the right to pursue the claims in the future. A third lawsuit was filed in April 2003 by two individual investors against Grand Bank, the Company, Trade Partners and certain individuals and entities associated with Trade Partners. The claims against Grand Bank and the Company in this lawsuit have been settled and dismissed with prejudice. In May 2003 a purported class action complaint was filed against the Company. As amended, this suit alleges that Grand Bank breached escrow agreements and fiduciary duties and violated the Michigan Uniform Securities Act with respect to the investments secured by the purported class in viaticals and in interests in limited partnerships which made loans to Trade Partners secured by viaticals, and with respect to loans made by purported class members directly to Trade Partners. The Company has answered the complaint denying the material allegations and raising certain affirmative defenses. In November 2006 the court denied class certification in this case. The Company believes that the class action, if it had been approved by the court, might have involved as many as 2,000 to 3,000 individual claimants. Since that denial of class certification, nine new actions, none of which is a class action, raising substantially the same allegations as the former class action have been filed in several jurisdictions on behalf of approximately 1,400 Trade Partners investors. Management believes the Company has strong defenses and will vigorously defend the cases.

Trade Partners is now in receivership. The supervising court authorized the receiver to borrow money from Macatawa Bank to pay premiums, if needed. Macatawa Bank extended a \$4 million line of credit to the receiver, conditioned upon obtaining a security interest in the viaticals. No draws were made against the line, and the line expired during the fourth quarter of 2004.

It is possible that one or more additional legal actions may be initiated involving the custodial and escrow agent services provided by Grand Bank in connection with Trade Partners. If any such legal actions are commenced, the Company intends to defend them vigorously. To the extent any pending or future claims allege errors or omissions on the part of Grand Bank or Macatawa Bank, management believes that some or all liability, if any is proven or established, will be covered by errors and omissions insurance maintained by Grand Bank and Macatawa Bank. The Company has reported the Trade Partners matter to its two insurance carriers. Federal Insurance Company has assumed the Company's defense and has advanced a portion of its defense costs pursuant to a reservation of rights letter asserting certain coverage defenses, and an Interim Funding Agreement. Federal Insurance Company on July 21, 2006 notified the Company that it had filed an Arbitration Demand with the American Arbitration Association, seeking a declaration that based on its asserted coverage defenses its policy does not cover this matter. The Company and Federal Insurance Company have agreed to defer any proceedings with respect to this Arbitration Demand. The Company believes that Federal Insurance Company is obligated to provide coverage, and the Company intends to vigorously pursue its rights under the insurance policy. The other carrier has taken the position that the duty of defense rests solely with the first carrier, and reserves its rights with respect to indemnity.

The legal actions involving Trade Partners have not progressed to trial and the outcome of such actions is uncertain. While we are therefore unable to determine at this time whether or to what extent these actions may impact the Company, the Company believes it has strong defenses and fully intends to defend any and all such actions vigorously.

MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 9 INTEREST RATE SWAPS

The Company entered into five interest rate swap agreements (i.e. swaps) during 2002, 2003 and 2004, each with a notional amount of \$20,000,000. A large portion of the Company's assets are loans on which the interest rates are variable. The Company entered into these swaps to convert the variable rate interest cash inflows on certain of its loans to fixed rates of interest. These swaps paid interest to the Company at a fixed rate and required interest payments from the Company at a variable rate.

At December 31, 2007, the Company determined that accounting for these swaps as cash flow hedges was not appropriate. Accordingly, changes in fair value of these swaps are reported in noninterest income rather than other comprehensive income.

In February of 2008, the Company chose to terminate all of its outstanding swaps, which had a total notional amount of \$60,000,000. The Company realized a gain of approximately \$832,000 associated with their settlements which was included in other noninterest income.

At December 31, 2007, outstanding swaps with a notional amount of \$60,000,000 had weighted average pay rates of 7.25%, weighted average receive rates of 6.65% and a weighted average maturity of 1.5 years. These swaps had a fair value of \$288,000 which was reported in other noninterest income.

NOTE 10 REGULATORY MATTERS

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

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If the Bank is only adequately capitalized, regulatory approval is required to accept brokered deposits; and if the Bank is undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 10 REGULATORY MATTERS (Continued)

At June 30, 2008 and December 31, 2007, actual capital levels and minimum required levels were (in thousands):

| | Actual | | Minimum Required For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Regulations | |
|--|----------------------|-------|--|-------|--|-------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | <u>June 30, 2008</u> | | | | | |
| Total capital (to risk weighted assets) | | | | | | |
| Consolidated | \$ 195,142 | 10.7% | \$ 145,950 | 8.0% | N/A | N/A |
| Bank | 193,334 | 10.6 | 145,761 | 8.0 | \$ 182,201 | 10.0 |
| Tier 1 capital (to risk weighted assets) | | | | | | |
| Consolidated | 172,227 | 9.4 | 72,975 | 4.0 | N/A | N/A |
| Bank | 170,448 | 9.4 | 72,881 | 4.0 | 109,321 | 6.0 |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | 172,227 | 8.2 | 84,016 | 4.0 | N/A | N/A |
| Bank | 170,448 | 8.1 | 83,908 | 4.0 | 104,885 | 5.0 |

December 31, 2007

| | | | | | | |
|--|------------|-------|------------|------|------------|------|
| Total capital (to risk weighted assets) | | | | | | |
| Consolidated | \$ 194,362 | 10.7% | \$ 145,898 | 8.0% | N/A | N/A |
| Bank | 192,677 | 10.6 | 145,715 | 8.0 | \$ 182,143 | 10.0 |
| Tier 1 capital (to risk weighted assets) | | | | | | |
| Consolidated | 171,434 | 9.4 | 72,949 | 4.0 | N/A | N/A |
| Bank | 169,778 | 9.3 | 72,857 | 4.0 | 109,286 | 6.0 |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | 171,434 | 8.3 | 82,850 | 4.0 | N/A | N/A |
| Bank | 169,778 | 8.2 | 82,754 | 4.0 | 103,443 | 5.0 |

The Bank was categorized as well capitalized at June 30, 2008 and December 31, 2007. There are no conditions or events since June 30, 2008 that management believes have changed its category.

NOTE 11 FAIR VALUE

Statement 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has 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; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 (Unaudited)

NOTE 11 FAIR VALUE (continued)

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used to in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Assets and liabilities measured at fair value on a recurring basis, are summarized below (in thousands):

Fair Value Measurements at June 30, 2008 Using

| | June 30, 2008 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|----------------------|---|--|--|
| Assets: | | | | |
| Available for sale securities | \$ 169,378 | \$ --- | \$ 169,378 | \$ --- |
| Loans held for sale | 992 | \$ --- | 992 | \$ --- |
| <u>Assets and Liabilities Measured on a Non-Recurring Basis</u> | | | | |

Assets and liabilities measured at fair value on a non-recurring basis are summarized below (in thousands):

Fair Value Measurements at June 30, 2008 Using

| | June 30, 2008 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|----------------|----------------------|---|--|--|
| Assets: | | | | |
| Impaired loans | \$ 72,604 | \$ --- | \$ 72,604 | \$ --- |

The following represent impairment charges recognized during the period:

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$72.6 million, with a valuation allowance of \$12.6 million, resulting in an additional provision for loan losses of approximately \$799,000 and \$1.1 million for the three and six month periods ended June 30, 2008.

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

Macatawa Bank Corporation is a Michigan corporation and is the holding company for a wholly owned subsidiary, Macatawa Bank and for two trusts, Macatawa Statutory Trust I and Macatawa Statutory Trust II. Macatawa Bank Corporation is a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act. Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The bank operates twenty-six branch offices and a lending and operational service facility, providing a full range of commercial and consumer banking and trust and brokerage services in Kent County, Ottawa County, and northern Allegan County, Michigan. Macatawa Statutory Trusts I and II are grantor trusts and issued \$20.0 million each of pooled trust preferred securities. These trusts are not consolidated in the Corporation's financial statements. For further information regarding consolidation, see the Notes to the Consolidated Financial Statements included herein.

Since opening in November of 1997, Macatawa Bank has experienced substantial growth. We believe that growth in core deposits is key to our long-term success and is our primary funding source for asset growth. Establishing a branching network in our markets has been of high importance in order to facilitate this core deposit growth. We have gained community awareness and acceptance in our markets through our expanding branch network and high quality service standards.

The West Michigan markets within which we operate continue to provide expansion opportunities for us. We opened our twenty-sixth branch in Cascade on the east side of the greater Grand Rapids area during the second quarter of 2007. Because of the significance of the greater Grand Rapids market and the great opportunity for market share growth, we anticipate additional branch openings in this market. We also continue to enjoy success in building new and existing relationships in both our Holland/Zeeland and Grand Haven markets. We anticipate that we will continue to experience long-term growth in our balance sheet and in our earnings due to these expansion opportunities.

RESULTS OF OPERATIONS

Summary: Net income for the quarter ended June 30, 2008 was \$2.2 million, a decrease of 53% as compared to second quarter 2007 net income of \$4.6 million. Earnings per share on a diluted basis were \$0.13 for the second quarter of 2008 compared to \$0.26 for the same period in 2007. Net income for the six months ended June 30, 2008 was \$4.6 million, a decrease of 51% compared to \$9.4 million for the same period in the prior year. Earnings per share on a diluted basis were \$0.27 for the six months ended June 30, 2008 compared to \$0.54 for the same period in the prior year.

The decrease in net income for both the three and six months ended June 30, 2008 compared to the same periods in the prior year was primarily due to increases in the provision for loan losses, a decrease in net interest income and an increase in noninterest expense partially offset by an increase in noninterest income.

Net Interest Income: Net interest income totaled \$15.1 million for the second quarter of 2008, a decrease of \$1.2 million, or 8%, as compared to the second quarter of 2007. Net interest income for the first six months of 2008 totaled \$29.8 million, a decrease of \$2.6 million or 8% as compared to \$32.4 million for the same period in 2007. The decrease in net interest income for both the three and six month periods was primarily from a decline in the net interest margin partially offset by an increase in average earning assets. The net interest margin decreased 26 basis points to 3.06% for the second quarter of 2008 and 30 basis points to 3.03% for the first six months of 2008 when compared to the same periods in the prior year. Only 6 and 11 basis points, respectively, of the declines for both the three and six month periods ended June 30, 2008 compared to the same periods in the prior year were primarily related to the impact of the 325 basis point decline in the Federal funds and prime rates that began in September of 2007. The remaining margin declines were associated with higher balances of nonperforming assets. Average earning assets increased \$13.4 million to \$1.98 billion for the second quarter of 2008 and \$23.3 million to \$1.98 billion for the six month period ended June 30, 2008 compared to the same periods of the prior year.

During both the three and six month periods, the decrease in the yield on assets exceeded the decrease in the cost of funds and was the primary reason for the decline in the net interest margin.

The yield on earning assets decreased by 135 basis points for the three months ended June 30, 2008 and 113 basis points for the six months ended June 30, 2008 compared to the same periods in the prior year. The short-term interest rate cuts that began in the third quarter of 2007 caused a decrease in the yield on our variable rate loan portfolio and were the primary reason for the decrease in yield on earning assets. Also contributing to the decrease was the impact of rising balances of nonperforming loans throughout 2007 and into 2008 which resulted in a decline of approximately 20 basis points for both the three and six months ended June 30, 2008.

The cost of funds decreased 119 basis points for the three months ended June 30, 2008 and 91 basis points for the six months ended June 30, 2008 compared to the same periods in the prior year. A decrease in the rates paid on our deposit accounts, the rollover of time deposits at lower rates, and the repositioning of other borrowings within the lower rate environment were the primary reasons for the decrease in the cost of funds.

We expect growth in earning assets to be at lower levels than we have experienced in the past due to the generally weak economic conditions in Michigan. The 225 basis point cuts in the Federal funds and prime rates that occurred in the first six months of 2008 are anticipated to have a minimal impact on net interest income over the next twelve months. The Company's variable rate loan portfolio exceeds the level of variable rate funding, but the fixed rate funding portfolio that reprices over the next twelve months is expected to offset this excess.

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The following table shows an analysis of net interest margin for the three-month periods ending June 30, 2008 and 2007.

For the three months ended June 30,

| | 2008 | | | 2007 | | |
|---|------------------------|-------------------------------|-----------------------------|--------------------|-------------------------------|-----------------------------|
| | Average Balance | Interest Earned or paid | Average Yield or cost | Average Balance | Interest Earned or paid | Average Yield or cost |
| | (Dollars in thousands) | | | | | |
| Assets | | | | | | |
| Taxable securities | \$ 135,826 | \$ 1,497 | 4.41% | \$ 148,593 | \$ 1,644 | 4.42% |
| Tax-exempt securities (1) | 51,427 | 543 | 6.50% | 52,105 | 548 | 6.48% |
| Loans(2) | 1,771,590 | 26,934 | 6.03% | 1,733,992 | 33,105 | 7.57% |
| Federal Home Loan Bank stock | 12,275 | 174 | 5.60% | 12,275 | 123 | 3.95% |
| Federal funds sold | 9,352 | 51 | 2.15% | 20,090 | 263 | 5.18% |
| | | | | | | |
| Total interest earning assets (1) | 1,980,470 | 29,199 | 5.91% | 1,967,055 | 35,683 | 7.26% |
| Noninterest earning assets: | | | | | | |
| Cash and due from banks | 25,940 | | | 30,919 | | |
| Other | 125,569 | | | 117,000 | | |
| | | | | | | |
| Total assets | \$ 2,131,979 | | | \$ 2,114,974 | | |
| | | | | | | |
| Liabilities | | | | | | |
| NOWs and MMDAs | \$ 605,666 | 2,218 | 1.47% | \$ 739,338 | 6,735 | 3.65% |
| Savings | 45,339 | 46 | 0.41% | 42,514 | 61 | 0.58% |
| IRAs | 43,482 | 437 | 4.04% | 43,103 | 513 | 4.78% |
| Time deposits | 730,445 | 7,382 | 4.07% | 656,362 | 7,987 | 4.88% |
| Other borrowed funds | 310,072 | 3,379 | 4.31% | 248,549 | 3,102 | 4.94% |
| Long-term debt | 41,238 | 603 | 5.66% | 41,238 | 860 | 8.25% |
| Federal funds borrowed | 10,473 | 47 | 2.23% | 6,548 | 90 | 5.44% |
| | | | | | | |
| Total interest bearing liabilities | 1,786,715 | 14,112 | 3.16% | 1,777,652 | 19,348 | 4.35% |
| Noninterest bearing liabilities: | | | | | | |
| Noninterest bearing demand accounts | 168,520 | | | 164,532 | | |
| Other noninterest bearing liabilities | 12,515 | | | 7,088 | | |
| Shareholders' equity | 164,229 | | | 165,702 | | |
| | | | | | | |
| Total liabilities and shareholders' equity | \$ 2,131,979 | | | \$ 2,114,974 | | |
| | | | | | | |
| Net interest income | | \$ 15,087 | | | \$ 16,335 | |
| | | | | | | |
| Net interest spread (1) | | | 2.75% | | | 2.91% |
| Net interest margin (1) | | | 3.06% | | | 3.32% |
| Ratio of average interest earning assets to average interest bearing liabilities | 110.84% | | | 110.65% | | |
| (1) Yield adjusted to fully tax equivalent. | | | | | | |
| (2) Includes non-accrual loans. | | | | | | |

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The following table shows an analysis of net interest margin for the six-month periods ending June 30, 2008 and 2007.

| | For the six months ended June 30, | | | | | |
|---|-----------------------------------|-------------------------------|-----------------------------|--------------------|-------------------------------|-----------------------------|
| | 2008 | | | 2007 | | |
| | Average Balance | Interest Earned or paid | Average Yield or cost | Average Balance | Interest Earned or paid | Average Yield or cost |
| | (Dollars in thousands) | | | | | |
| Assets | | | | | | |
| Taxable securities | \$ 140,477 | \$ 3,140 | 4.47% | \$ 149,570 | \$ 3,308 | 4.42% |
| Tax-exempt securities (1) | 51,423 | 1,085 | 6.49% | 52,244 | 1,100 | 6.48% |
| Loans(2) | 1,765,774 | 55,899 | 6.28% | 1,724,251 | 65,563 | 7.58% |
| Federal Home Loan Bank stock | 12,275 | 327 | 5.27% | 12,275 | 280 | 4.54% |
| Federal funds sold | 5,679 | 64 | 2.23% | 13,965 | 364 | 5.19% |
| | 1,975,628 | 60,515 | 6.14% | 1,952,305 | 70,615 | 7.27% |
| Noninterest earning assets: | | | | | | |
| Cash and due from banks | 26,846 | | | 31,067 | | |
| Other | 121,818 | | | 113,466 | | |
| | 2,124,292 | | | 2,096,838 | | |
| Liabilities | | | | | | |
| NOWs and MMDAs | \$ 614,114 | 5,726 | 1.88% | \$ 733,888 | 13,293 | 3.66% |
| Savings | 43,150 | 103 | 0.48% | 41,557 | 120 | 0.58% |
| IRAs | 42,853 | 914 | 4.29% | 42,174 | 988 | 4.72% |
| Time deposits | 706,287 | 15,174 | 4.32% | 667,196 | 16,133 | 4.78% |
| Other borrowed funds | 324,363 | 7,234 | 4.41% | 232,477 | 5,751 | 4.92% |
| Long-term debt | 41,238 | 1,371 | 6.57% | 41,238 | 1,712 | 8.26% |
| Federal funds borrowed | 13,726 | 209 | 3.02% | 8,138 | 223 | 5.45% |
| | 1,785,731 | 30,731 | 3.44% | 1,766,668 | 38,220 | 4.35% |
| Noninterest bearing liabilities: | | | | | | |
| Noninterest bearing demand accounts | 164,523 | | | 161,013 | | |
| Other noninterest bearing liabilities | 9,672 | | | 6,117 | | |
| Shareholders' equity | 164,366 | | | 163,040 | | |
| | 2,124,292 | | | 2,096,838 | | |
| Net interest income | | | | | | |
| | | \$29,784 | | | \$ 32,395 | |
| Net interest spread (1) | | | | | | |
| | | | 2.70% | | | 2.92% |
| Net interest margin (1) | | | | | | |
| | | | 3.03% | | | 3.33% |
| Ratio of average interest earning assets to average interest bearing liabilities | | | | | | |
| | 110.63% | | | 110.51% | | |
| (1) Yield adjusted to fully tax equivalent. | | | | | | |
| (2) Includes non-accrual loans. | | | | | | |

Provision for Loan Losses: The provision for loan losses for the three and six month periods ended June 30, 2008 was \$3.5 million and \$6.2 million compared to \$965,000 and \$1.8 million for the same periods in the prior year. The increases in the provision for loan losses for both the three and six month periods ended June 30, 2008 were the result of higher net charge-offs and higher levels of problem loans as compared to the same periods in 2007. The amounts of loan loss provision in both the current and prior year periods were a byproduct of establishing our allowance for loan losses at levels deemed necessary in our methodology for determining the adequacy of the allowance. For more information about our allowance for loan losses and our methodology for establishing its level, see the discussion below under Portfolio Loans and Asset Quality.

Noninterest Income: Noninterest income for the three and six month periods ended June 30, 2008 increased to \$5.1 million and \$10.1 million, respectively, from \$4.0 million and \$7.8 million for the same periods in the prior year. The increase for both the three and six month periods included approximately \$412,000 and \$243,000, respectively, of gains on the sale of securities and the termination of certain borrowings. The increase in the six month period included \$832,000 of gains realized on the settlement of interest rate swaps which were free standing derivatives carried at fair value. The Company chose to execute each of these transactions to support its shift to a more balanced sensitivity to future interest rate changes. For more information about the interest rate swaps, refer to Note 9 of the Financial Statements. Increases in revenues from deposit services, investment services, ATM and debit card processing were offset by slight declines in trust income for both the three and six month periods ended June 30, 2008.

Noninterest Expense: Noninterest expense for the three and six month periods ended June 30, 2008 increased to \$13.6 million and \$27.2 million, respectively, from \$12.6 million and \$24.4 million for the same periods in the prior year. Increases of \$530,000 and \$1.3 million in salaries and benefits for the three and six month periods primarily related to general staff additions and merit increases since the prior year. Staff additions were in varied positions throughout the Company, including risk management, credit administration and problem asset departments, and selective sales personnel to support growth in deposits and commercial and industrial lending.

The increase in legal and professional fees and the increase of \$323,000 and \$966,000 in other expense for the three and six month periods primarily related to the impact of higher levels of nonperforming assets. Costs associated with nonperforming assets include legal costs, survey and appraisal fees, repossession expenses and disposition and other carrying costs. These costs increased by approximately \$431,000 and \$784,000 for the three and six month periods ended June 30, 2008 compared to the same periods in the prior year. FDIC assessments increased by \$84,000 and \$222,000 for the three and six month periods due to an increase in insurance rates related to higher nonperforming asset levels. The Company was able to manage costs in other areas to offset these increases. We expect efficiency to continue to improve by better utilizing our capacity as we grow. We believe the additional capacity within our branch network will provide future growth opportunities without significant additional costs.

Federal Income Tax Expense: The Company's federal income tax expense was \$830,000 and \$1.8 million resulting in an effective tax rate of 27.7% and 28.1% for the three and six month periods ended June 30, 2008. This compared to \$2.2 million and \$4.5 million resulting in an effective tax rate of 32.4% and 32.3% for the same periods in the prior year. The decline in the effective tax rate was primarily due to tax exempt income representing a higher percentage of total income in 2008.

FINANCIAL CONDITION

Summary: Total assets were \$2.12 billion at June 30, 2008, a decrease of \$11.2 million from \$2.13 billion at December 31, 2007. The decline was primarily from a decrease of \$32.1 million in available for sale securities and partially offset by an increase in portfolio loans of \$15.1 million.

Securities Available for Sale: Securities available for sale were \$169.4 million at June 30, 2008 compared to \$201.5 million at December 31, 2007. The decrease was primarily due to calls and maturities and the sale of approximately \$21.7 million of U.S. Government Agency bonds, partially offset by purchases of U.S. Government Agency bonds. The sales of securities helped support the Company's interest in positioning its assets and liabilities to a more balanced sensitivity to interest rates and resulted in gross gains of \$412,000.

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Portfolio Loans and Asset Quality: Total portfolio loans were \$1.77 billion at June 30, 2008 compared to \$1.75 billion at December 31, 2007. In recent quarters, residential mortgage loans have led our loan portfolio growth. Because of the relatively short duration of our assets, we have viewed the recent improvement in rates on residential mortgage loans as an opportunity to hold more of these higher quality loans in our portfolio. During the first six months of 2008, our residential mortgage loan portfolios increased by \$35.9 million, while our commercial and consumer loan portfolios declined \$18.1 million and \$2.7 million, respectively.

The slower loan growth in commercial and consumer loans in recent quarters is a reflection of the weak economic conditions in West Michigan and our interest in maintaining the quality of our loan portfolio. In particular, deterioration in residential land development has impacted both asset growth and asset quality.

Commercial and commercial real estate loans still remain our largest loan segment and accounted for approximately 72% and 74% of the total loan portfolio at June 30, 2008 and December 31, 2007. Residential mortgage loans and consumer loans comprised 17% and 11% of total loans at June 30, 2008, and 15% and 11% at December 31, 2007.

A further breakdown of the composition of commercial loans is shown in the table below (in thousands):

| | June 30, 2008 | December 31, 2007 |
|------------------------------------|----------------------|--------------------------|
| Construction/Land Development | \$ 319,379 | \$ 335,366 |
| Farmland and Agriculture | 23,186 | 30,371 |
| Nonfarm, Nonresidential | 462,204 | 454,764 |
| Multi-family | 29,921 | 35,381 |
| | 834,690 | 855,882 |
| Total Commercial Real Estate Loans | 834,690 | 855,882 |
| Commercial and Industrial | 441,882 | 438,743 |
| | 1,276,572 | 1,294,625 |
| Total Commercial Loans | \$ 1,276,572 | \$ 1,294,625 |

Loans for the development or sale of 1-4 family residential properties were approximately \$242.9 million at June 30, 2008, representing approximately 76% of the construction and land development portfolio. Of this total, approximately \$31.9 million was secured by vacant land, \$132.8 million was secured by developed residential land and \$78.2 million was secured by 1-4 family properties held for speculative purposes. Vacant land is land zoned for residential purposes but with no further development. Developed residential land is land that has been further developed for future residential construction, including but not limited to completed lot surveys, road work, water, sewer and other utility preparation and general land grade. 1-4 family properties held for speculative purposes are on developed residential lots and include completed residential homes or residential homes in the process of construction. The balances of these loan portfolios remained relatively stable compared to December 31, 2007.

Our loan portfolio is reviewed regularly by our senior management, our loan officers, and an internal loan review team that is independent of our loan originators. When reasonable doubt exists concerning collectibility of interest or principal of one of our loans, that loan is placed in non-accrual status. Any interest previously accrued but not collected is reversed and charged against current earnings.

Nonperforming assets are comprised of nonperforming loans, foreclosed assets and repossessed assets. Nonperforming loans include loans on non-accrual status, restructured loans and loans delinquent more than 90 days but still accruing. Foreclosed and repossessed assets include assets acquired in settlement of loans.

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As of June 30, 2008, nonperforming loans totaled \$80.2 million or 4.54% of total portfolio loans compared to \$73.9 million or 4.22% of total portfolio loans at December 31, 2007.

Loans for the development or sale of 1-4 family residential properties were approximately \$62.9 million or 78% of total non-performing loans at June 30, 2008. Of this total, approximately \$2.9 million was secured by vacant land, \$41.8 million was secured by developed residential land and \$18.2 million was secured by 1-4 family properties held for speculative purposes. The remaining balance of nonperforming loans at June 30, 2008 consisted of a number of commercial loans most of which were on nonaccrual and which we consider to be well collateralized or adequately reserved through the allowance for loan losses.

Foreclosed assets totaled \$8.0 million at June 30, 2008 compared to \$5.7 million at December 31, 2007. The balance at June 30, 2008 was comprised of a number of real estate properties for which no loss is expected upon disposition.

The following table shows the composition and amount of our nonperforming assets:

| (Dollars in thousands) | June 30, 2008 | December 31, 2007 |
|---|------------------|-------------------|
| Nonaccrual loans | \$ 77,362 | \$ 70,999 |
| Renegotiated loans | 30 | 38 |
| Loans 90 days past due and still accruing | 2,801 | 2,872 |
| Total nonperforming loans | 80,193 | 73,909 |
| Foreclosed assets | 7,960 | 5,704 |
| Repossessed assets | 333 | 172 |
| Total nonperforming assets | \$ 88,486 | \$ 79,785 |

Nonperforming loans to total loans 4.54% 4.22%

Nonperforming assets to total assets 4.18% 3.75%

Allowance for loan losses: The allowance for loan losses as of June 30, 2008 was \$31.8 million or 1.80% of total portfolio loans, compared to \$33.4 million or 1.91% of total portfolio loans at December 31, 2007. Net charge-offs for the six months ended June 30, 2008 totaled \$7.9 million as compared to \$1.2 million for the same period in 2007. Of the \$7.9 million in charge-offs, approximately \$4.6 million were from impaired loans with previously established specific allowances. The ratio of net charge-offs to average loans was 0.89% on an annualized basis for the first six months of 2008 compared to 0.13% for the first six months of 2007. The provision for loan losses increased \$4.4 million to \$6.2 million for the six months ended June 30, 2008 compared to \$1.8 million for the same period of the prior year primarily due to higher levels of nonperforming loans and an increase in net charge-offs.

Our allowance for loan losses is maintained at a level considered appropriate based upon our regular, quarterly assessments of the probable estimated losses inherent in the loan portfolio. Our methodology for measuring the appropriate level of allowance is comprised of several key elements, which include specific allowances for loans considered impaired, formula allowance for graded loans, general allocations based on historical trends for pools of similar loan types, and under certain circumstances, an unallocated reserve related to current market conditions that are pertinent to certain aspects of the loan portfolio.

Specific allowances are established in cases where senior credit management has identified significant conditions or circumstances related to an individually impaired credit that we believe indicates the probability that a loss has been incurred. This amount is determined by methods prescribed by SFAS No. 114, Accounting by Creditors for Impairment of a Loan. Impaired loans increased to \$112.2 million at June 30, 2008 from \$99.0 million at December 31, 2007. The increase in impaired loans is primarily from loans associated with residential land development. Despite the increase in the balance of impaired loans, the reserves associated with impaired loans declined. The specific allowance for impaired loans was \$12.6 million at June 30, 2008 and \$15.8 million at December 31, 2007. The decline is primarily from the charge-offs recorded on impaired loans during 2008. This was partially offset by reserves established for impaired loans added during the first six months of 2008.

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The allowance allocated to commercial loans that are not considered to be impaired is based upon the internal risk grade of such loans. We use a loan rating method based upon an eight point system. Loans are assigned a loss allocation factor for each loan classification category. The lower the grade assigned to a loan category, the greater the allocation percentage that is applied. Changes in risk grade of loans affect the amount of the allowance allocation. An allowance for these types may be established due to a change in economic conditions and trends for that type. The determination of our loss factors is based upon our actual loss history by loan grade and adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the analysis date. The commercial loan allowance was \$16.6 million at June 30, 2008 compared to \$15.3 million at December 31, 2007 and increased primarily from a general migration of loans to a lower risk grade.

Groups of homogeneous loans, such as residential real estate, open- and closed-end consumer loans, etc., receive allowance allocations based on loan type. As with commercial loans, the determination of the allowance allocation percentage includes consideration of historical loss trends based on industry and peer experience as well as our historical loss experience. General economic and business conditions, credit quality and delinquency trends, collateral values, and recent loss experience are considered in connection with allocation factors for these similar pools of loans. The homogeneous loan allowance was \$2.6 million at June 30, 2008 compared to \$2.3 million at December 31, 2007. The increase was primarily related to an increase in the balance of our mortgage loan portfolio.

Deposits and Other Borrowings: Total deposits increased \$80.5 million to \$1.60 billion at June 30, 2008 compared to \$1.52 billion at December 31, 2007. Of the \$80.5 million in deposit growth, approximately \$41 million was from deposits generated within our market area, while approximately \$39.2 million was from deposits generated through brokers. The growth in deposits within the Company's markets was primarily from certificates of deposits, money market accounts and regular savings accounts, as deposit customers continue to prefer such accounts within the current rate environment. The growth in deposits allowed the Company to reduce its other borrowing levels since the beginning of the year. With our continued focus on quality customer service, the desire of customers to deal with a local bank, and the convenience of our expanding and maturing branch network, we expect further growth in our core transaction deposits.

The decrease of \$37.8 million in Federal funds purchased and \$58.3 million in other borrowed funds was largely related to the growth in deposits discussed above. Of the decrease in other borrowed funds, \$38.3 million was due to a decrease in Federal Home Loan Bank advances and \$20 million was due to a decrease in borrowings associated with securities sold under agreements to repurchase (repo borrowings). The Company terminated \$20 million of repo borrowings in 2008 to support its shift to a more balanced sensitivity to future interest rate changes.

CAPITAL RESOURCES AND LIQUIDITY

Capital Resources: Total shareholders' equity remained relatively flat during the first six months and was \$160.8 million at June 30, 2008 compared to \$160.6 million at December 31, 2007.

Net income generated during the first six months of 2008 of \$4.6 million was offset by cash dividends of \$4.4 million, or \$.26 per share. We will continue to closely monitor the sufficiency of our earnings relative to these dividends.

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Our total capital to risk-weighted assets was 10.7% at both June 30, 2008 and December 31, 2007. Our Tier 1 Capital as a percent of average assets was 8.2% and 8.3%, respectively at June 30, 2008 and December 31, 2007. Both ratios continue to be maintained at levels in excess of the regulatory minimums for bank holding companies. The ratios remained flat since the beginning of the year primarily because our retained earnings have kept pace with the growth in our assets.

Liquidity: The liquidity of a financial institution reflects its ability to measure and monitor a variety of sources and uses of funds. Our Consolidated Statements of Cash Flows categorize these sources and uses into operating, investing and financing activities. We primarily focus on developing access to a variety of borrowing sources to supplement our deposit gathering activities and provide funds for growing our investment and loan portfolios. Our sources of liquidity include our borrowing capacity with the Federal Home Loan Bank, structured repo borrowings and federal funds purchased lines with our correspondent banks, loan payments by our borrowers, maturities and sales of our securities available for sale, growth of our deposits and deposit equivalents, federal funds sold, and the various capital resources discussed above. In addition, the Company has been approved to borrow from the Federal Reserve Bank of Chicago's discount window. Liquidity management involves the ability to meet the cash flow requirements of our customers. Our customers may be either borrowers with credit needs or depositors wanting to withdraw funds. We feel our liquidity position is sufficient to meet these needs.

Forward Looking Statements

This report includes forward-looking statements as that term is used in the securities laws. All statements regarding our expected financial position, business and strategies are forward-looking statements. In addition, the words anticipates, believes, estimates, seeks, expects, plans, intends, and similar expressions, as they relate to us or our management, are intended to identify forward-looking statements. The presentation and discussion of the provision and allowance for loan losses, statements concerning future profitability or future growth or increases, and statements about the adequacy of our capital resources are examples of inherently forward looking statements in that they involve judgments and statements of belief as to the outcome of future events. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on our operations and our future prospects include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in our market area and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning us and our business, including additional factors that could materially affect our financial results, is included in our filings with the Securities and Exchange Commission.

Item 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKMarket Risk Analysis

Our primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of our transactions are denominated in U.S. dollars with no specific foreign exchange exposure. Macatawa Bank has only limited agricultural-related loan assets, and therefore has no significant exposure to changes in commodity prices.

Our market risk exposure is mainly comprised of our sensitivity to interest rate risk. Our balance sheet has sensitivity, in various categories of assets and liabilities, to changes in prevailing rates in the U.S., including the Federal funds rate, the prime rate, mortgage rates, U.S. Treasury rates and various money market indexes. As part of our asset/liability management process, we identify and evaluate opportunities to structure our balance sheet to maximize our earnings while balancing our liquidity and interest rate risk within established parameters.

We utilize a simulation model as our primary measurement technique in our interest rate risk management. Our simulation analyses monitors the direction and magnitude of variations in net interest income and the economic value of equity (EVE) resulting from potential changes in market interest rates.

Key assumptions in the model include the repricing of cash flows and maturities of interest-sensitive assets and interest-sensitive liabilities at current market rates, prepayment speeds on certain assets, and changes in market conditions impacting loan and deposit pricing. We also assume certain levels of rate sensitivity to changes in market rates of our non-maturing transaction deposits based upon our historical sensitivity under previous interest rate cycles, and we include pricing floors on discretionary priced liability products which limit how low various checking and savings products could go under declining interest rates. These assumptions reflect our pricing philosophy in response to changing interest rates.

We forecast the next twelve months of net interest income under an assumed environment of gradual changes in market interest rates under various scenarios. The resulting change in net interest income is an indication of the sensitivity of our earnings to directional changes in market interest rates. The simulation also measures the change in EVE, or the net present value of our assets and liabilities, under an immediate shift, or shock, in interest rates under various scenarios, as calculated by discounting the estimated future cash flows using market-based discount rates.

The following table shows the impact of changes in interest rates on net interest income over the next twelve months and EVE based on our balance sheet as of June 30, 2008 (dollars in thousands).

| Interest Rate Scenario | Economic Value of Equity | Percent Change | Net Interest Income | Percent Change |
|--------------------------------------|---------------------------------|-----------------------|----------------------------|-----------------------|
| Interest rates up 200 basis points | \$ 199,338 | (9.39) | \$ 63,411 | 3.34% |
| Interest rates up 100 basis points | 212,007 | (3.63) | 62,423 | 1.73 |
| No change in interest rates | 220,003 | -- | 61,359 | -- |
| Interest rates down 100 basis points | 219,837 | (0.08) | 60,498 | (1.40) |
| Interest rates down 200 basis points | 216,442 | (1.62) | 60,281 | (1.76) |

This analysis suggests that net interest income will stay within a narrow range over the next twelve months under the differing rate scenarios. If interest rates were to rise, this analysis suggests that we are positioned for improvement in net interest income over the next twelve months.

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We also forecast the impact of immediate and parallel interest rate shocks on net interest income under various scenarios to measure the sensitivity of our earnings under extreme conditions.

The quarterly simulation analysis is monitored against acceptable interest rate risk parameters by the Asset/Liability Committee and reported to the Board of Directors.

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

Item 4: CONTROLS AND PROCEDURES

- (a) Evaluation of Disclosure Controls and Procedures. The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Form 10-Q Quarterly Report, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the company, particularly during the period in which this Form 10-Q Quarterly Report was being prepared.
- (b) Changes in Internal Controls. During the period covered by this report, there have been no changes in the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

Please refer to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, (Part II, Item 1 Legal Proceedings) for information concerning legal proceedings related to Trade Partners, Inc.

A lawsuit was filed in April 2003 by John and Kathryn Brand in Oklahoma state court against Grand Bank, the Company, Trade Partners and certain individuals and entities associated with Trade Partners. The complaint seeks damages for the asserted breach of certain escrow agreements for which Grand Bank served as custodian and escrow agent. The claims asserted against the Company and Grand Bank in this action have been settled and dismissed with prejudice.

In May 2003, a purported class action complaint was filed by Forrest W. Jenkins and Russell S. Vail against the Company in the United States District Court for the District of Western Michigan. As amended, this suit alleges that Grand Bank breached escrow agreements and fiduciary duties and violated the Michigan Uniform Securities Act with respect to the investments secured by the purported class in viaticals and in interests in limited partnerships which made loans to Trade Partners secured by viaticals, and with respect to loans made by purported class members directly to Trade Partners. Plaintiffs' motion for class certification was denied in November 2006. The Company has answered this complaint denying the material allegations and raising certain affirmative defenses.

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Following denial of class certification in the Jenkins case, nine new cases were filed in several different jurisdictions. These complaints are identical in all material respects other than the identity of the plaintiffs, and are substantially identical to the complaint in the Jenkins litigation. None of these complaints contain class action allegations, but the total number of named plaintiffs in all the nine cases is about 1,400. The cases are: Ronald Ash, et. al. v. Macatawa Bank Corporation, et. al. filed November 17, 2006 in the District Court for Oklahoma County, Oklahoma, subsequently removed by the Company to the United States District Court for the Western District of Oklahoma; Steven M. Adamson, et. al. v. Macatawa Bank Corporation, et. al. filed November 15, 2006 in the United States District Court for the Western District of Oklahoma; James Lee Myers et. al. v. Macatawa Bank Corporation, et. al. filed November 14, 2006 in the Superior Court for Los Angeles County, California, subsequently removed by the Company to the United States District Court for the Central District of California; Frank V. Bailey et. al. v. Macatawa Bank Corporation, et. al. filed November 29, 2006 in the United States District Court for the Northern District of Texas; Eddie Elkins, et. al. v. Macatawa Bank Corporation filed January 29, 2007 in the United States District Court for the Western District of Oklahoma; William A. Giese, et. al. v. Macatawa Bank Corporation, et. al. filed November 17, 2006 in the Circuit Court for Kent County, Michigan; Gerald Abraham, et. al. v. Macatawa Bank Corporation, et. al. filed November 29, 2006 in the Circuit Court for Kent County, Michigan; Jorge Acevedo, et. al. v. Macatawa Bank Corporation, et. al. filed December 17, 2006 in the Circuit Court for Kent County, Michigan; and Jose Javier Acasuso, et. al. v. Macatawa Bank Corporation, et. al. filed January 17, 2007 in the Circuit Court for Kent County, Michigan.

The Company believes it has meritorious defenses and intends to vigorously defend these cases.

On April 15, 2003, the United States District Court for the Western District of Michigan appointed a receiver for Trade Partners. In order to prevent or minimize any loss to investors in the viaticals sold by Trade Partners to investors, the court-appointed receiver coordinated the payment of premiums on the approximately 1,000 outstanding viaticated insurance policies in the Trade Partners portfolio so that the policies would not lapse. The receiver informed the Company that nine policies with a total face value of approximately \$1.4 million lapsed for failure to pay premiums prior to the receiver's coordination efforts. In addition, the receiver unsuccessfully contested a partial lapse totaling about \$700,000. In February 2008 the receiver reported that he had discovered that an unspecified number of group policies in an unspecified face amount had apparently lapsed prior to the receivership for various reasons, including companies that went out of business or employees who had been terminated.

On July 1, 2003, the United States District Court for the Western District of Michigan authorized the receiver to borrow money from Macatawa Bank to pay premiums, if needed. Macatawa Bank agreed to extend a \$4 million line of credit to the receiver, conditioned upon obtaining a security interest in the viaticals. No draws were made against the line, and the line expired during the fourth quarter of 2004.

The receiver received authorization from the Court in July 2005 to sell the entire portfolio, which the receiver said had a face value of approximately \$170 million, to Universal Settlements International, Inc., a Canadian company, for an amount equal to 26.58% of face value. Under the terms of the sale, payments are to be made by Universal Settlements to the receivership as policy transfers are processed by the issuing insurance companies. The receiver has reported that as of July 15, 2008 he had received sale payments of approximately \$39.7 million and proceeds of maturities aggregating another \$31.7 million.

The receiver on July 21, 2006 filed a proposed amended plan of distribution and related disclosure statement, contemplating a complete liquidation of the assets of Trade Partners. The plan was approved by the Court on January 7, 2007. The receiver reported as of February 5, 2008 that claims against the receivership estate totaled \$169,430,383.85, but that contrary to his earlier reports he now expected that there may be one or two additional claims in unspecified amounts that will be filed.

The receiver reported that he commenced distributions on January 19, 2007, and that as of July 15, 2008 \$46,940,264 in court-approved claims and settlements had been distributed. There may be additional distributions, but the Company does not know when they might be made or in what amount.

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It is possible that one or more additional legal actions may be initiated involving the custodial and escrow agent services provided by Grand Bank in connection with Trade Partners. If any such legal actions are commenced, the Company intends to defend them vigorously. To the extent any pending or future claims allege errors or omissions on the part of Grand Bank or Macatawa Bank, Management believes that some or all liability, if any is proven or established, will be covered by errors and omissions insurance maintained by Grand Bank and Macatawa Bank. The Company has reported the Trade Partners matter to its two insurance carriers. Federal Insurance Company has assumed the Company's defense and has advanced a portion of its defense costs pursuant to a reservation of rights letter asserting certain coverage defenses, and an Interim Funding Agreement. Federal Insurance Company notified the Company on July 21, 2006 that it has filed an Arbitration Demand with the American Arbitration Association, seeking a declaration that based upon its asserted coverage defenses its policy does not cover this matter. The Company and Federal Insurance Company have agreed to defer any proceedings with respect to this Arbitration Demand. The Company believes that Federal Insurance Company is obligated to provide coverage, and the Company intends to vigorously pursue its rights under the insurance policy. The other carrier has taken the position that the duty of defense rests solely with the first carrier, and reserves its rights with respect to indemnity pursuant to a reservation letter asserting certain coverage defenses.

As of the date hereof, except as disclosed above, there were no material pending legal proceedings, other than routine litigation incidental to the business of banking to which we or any of our subsidiaries are a party of or which any of our properties are the subject.

Item 1A. Risk Factors.

There have been no material changes in the risk factors applicable to the Company from those disclosed in its Annual Report on Form 10-K for the year ended December 31, 2007.

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

On May 17, 2007, the Corporation announced a repurchase plan that authorized share repurchases of up to \$30 million of the Corporation's common stock. The Corporation did not repurchase any shares of its common stock in open market under the repurchase plan during the first six months of 2008. The Corporation has remaining authority to repurchase up to \$26,103,695 of market value of its common stock under the repurchase plan.

Item 3. Defaults Upon Senior Securities. None.

Item 4. Submission of Matters to a Vote of Securities Holders.

- a) The annual meeting of shareholders was held on April 22, 2008, at which the shareholders of Macatawa Bank Corporation voted to elect two directors for a term of three years. The results are as follows:

| <u>Director Nominee</u> | <u>For</u> | <u>Withheld</u> |
|-------------------------|------------|-----------------|
| Robert E. DenHerder | 15,471,229 | 283,280 |
| Arend D. Lubbers | 15,130,030 | 624,479 |

Item 5. Other Information. None.

Item 6. Exhibits.

- 31.1 Certificate of the Chief Executive Officer of Macatawa Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certificate of the Chief Financial Officer of Macatawa Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certificate of the Chief Executive Officer and the Chief Financial Officer of Macatawa Bank Corporation pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, to be signed on its behalf by the undersigned, thereunto duly authorized.

MACATAWA BANK CORPORATION

/s/ Benj. A. Smith, III

Benj. A. Smith, III
Chairman and Chief Executive Officer

/s/ Jon W. Swets

Jon W. Swets
Chief Financial Officer
(Principal Financial and Accounting Officer)

DATE: August 8, 2008

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EXHIBIT INDEX

| <u>Exhibit</u> | <u>Description</u> |
|----------------|---|
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