MERCANTILE BANK CORP
Form 10-Q
August 09, 2010

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2010

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________.

Commission File No. 000-26719
MERCANTILE BANK CORPORATION
(Exact name of registrant as specified in its charter)

Michigan	38-3360865
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

310 Leonard Street, NW, Grand Rapids, MI 49504
(Address of principal executive offices) (Zip Code)
(616) 406-3000
(Registrant s telephone number, including area code)

Indicate by check mark 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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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

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

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

Yes o No þ

At August 9, 2010, there were 8,594,307 shares of Common Stock outstanding.

MERCANTILE BANK CORPORATION

INDEX

	Page No.
PART I. Financial Information	
Item 1. Financial Statements	
Consolidated Balance Sheets June 30, 2010 (Unaudited) and December 31, 2009	1
Consolidated Statements of Operations Three and Six Months Ended June 30, 2010 (Unaudited) and June 30, 2009 (Unaudited)	2
Consolidated Statements of Changes in Shareholders Equity Six Months Ended June 30, 2010 (Unaudited) and June 30, 2009 (Unaudited)	4
Consolidated Statements of Cash Flows Six Months Ended June 30, 2010 (Unaudited) and June 30, 2009 (Unaudited)	6
Notes to Consolidated Financial Statements (Unaudited)	8
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 3. Quantitative and Qualitative Disclosures About Market Risk	49
Item 4. Controls and Procedures	52
PART II. Other Information	
Item 1. Legal Proceedings	53
Item 1A. Risk Factors	53
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	53
Item 3. Defaults Upon Senior Securities	54
Item 4. Reserved	54
Item 5. Other Information	54
Item 6. Exhibits	54
Signatures	55
EX-31	
EX-32.1	
EX-32.2	

Table of Contents

MERCANTILE BANK CORPORATION
PART I FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (Unaudited)	December 31, 2009 (Audited)
ASSETS		
Cash and due from banks	$ 16,521,000	$ 18,896,000
Short-term investments	9,470,000	1,471,000
Federal funds sold	53,892,000	1,368,000
Total cash and cash equivalents	79,883,000	21,735,000
Securities available for sale	217,117,000	182,492,000
Securities held to maturity (fair value of $60,271,000 at December 31, 2009)	0	59,211,000
Federal Home Loan Bank stock	15,681,000	15,681,000
Loans and leases	1,410,710,000	1,539,818,000
Allowance for loan and lease losses	(47,738,000)	(47,878,000)
Loans and leases, net	1,362,972,000	1,491,940,000
Premises and equipment, net	28,636,000	29,684,000
Bank owned life insurance	45,890,000	45,024,000
Accrued interest receivable	6,278,000	7,088,000
Other real estate owned and repossessed assets	23,020,000	26,608,000
Other assets	24,585,000	26,745,000
Total assets	$ 1,804,062,000	$ 1,906,208,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest-bearing	$ 126,572,000	$ 121,157,000
Interest-bearing	1,213,588,000	1,280,470,000
Total deposits	1,340,160,000	1,401,627,000
Securities sold under agreements to repurchase	108,271,000	99,755,000
Federal funds purchased	0	2,600,000
Federal Home Loan Bank advances	160,000,000	205,000,000
Subordinated debentures	32,990,000	32,990,000
Other borrowed money	16,836,000	16,890,000
Accrued expenses and other liabilities	6,762,000	7,242,000

Total liabilities	1,665,019,000	1,766,104,000
Shareholders equity		
Preferred stock, no par value; 1,000,000 shares authorized; 21,000 shares outstanding at June 30, 2010 and December 31, 2009	19,955,000	19,839,000
Common stock, no par value: 20,000,000 shares authorized; 8,594,307 shares outstanding at June 30, 2010 and 8,592,514 shares outstanding at December 31, 2009	172,631,000	172,438,000
Common stock warrant	1,138,000	1,138,000
Retained earnings (deficit)	(57,818,000)	(54,170,000)
Accumulated other comprehensive income	3,137,000	859,000
Total shareholders equity	139,043,000	140,104,000
Total liabilities and shareholders equity	$ 1,804,062,000	$ 1,906,208,000

See accompanying notes to consolidated financial statements.

Table of Contents

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30, 2010 (Unaudited)	Three Months Ended June 30, 2009 (Unaudited)	Six Months Ended June 30, 2010 (Unaudited)	Six Months Ended June 30, 2009 (Unaudited)
Interest income				
Loans and leases, including fees	$ 20,066,000	$ 24,080,000	$ 40,471,000	$ 49,265,000
Securities, taxable	2,039,000	1,889,000	4,022,000	3,825,000
Securities, tax-exempt	544,000	855,000	1,304,000	1,695,000
Federal funds sold	37,000	39,000	69,000	86,000
Short-term investments	10,000	3,000	19,000	16,000
Total interest income	22,696,000	26,866,000	45,885,000	54,887,000
Interest expense				
Deposits	5,992,000	11,220,000	12,489,000	24,061,000
Short-term borrowings	353,000	475,000	697,000	915,000
Federal Home Loan Bank advances	1,576,000	2,295,000	3,272,000	4,747,000
Other borrowings	354,000	426,000	700,000	909,000
Total interest expense	8,275,000	14,416,000	17,158,000	30,632,000
Net interest income	14,421,000	12,450,000	28,727,000	24,255,000
Provision for loan and lease losses	6,200,000	11,500,000	14,600,000	21,900,000
Net interest income after provision for loan and lease losses	8,221,000	950,000	14,127,000	2,355,000
Noninterest income				
Services charges on accounts	447,000	500,000	913,000	1,012,000
Earnings on bank owned life insurance	454,000	296,000	865,000	641,000
Rental income from other real estate owned	390,000	60,000	791,000	193,000
Mortgage banking activities	130,000	403,000	230,000	772,000
Net gain on sales of securities	0	0	476,000	0
Gain on sales of commercial loans	5,000	0	225,000	0
Other income	570,000	604,000	1,151,000	1,277,000
Total noninterest income	1,996,000	1,863,000	4,651,000	3,895,000
Noninterest expense				

Salaries and benefits	4,559,000	5,247,000	9,225,000	10,799,000
Occupancy	723,000	883,000	1,473,000	1,804,000
Furniture and equipment depreciation, rent and maintenance	396,000	466,000	805,000	933,000
Nonperforming asset costs	2,460,000	1,119,000	4,964,000	2,101,000
FDIC insurance costs	1,167,000	1,796,000	2,353,000	2,430,000
Branch consolidation costs	0	1,150,000	0	1,150,000
Other expense	2,137,000	1,703,000	4,256,000	3,919,000
Total noninterest expenses	11,442,000	12,364,000	23,076,000	23,136,000
Income (loss) before federal income tax expense (benefit)	(1,225,000)	(9,551,000)	(4,298,000)	(16,886,000)
Federal income tax expense (benefit)	(862,000)	(3,326,000)	(1,292,000)	(6,172,000)
Net income (loss)	(363,000)	(6,225,000)	(3,006,000)	(10,714,000)
Preferred stock dividends and accretion	321,000	163,000	641,000	163,000
Net income (loss) available to common shareholders	$ (684,000)	$ (6,388,000)	$ (3,647,000)	$ (10,877,000)

See accompanying notes to consolidated financial statements.

Table of Contents

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS (Continued)
(Unaudited)

	Three Months Ended June 30, 2010 (Unaudited)	Three Months Ended June 30, 2009 (Unaudited)	Six Months Ended June 30, 2010 (Unaudited)	Six Months Ended June 30, 2009 (Unaudited)
Basic earnings (loss) per share	$ (0.08)	$ (0.75)	$ (0.43)	$ (1.28)
Diluted earnings (loss) per share	$ (0.08)	$ (0.75)	$ (0.43)	$ (1.28)
Cash dividends per share	$ 0.00	$ 0.01	$ 0.01	$ 0.05
Average basic shares outstanding	8,505,086	8,487,747	8,503,388	8,484,524
Average diluted shares outstanding	8,505,086	8,487,747	8,503,388	8,484,524

See accompanying notes to consolidated financial statements.

Table of Contents

MERCANTILE BANK CORPORATION

CONSOLIDATED STATEMENTS OF
CHANGES IN SHAREHOLDERS EQUITY
(Unaudited)

($ in thousands)	Preferred Stock	Common Stock	Common Stock Warrant	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Balances, January 1, 2010	$ 19,839	$ 172,438	$ 1,138	$ (54,170)	$ 859	$ 140,104
Accretion of preferred stock	116			(116)		0
Employee stock purchase plan (5,086 shares)		23				23
Dividend reinvestment plan (687 shares)		3				3
Stock-based compensation expense		252				252
Cash dividends ($0.01 per common share)		(85)				(85)
Preferred stock dividends				(526)		(526)
Comprehensive income (loss):						
Net loss for the period from January 1, 2010 through June 30, 2010				(3,006)		(3,006)
Change in net unrealized gain on securities available for sale, net of reclassifications and tax effect					2,068	2,068
Net unrealized gain on securities transferred from held to maturity to available for sale, net of tax effect					274	274

Reclassification of unrealized gain on interest rate swaps, net of tax effect					(64)	(64)
Total comprehensive loss						(728)
Balances, June 30, 2010	$ 19,955	$ 172,631	$ 1,138	$ (57,818)	$ 3,137	$ 139,043

See accompanying notes to consolidated financial statements.

Table of Contents

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF
CHANGES IN SHAREHOLDERS EQUITY (Continued)
(Unaudited)

($ in thousands)	Preferred Stock	Common Stock	Common Stock Warrant	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Balances, January 1, 2009	$ 0	$ 172,353	$ 0	$ (1,281)	$ 3,300	$ 174,372
Preferred stock issued, net	19,696					19,696
Accretion of preferred stock	29			(29)		0
Common stock warrant issued			1,138			1,138
Employee stock purchase plan (6,979 shares)		30				30
Dividend reinvestment plan (2,212 shares)		8				8
Stock-based compensation expense		310				310
Cash dividends ($0.05 per common share)		(424)				(424)
Preferred stock dividends				(134)		(134)
Comprehensive income (loss):						
Net loss for the period from January 1, 2009 through June 30, 2009				(10,714)		(10,714)
Change in net unrealized gain (loss) on securities available for sale, net of reclassifications and tax effect					(1,748)	(1,748)
					(842)	(842)

Reclassification of unrealized gain on interest rate swaps, net of tax effect						
Total comprehensive loss						(13,304)
Balances June 30, 2009	$ 19,725	$ 172,277	$ 1,138	$ (12,158)	$ 710	$ 181,692

See accompanying notes to consolidated financial statements.

Table of Contents

MERCANTILE BANK CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Cash flows from operating activities		
Net income (loss)	$ (3,006,000)	$ (10,714,000)
Adjustments to reconcile net income (loss) to net cash from operating activities		
Depreciation and amortization	1,306,000	1,472,000
Provision for loan and lease losses	14,600,000	21,900,000
Stock-based compensation expense	252,000	310,000
Proceeds from sales of mortgage loans held for sale	14,497,000	54,068,000
Origination of mortgage loans held for sale	(13,215,000)	(56,279,000)
Net gain from sales of mortgage loans held for sale	(147,000)	(608,000)
Gain from sale of commercial loans	(225,000)	0
Net gain from sale of held to maturity securities	(476,000)	0
Net loss from sale and valuation write-down of foreclosed assets	1,523,000	544,000
Recognition of unrealized gain on interest rate swaps	(99,000)	(1,296,000)
Earnings on bank owned life insurance	(865,000)	(641,000)
Net change in:		
Accrued interest receivable	810,000	780,000
Other assets	599,000	(6,397,000)
Accrued expenses and other liabilities	(480,000)	(644,000)
Net cash from operating activities	15,074,000	2,495,000
Cash flows from investing activities		
Loan and lease originations and payments, net	101,912,000	127,948,000
Purchases of:		
Securities available for sale	(37,516,000)	(31,790,000)
Securities held to maturity	0	(1,024,000)
Proceeds from:		
Maturities, calls and repayments of available for sale securities	45,836,000	33,088,000
Maturities, calls and repayments of held to maturity securities	0	3,520,000
Sales of held to maturity securities	20,452,000	0
Proceeds from sales of commercial loans	5,648,000	0
Proceeds from sales of foreclosed assets	7,962,000	1,887,000
Purchases of premises and equipment, net	(30,000)	(26,000)
Net cash from investing activities	144,264,000	133,603,000
Cash flows from financing activities		
Net decrease in time deposits	(152,027,000)	(130,246,000)
Net increase in all other deposits	90,560,000	9,304,000
Net increase in securities sold under agreements to repurchase	8,516,000	15,172,000

Net decrease in federal funds purchased	(2,600,000)	0
Proceeds from Federal Home Loan Bank advances	0	5,000,000
Maturities of Federal Home Loan Bank advances	(45,000,000)	(40,000,000)
Net decrease in other borrowed money	(54,000)	(2,678,000)
Proceeds from issuance of preferred stock and common stock warrant, net	0	20,834,000
Employee stock purchase plan	23,000	30,000
Dividend reinvestment plan	3,000	8,000
Payment of cash dividends on preferred stock	(526,000)	0
Payment of cash dividends on common shares	(85,000)	(424,000)
Net cash for financing activities	(101,190,000)	(123,000,000)

See accompanying notes to consolidated financial statements.

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Net change in cash and cash equivalents	58,148,000	13,098,000
Cash and cash equivalents at beginning of period	21,735,000	25,804,000
Cash and cash equivalents at end of period	$ 79,883,000	$ 38,902,000
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 18,631,000	$ 33,867,000
Federal income tax	0	0
Noncash financing and investing activities:		
Transfers from loans and leases to foreclosed assets	5,898,000	6,859,000
Preferred stock cash dividend accrued	134,000	134,000

See accompanying notes to consolidated financial statements.

MERCANTILE BANK CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: The unaudited financial statements for the six months ended June 30, 2010 include the consolidated results of operations of Mercantile Bank Corporation and its consolidated subsidiaries. These subsidiaries include Mercantile Bank of Michigan (our bank) and our bank s three subsidiaries, Mercantile Bank Mortgage Company, LLC (our mortgage company), Mercantile Bank Real Estate Co., LLC (our real estate company), and Mercantile Insurance Center, Inc. (our insurance center). These consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and Item 303(b) of Regulation S-K and do not include all disclosures required by accounting principles generally accepted in the United States of America for a complete presentation of our financial condition and results of operations. In the opinion of management, the information reflects all adjustments (consisting only of normal recurring adjustments) which are necessary in order to make the financial statements not misleading and for a fair presentation of the results of operations for such periods. The results for the period ended June 30, 2010 should not be considered as indicative of results for a full year. For further information, refer to the consolidated financial statements and footnotes included in our annual report on Form 10-K for the year ended December 31, 2009.

We formed a business trust, Mercantile Bank Capital Trust I (the trust), in 2004 to issue trust preferred securities. We issued subordinated debentures to the trust in return for the proceeds raised from the issuance of the trust preferred securities. The trust is not consolidated, but instead we report the subordinated debentures issued to the trust as a liability.

Earnings Per Share: Basic earnings per share is based on the weighted average number of common shares and participating securities outstanding during the period. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under our stock-based compensation plans and our common stock warrant, and are determined using the treasury stock method. Our unvested restricted shares, which contain non-forfeitable rights to dividends whether paid or accrued (i.e., participating securities), are included in the number of shares outstanding for both basic and diluted earnings per share calculations. In the event of a net loss, our unvested restricted shares are excluded from the calculation of both basic and diluted earnings per share.

Due to our net loss, approximately 88,000 unvested restricted shares were not included in determining both basic and diluted earnings per share for the three and six months ended June 30, 2010, and approximately 98,000 unvested restricted shares were not included in determining both basic and diluted earnings per share for the three and six months ended June 30, 2009. In addition, stock options and a stock warrant for approximately 285,000 and 616,000 shares of common stock, respectively, were antidilutive and not included in determining diluted earnings per share for the three and six months ended June 30, 2010, and stock options and a stock warrant for approximately 319,000 and 616,000 shares of common stock, respectively, were antidilutive and not included in determining diluted earnings per share for the three and six months ended June 30, 2009. Weighted average diluted common shares outstanding equals the weighted average common shares outstanding during the three and six month periods ended June 30, 2010 and 2009 due to the net losses recorded during those time periods.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. **SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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

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

Troubled Debt Restructurings: A loan or lease is accounted for as a troubled debt restructuring if we, for economic or legal reasons related to the borrower s financial condition, grant a significant concession to the borrower that we would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan or lease, or a modification of terms such as a reduction of the stated interest rate or balance of the loan or lease, a reduction of accrued interest, an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings generally remain categorized as nonperforming loans and leases until a six-month payment history has been maintained.

Derivatives: Derivative financial instruments are recognized as assets or liabilities at fair value. The accounting for changes in the fair value of derivatives depends on the use of the derivatives and whether the derivatives qualify for hedge accounting. Historically, our derivatives have consisted of interest rate swap agreements, which are used as part of our asset and liability management to help manage interest rate risk. We do not use derivatives for trading purposes.

(Continued)

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Changes in the fair value of derivatives that are designated as a hedge of the variability of cash flows to be received on various loans and are effective are reported in other comprehensive income. They are later reclassified into earnings in the same periods during which the hedged transaction affects earnings and are included in the line item in which the hedged cash flows are recorded. If hedge accounting does not apply, changes in the fair value of derivatives are recognized immediately in current earnings as noninterest income or expense.

If designated as a hedge, we formally document the relationship between derivatives as hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions. This documentation includes linking cash flow hedges to specific assets on the balance sheet. If designated as a hedge, we also formally assess, both at the hedge s inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in cash flows of the hedged items. Ineffective hedge gains and losses are recognized immediately in current earnings as noninterest income or expense. We discontinue hedge accounting when we determine the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative is settled or terminates, or treatment of the derivatives as a hedge is no longer appropriate or intended.

Adoption of New Accounting Standards: In December 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) ASU 2009-16, *Accounting for Transfers of Financial Assets* (formerly Statement No. 166, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140*). This ASU amends the guidance on accounting for transfers of financial assets, including securitization transactions, where entities have continued exposure to risks related to transferred financial assets. This ASU also expands the disclosure requirements for such transactions. It is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The adoption of this ASU on January 1, 2010 had no impact on our results of operations or financial position.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosure about Fair Value Measurements*. This ASU requires new disclosures on the amount and reason for transfers in and out of Level 1 and Level 2 recurring fair value measurements. The ASU also requires disclosure of activities (i.e., on a gross basis), including purchases, sales, issuances, and settlements, in the reconciliation of Level 3 fair value recurring measurements. The ASU clarifies existing disclosure requirements on levels of disaggregation and disclosures about inputs and valuation techniques. The new disclosures regarding Level 1 and Level 2 fair value measurements and clarification of existing disclosures are effective for periods beginning after December 15, 2009. The disclosures about the reconciliation of information in Level 3 recurring fair value measurements are required for periods beginning after December 15, 2010. Upon adoption of the applicable portions of this ASU on January 1, 2010, we provided the required disclosures as presented in Note 12. For those additional disclosures required for fiscal years beginning after December 15, 2010, we anticipate first including those disclosures in our financial statements for the period ending March 31, 2011.

(Continued)

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. In order to provide greater transparency, this ASU requires significant new disclosures on a disaggregated basis about the allowance for credit losses (e.g., allowance for loan and lease losses for banks) and the credit quality of financing receivables (e.g., loans and leases for banks). Under the ASU, a rollforward schedule of the allowance for loan and lease losses, with the ending allowance balance further disaggregated on the basis of the impairment method, along with the related ending loan and lease balance and significant purchases and sales of loans and leases during the period are to be disclosed by portfolio segment (e.g., commercial loans, retail loans). Additional disclosures are required by class of loan and lease (e.g., commercial real estate, construction and development, residential, consumer), including credit quality, aging of past due loans, nonaccrual status and impairment information. Disclosure of the nature and extent of troubled debt restructurings that occurred during the period and their effect on the allowance for loan and lease losses as well as the effect on the allowance of troubled debt restructurings that occurred within the prior 12 months that defaulted during the current reporting period will also be required. The disclosures are to be presented at the level of disaggregation that management uses when assessing and monitoring the loan and lease portfolio s risk and performance. The majority of the disclosures, required as of the end of a reporting period, are effective for interim and annual periods ending after December 15, 2010 and will be first included in our annual financial statements for the year ending December 31, 2010. The disclosures about activity that occurred prior to issuance of the ASU (e.g., allowance rollforward and loan modification disclosures) are effective for interim and annual reporting periods beginning after December 15, 2010 and will be first disclosed in our financial statements for the interim period ending March 31, 2011. Comparative disclosures for earlier reporting periods ending after initial adoption are required and encouraged for reporting periods ending before initial adoption.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. SECURITIES

The amortized cost and fair value of available for sale securities and the related pre-tax gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2010				
U.S. Government agency debt obligations	$ 100,731,000	$ 1,577,000	$ (9,000)	$ 102,299,000
Mortgage-backed securities	54,289,000	3,702,000	0	57,991,000
Michigan Strategic Fund bonds	19,695,000	0	0	19,695,000
Municipal general obligation bonds	29,866,000	361,000	(153,000)	30,074,000
Municipal revenue bonds	5,548,000	50,000	(11,000)	5,587,000
Mutual funds	1,448,000	23,000	0	1,471,000
	$ 211,577,000	$ 5,713,000	$ (173,000)	$ 217,117,000
December 31, 2009				
U.S. Government agency debt obligations	$ 96,438,000	$ 490,000	$ (1,384,000)	$ 95,544,000
Mortgage-backed securities	62,171,000	2,811,000	0	64,982,000
Michigan Strategic Fund bonds	20,550,000	0	0	20,550,000
Mutual funds	1,425,000	0	(9,000)	1,416,000
	$ 180,584,000	$ 3,301,000	$ (1,393,000)	$ 182,492,000

The carrying amount, unrecognized gains and losses, and fair value of securities categorized as held to maturity were as follows at December 31, 2009 (none at June 30, 2010):

	Carrying Amount	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2009				
Municipal general obligation bonds	$ 49,892,000	$ 1,000,000	$ (111,000)	$ 50,781,000
Municipal revenue bonds	9,319,000	190,000	(19,000)	9,490,000
	$ 59,211,000	$ 1,190,000	$ (130,000)	$ 60,271,000

After analyzing our current and forecasted federal income tax position, we sold certain tax-exempt municipal bonds with an aggregate book value of $20.0 million in late March of 2010. Immediately subsequent to the sale, we reclassified the remaining tax-exempt municipal bonds with an amortized cost of $39.2 million from held to maturity to available for sale. The net unrealized gain at the date of transfer amounted to $0.4 million and was reported in other comprehensive income net of tax effect.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. SECURITIES (Continued)

Securities with unrealized losses at June 30, 2010 and December 31, 2009, aggregated by investment category and length of time that individual securities have been in a continuous loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
June 30, 2010						
U.S. Government agency debt obligations	$ 2,743,000	$ (7,000)	$ 999,000	$ (2,000)	$ 3,742,000	$ (9,000)
Mortgage-backed securities	0	0	0	0	0	0
Michigan Strategic Fund bonds	0	0	0	0	0	0
Mutual funds	0	0	0	0	0	0
Municipal general obligation bonds	0	0	9,978,000	(153,000)	9,978,000	(153,000)
Municipal revenue bonds	0	0	1,066,000	(11,000)	1,066,000	(11,000)
	$ 2,743,000	$ (7,000)	$ 12,043,000	$ (166,000)	$ 14,786,000	$ (173,000)
December 31, 2009						
U.S. Government agency debt obligations	$ 50,190,000	$ (1,322,000)	$ 7,927,000	$ (62,000)	$ 58,117,000	$ (1,384,000)
Mortgage-backed securities	0	0	0	0	0	0
Michigan Strategic Fund bonds	0	0	0	0	0	0
Mutual funds	0	0	1,211,000	(9,000)	1,211,000	(9,000)
Municipal general obligation bonds	738,000	(5,000)	8,638,000	(106,000)	9,376,000	(111,000)
Municipal revenue bonds	228,000	(12,000)	1,073,000	(7,000)	1,301,000	(19,000)
	$ 51,156,000	$ (1,339,000)	$ 18,849,000	$ (184,000)	$ 70,005,000	$ (1,523,000)

(Continued)

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. SECURITIES (Continued)

We evaluate securities for other-than-temporary impairment at least on a quarterly basis. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability we have to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Effective in the second quarter of 2009, with the adoption of new fair value guidance, for those debt securities whose fair value is less than their amortized cost basis, we also consider our intent to sell the security, whether it is more likely than not that we will be required to sell the security before recovery and if we do not expect to recover the entire amortized cost basis of the security. In analyzing an issuer s financial condition, we may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer s financial condition.

There were 33 municipal general obligation bonds, 4 municipal revenue bonds, and 1 U.S. Government agency debt obligation in continuous loss positions for 12 months or more at June 30, 2010. At June 30, 2010, 41 debt securities with a fair value totaling $14.8 million have unrealized losses with aggregate depreciation of $0.2 million, or 0.1% from the amortized cost basis of total securities. At June 30, 2010, 223 debt securities and a mutual fund with a fair value totaling $168.4 million have unrealized gains with aggregate appreciation of $5.7 million, or 2.7% from the amortized cost basis of total securities. After we considered whether the securities were issued by the federal government or its agencies and whether downgrades by bond rating agencies had occurred, we determined that unrealized losses were due to changing interest rate environments. As we do not intend to sell our debt securities before recovery of their cost basis and we believe it is more likely than not that we will not have to sell our debt securities before recovery of the cost basis, no declines are deemed to be other-than-temporary.

The amortized cost and fair values of debt securities at June 30, 2010, by contractual maturity, are shown below. The contractual maturity is utilized below for U.S. Government agency debt obligations and municipal bonds. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. SECURITIES (Continued)

The maturities of securities and their weighted average yields at June 30, 2010 are also shown in the following table. The yields for municipal securities are shown at their tax equivalent yield.

	Weighted Average Yield	Amortized Cost	Fair Value
Due in 2010	5.43%	$ 3,333,000	$ 3,354,000
Due in 2011 through 2015	5.98	6,060,000	6,474,000
Due in 2016 through 2020	4.49	19,361,000	19,523,000
Due in 2021 and beyond	5.24	107,391,000	108,609,000
Mortgage-backed securities	5.14	54,289,000	57,991,000
Michigan Strategic Fund bonds	3.07	19,695,000	19,695,000
Mutual funds	3.06	1,448,000	1,471,000
	4.95%	$ 211,577,000	$ 217,117,000

At June 30, 2010, and December 31, 2009, the amortized cost of securities issued by the State of Michigan and all its political subdivisions totaled $35.4 million and $59.2 million, with an estimated market value of $35.7 million and $60.3 million, respectively. Total securities of any other specific issuer, other than the U.S. Government and its agencies, did not exceed 10% of shareholders equity.

The carrying value of U.S. Government agency debt obligations and mortgage-backed securities that are pledged to secure repurchase agreements, other deposits, and letters of credit issued on behalf of our customers was $154.2 million and $158.1 million at June 30, 2010 and December 31, 2009, respectively. In addition, substantially all of our municipal bonds have been pledged to the Discount Window of the Federal Reserve Bank of Chicago. Investments in Federal Home Loan Bank stock are restricted and may only be resold or redeemed by the issuer.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. LOANS

Our total loans at June 30, 2010 were $1.41 billion compared to $1.54 billion at December 31, 2009, a decrease of $129.1 million, or 8.4%. The components of our outstanding balances at June 30, 2010 and December 31, 2009, and the percentage change in loans from the end of 2009 to the end of the second quarter 2010, are as follows:

	June 30, 2010 Balance	%	December 31, 2009 Balance	%	Percent Increase (Decrease)
Real Estate:					
Construction and land development	$ 152,546,000	10.8%	$ 176,078,000	11.4%	(13.4)%
Secured by 1-4 family properties	119,177,000	8.4	124,805,000	8.1	(4.5)
Secured by multi-family properties	43,557,000	3.1	47,679,000	3.1	(8.6)
Secured by nonresidential properties	771,274,000	54.7	814,058,000	52.9	(5.3)
Commercial	317,940,000	22.5	370,146,000	24.0	(14.1)
Leases	630,000	0.1	1,055,000	0.1	(40.3)
Consumer	5,586,000	0.4	5,997,000	0.4	(6.9)
Total loans and leases	$ 1,410,710,000	100.0%	$ 1,539,818,000	100.0%	(8.4)%

4. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following is a summary of the change in our allowance for loan and lease losses for the six months ended June 30:

	2010	2009
Balance at January 1	$ 47,878,000	$ 27,108,000
Charge-offs	(16,737,000)	(16,851,000)
Recoveries	1,997,000	448,000
Provision for loan and lease losses	14,600,000	21,900,000
Balance at June 30	$ 47,738,000	$ 32,605,000

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

5. PREMISES AND EQUIPMENT, NET

Premises and equipment are comprised of the following:

	June 30, 2010	December 31, 2009
Land and improvements	$ 8,531,000	$ 8,531,000
Buildings and leasehold improvements	24,516,000	24,515,000
Furniture and equipment	12,464,000	12,532,000
	45,511,000	45,578,000
Less: accumulated depreciation	16,875,000	15,894,000
Premises and equipment, net	$ 28,636,000	$ 29,684,000

Depreciation expense totaled $0.5 million during the second quarter of 2010, compared to $0.6 million during the second quarter of 2009. Depreciation expense totaled $1.1 million during the first six months of 2010, compared to $1.3 million during the first six months of 2009.

6. DEPOSITS

Our total deposits at June 30, 2010 were $1.34 billion compared to $1.40 billion at December 31, 2009, a decrease of $61.5 million, or 4.4%. The components of our outstanding balances at June 30, 2010 and December 31, 2009, and percentage change in deposits from the end of 2009 to the end of the second quarter 2010, are as follows:

	June 30, 2010		December 31, 2009		Percent Increase
	Balance	%	Balance	%	(Decrease)
Noninterest-bearing demand	$ 126,572,000	9.4%	$ 121,157,000	8.6%	4.5%
Interest-bearing checking	128,293,000	9.6	86,320,000	6.2	48.6
Money market	79,210,000	5.9	32,008,000	2.3	147.5
Savings	34,595,000	2.6	38,625,000	2.8	(10.4)
Time, under $100,000	78,267,000	5.8	105,195,000	7.5	(25.6)
Time, $100,000 and over	234,059,000	17.5	293,455,000	20.9	(20.2)
	680,996,000	50.8	676,760,000	48.3	0.6
Out-of-area time, under $100,000	47,717,000	3.6	62,760,000	4.5	(24.0)
Out-of-area time, $100,000 and over	611,447,000	45.6	662,107,000	47.2	(7.7)
	659,164,000	49.2	724,867,000	51.7	(9.1)
Total deposits	$ 1,340,160,000	100.0%	$ 1,401,627,000	100.0%	(4.4)%

(Continued)

17

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

7. SHORT-TERM BORROWINGS

Information relating to our securities sold under agreements to repurchase follows:

	Six Months Ended June 30, 2010	Twelve Months Ended December 31, 2009
Outstanding balance at end of period	$ 108,271,000	$ 99,755,000
Average interest rate at end of period	1.41%	1.41%
Average balance during the period	$ 100,110,000	$ 98,409,000
Average interest rate during the period	1.40%	1.87%
Maximum month end balance during the period	$ 108,705,000	$ 111,692,000

Securities sold under agreements to repurchase (repurchase agreements) generally have original maturities of less than one year. Repurchase agreements are treated as financings and the obligations to repurchase securities sold are reflected as liabilities. Securities involved with the agreements are recorded as assets of our bank and are held in safekeeping by a correspondent bank. Repurchase agreements are offered principally to certain large deposit customers. Repurchase agreements are secured by securities with an aggregate market value equal to the aggregate outstanding balance.

8. FEDERAL HOME LOAN BANK ADVANCES

Our outstanding balances at June 30, 2010 totaled $160.0 million and mature at varying dates from December 2010 through January 2014, with fixed rates of interest from 2.97% to 4.42% and averaging 3.52%. At December 31, 2009, outstanding balances totaled $205.0 million with maturities ranging from January 2010 through January 2014 and fixed rates of interest from 2.95% to 4.42% and averaging 3.50%.

Each advance is payable at its maturity date, and is subject to a prepayment fee if paid prior to the maturity date. The advances are collateralized by residential mortgage loans, first mortgage liens on multi-family residential property loans, first mortgage liens on commercial real estate property loans, and substantially all other assets of our bank, under a blanket lien arrangement. Our borrowing line of credit as of June 30, 2010 totaled about $220.0 million, with availability approximating $56.0 million.

Maturities of currently outstanding FHLB advances during the next 60 months are:

2010	$20,000,000
2011	85,000,000
2012	40,000,000
2013	10,000,000
2014	5,000,000

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. COMMITMENTS AND OFF-BALANCE SHEET RISK

Our bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Loan commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Standby letters of credit are conditional commitments issued by our bank to guarantee the performance of a customer to a third party. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized, if any, in the balance sheet. Our bank s maximum exposure to loan loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. Our bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Collateral, such as accounts receivable, securities, inventory, and property and equipment, is generally obtained based on our credit assessment of the borrower. If required, estimated loss exposure resulting from these instruments is expensed and recorded as a liability. The balance of the liability was $0 as of June 30, 2010 and December 31, 2009.

A summary of the contractual amounts of our financial instruments with off-balance sheet risk at June 30, 2010 and December 31, 2009 follows:

	June 30, 2010	December 31, 2009
Commercial unused lines of credit	$ 172,889,000	$ 205,018,000
Unused lines of credit secured by 1 4 family residential properties	25,214,000	24,916,000
Credit card unused lines of credit	8,253,000	8,565,000
Other consumer unused lines of credit	3,518,000	4,526,000
Commitments to extend credit	11,191,000	7,701,000
Standby letters of credit	27,573,000	36,512,000
	$ 248,638,000	$ 287,238,000

(Continued)

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Certain of our commercial loan customers have entered into interest rate swap agreements directly with our correspondent banks. To assist our commercial loan customers in these transactions, and to encourage our correspondent banks to enter into the interest rate swap transactions with minimal credit underwriting analyses on their part, we have entered into risk participation agreements with the correspondent banks whereby we agree to make payments to the correspondent banks owed by our commercial loan customers under the interest rate swap agreement in the event that our commercial loan customers do not make the payments. We are not a party to the interest rate swap agreements under these arrangements. As of June 30, 2010, the total notional amount of the underlying interest rate swap agreements was $52.1 million, with a net fair value from our commercial loan customers perspective of negative $5.7 million. Payments made in regards to the risk participation agreements total $460,000; however, we believe the affected customer will reimburse us for such payments and therefore we have accrued no valuation allowance for our receivable from this customer and have accrued no liability for potential future payments. These risk participation agreements are considered financial guarantees in accordance with applicable accounting guidance and are therefore recorded as liabilities at fair value, generally equal to the fees collected at the time of their execution. These liabilities are accreted into income during the term of the interest rate swap agreements, generally ranging from four to fifteen years.

10. HEDGING ACTIVITIES

Our interest rate risk policy includes guidelines for measuring and monitoring interest rate risk. Within these guidelines, parameters have been established for maximum fluctuations in net interest income. Possible fluctuations are measured and monitored using net interest income simulation. Our policy provides for the use of certain derivative instruments and hedging activities to aid in managing interest rate risk to within the policy parameters.

A majority of our assets are comprised of commercial loans on which the interest rates are variable, while a majority of our liabilities are comprised of fixed rate certificates of deposit and FHLB advances. Due to this repricing mismatch, we may periodically enter into derivative financial instruments to mitigate the exposure in cash flows resulting from changes in interest rates.

During 2008, we entered into several interest rate swaps with an aggregate notional amount of $275.0 million. The interest rate swaps qualified as cash flow hedges that converted the variable rate cash inflows on certain of our prime-based commercial loans to a fixed rate of interest. The interest rate swaps paid interest to us at stated fixed rates and required that we make interest payments based on the average of the Wall Street Journal Prime Rate.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

10. HEDGING ACTIVITIES (Continued)

On October 30, 2008, we terminated all of our interest rate swaps. The termination coincided with our decision to not lower our prime rate in association with the Federal Open Market Committee s reduction of the targeted federal funds rate by 50 basis points on October 29, 2008. Virtually all of our prime rate-based commercial floating rate loans are tied to the Mercantile Bank Prime Rate, while our interest rate swaps utilized the Wall Street Journal Prime Rate. The resulting difference negatively impacted the effectiveness of our interest rate swaps, so we believed it was prudent to terminate them. The aggregate fair value of the interest rate swaps on October 30, 2008 was $2.4 million, which has been accreted into interest income on loans and leases based on the original term of the interest rate swaps. As of June 30, 2010, we had fully accreted the $2.4 million into interest income, including $0.1 million during the first six months of 2010.

11. FAIR VALUES OF FINANCIAL INSTRUMENTS

Carrying amount and estimated fair values of financial instruments were as follows as of June 30, 2010 and December 31, 2009:

	June 30, 2010		December 31, 2009	
	Carrying Values	Fair Values	Carrying Values	Fair Values
Financial assets				
Cash and cash equivalents	$ 79,883,000	$ 79,883,000	$ 21,735,000	$ 21,735,000
Securities available for sale	217,117,000	217,117,000	182,492,000	182,492,000
Securities held to maturity	0	0	59,211,000	60,271,000
Federal Home Loan Bank stock	15,681,000	15,681,000	15,681,000	15,681,000
Loans, net	1,362,972,000	1,372,716,000	1,491,940,000	1,501,860,000
Bank owned life insurance	45,890,000	45,890,000	45,024,000	45,024,000
Accrued interest receivable	6,278,000	6,278,000	7,088,000	7,088,000
Financial liabilities				
Deposits	1,340,160,000	1,347,542,000	1,401,627,000	1,407,310,000
Securities sold under agreements to repurchase	108,271,000	108,271,000	99,755,000	99,755,000
Federal funds purchased	0	0	2,600,000	2,600,000
Federal Home Loan Bank advances	160,000,000	164,360,000	205,000,000	208,435,000
Subordinated debentures	32,990,000	33,917,000	32,990,000	32,971,000
Accrued interest payable	4,686,000	4,686,000	6,158,000	6,158,000

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

11. FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

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

Current accounting pronouncements require disclosure of the estimated fair value of financial instruments as disclosed in Note 12. Given current market conditions, a portion of our loan portfolio is not readily marketable and market prices do not exist. We have not attempted to market our loans to potential buyers, if any exist, to determine the fair value of those instruments. Since negotiated prices in illiquid markets depend upon the then present motivations of the buyer and seller, it is reasonable to assume that actual sales prices could vary widely from any estimate of fair value made without the benefit of negotiations. Additionally, changes in market interest rates can dramatically impact the value of financial instruments in a short period of time. Accordingly, the fair value measurements for loans included in the table above are unlikely to represent the instruments liquidation values.

12. FAIR VALUES

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

12. FAIR VALUES (Continued)

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

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

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be derived from or corroborated by observable market data by correlation or other means.

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

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

Securities available for sale. Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based on quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models. Level 2 securities include U.S. Government agency bonds, mortgage-backed securities issued or guaranteed by U.S. Government agencies, municipal general obligation and revenue bonds, Michigan Strategic Fund bonds and mutual funds. We have no Level 1 or 3 securities.

Securities held to maturity. Securities held to maturity are carried at amortized cost when we have the positive intent and ability to hold them to maturity. The fair value of held to maturity securities, as disclosed in the accompanying consolidated financial statements, is based on quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

12. FAIR VALUES (Continued)

Mortgage loans held for sale. Mortgage loans held for sale are carried at the lower of cost or fair value and are measured on a nonrecurring basis. Fair value is based on independent quoted market prices, where applicable, or the prices for other mortgage whole loans with similar characteristics. As of June 30, 2010 and December 31, 2009, we determined that the fair value of our mortgage loans held for sale was similar to the cost; therefore, we carried the $1.4 million and $0.9 million, respectively, of such loans at cost so they are not included in the nonrecurring table below.

Loans and leases. We do not record loans and leases at fair value on a recurring basis. However, from time to time, we record nonrecurring fair value adjustments to collateral dependent loans and leases to reflect partial write-downs or specific reserves that are based on the observable market price or current estimated value of the collateral. These loans and leases are reported in the nonrecurring table below at initial recognition of impairment and on an ongoing basis until recovery or charge-off.

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

Derivatives. For interest rate swaps, we measure fair value utilizing models that use primarily market observable inputs, such as yield curves and option volatilities, and accordingly, are classified as Level 2. We had no interest rate swaps contracts outstanding as of June 30, 2010 or December 31, 2009.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2010 are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government agency debt obligations	$ 102,299,000	$ 0	$ 102,299,000	$ 0
Mortgage-backed securities	57,991,000	0	57,991,000	0
Michigan Strategic Fund bonds	19,695,000	0	19,695,000	0
Municipal general obligation bonds	30,074,000	0	30,074,000	0
Municipal revenue bonds	5,587,000	0	5,587,000	0
Mutual funds	1,471,000	0	1,471,000	0
Total	$ 217,117,000	$ 0	$ 217,117,000	$ 0

There were no transfers in or out of Level 1, Level 2 or Level 3 during the first six months of 2010.

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

12. FAIR VALUES (Continued)

The balances of assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale	$ 182,492,000	$ 0	$ 182,492,000	$ 0
Total	$ 182,492,000	$ 0	$ 182,492,000	$ 0

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The balances of assets and liabilities measured at fair value on a nonrecurring basis as of June 30, 2010 are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (1)	$ 51,935,000	$ 0	$ 0	$ 51,935,000
Foreclosed assets (1)	23,020,000	0	0	23,020,000
Total	$ 74,955,000	$ 0	$ 0	$ 74,955,000

The balances of assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2009 are as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (1)	$ 41,456,000	$ 0	$ 0	$ 41,456,000

Foreclosed assets [1]	26,608,000	0	0	26,608,000
Total	$ 68,064,000	$ 0	$ 0	$ 68,064,000

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

13. REGULATORY MATTERS

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

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If an institution is not well capitalized, regulatory approval is required to accept brokered deposits. Subject to limited exceptions, no institution may make a capital distribution if, after making the distribution, it would be undercapitalized. If an institution is undercapitalized, it is subject to close monitoring by its principal federal regulator, its asset growth and expansion are restricted, and plans for capital restoration are required. In addition, further specific types of restrictions may be imposed on the institution at the discretion of the federal regulator. At June 30, 2010 and December 31, 2009, our bank was in the well capitalized category under the regulatory framework for prompt corrective action. There are no conditions or events since June 30, 2010 that we believe has changed our bank s categorization.

Our actual capital levels (dollars in thousands) and the minimum levels required to be categorized as adequately and well capitalized were:

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2010						
Total capital (to risk weighted assets)						
Consolidated	$ 187,957	11.9%	$ 126,117	8.0%	$ NA	NA
Bank	186,655	11.9	125,998	8.0	157,498	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	167,905	10.7	63,059	4.0	NA	NA
Bank	166,622	10.6	62,999	4.0	94,499	6.0
Tier 1 capital (to average assets)						
Consolidated	167,905	9.0	74,487	4.0	NA	NA
Bank	166,622	9.0	74,446	4.0	93,057	5.0

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

13. REGULATORY MATTERS (Continued)

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2009						
Total capital (to risk weighted assets)						
Consolidated	$ 193,157	11.2%	$ 138,169	8.0%	$ NA	NA
Bank	191,146	11.1	138,051	8.0	172,563	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	171,244	9.9	69,085	4.0	NA	NA
Bank	169,251	9.8	69,026	4.0	103,538	6.0
Tier 1 capital (to average assets)						
Consolidated	171,244	8.6	79,325	4.0	NA	NA
Bank	169,251	8.6	79,119	4.0	98,899	5.0

Our consolidated capital levels as of June 30, 2010 and December 31, 2009 include $32.0 million of trust preferred securities issued by the trust in September 2004 and December 2004 subject to certain limitations. Under applicable Federal Reserve guidelines, the trust preferred securities constitute a restricted core capital element. The guidelines provide that the aggregate amount of restricted core elements that may be included in our Tier 1 capital must not exceed 25% of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. As of June 30, 2010 and December 31, 2009, all $32.0 million of the trust preferred securities were included as Tier 1 capital.

On July 9, 2010, we announced via a Form 8-K filed with the SEC that we are deferring regularly scheduled quarterly interest payments on our subordinated debentures beginning with the quarterly interest payment scheduled to be paid on July 18, 2010. The deferral of interest payments on the subordinated debentures results in the deferral of distributions on our trust preferred securities. We also announced that we are deferring regularly scheduled quarterly dividend payments on our preferred stock beginning with the quarterly dividend payment scheduled to be paid on August 15, 2010. We have not determined the duration of the deferral period.

(Continued)

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

13. REGULATORY MATTERS (Continued)

Our and our bank s ability to pay cash and stock dividends is subject to limitations under various laws and regulations and to prudent and sound banking practices. On January 14, 2010, we declared a $0.01 per share cash dividend on our common stock, which was paid on March 10, 2010 to record holders as of February 10, 2010. Because we had a retained deficit at the time of the declaration, the cash dividend was recorded as a reduction of our common stock account. In April 2010, we suspended future payments of cash dividends on our common stock until economic conditions and our financial performance improve. In addition, we are precluded from paying dividends on our common stock and preferred stock because, under the terms of our subordinated debentures, we cannot pay dividends during periods when we have deferred the payment of interest on our subordinated debentures; and, as indicated above in this Note 13, we are now deferring such interest payments. Also, pursuant to our articles of incorporation, we are precluded from paying dividends on our common stock while any dividends accrued on our preferred stock have not been declared and paid. Because, as indicated above in this Note 13, we have suspended the payment of dividends on our preferred stock, we are precluded from paying dividends on our common stock.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION

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

Forward Looking Statements

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

Future Factors include, among others, changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking regulation or actions by bank regulators; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; governmental and regulatory policy changes; the outcomes of contingencies; trends in customer behavior as well as their ability to repay loans; changes in local real estate values; changes in the national and local economies; and risk factors described in our annual report on Form 10-K for the year ended December 31, 2009 or in this report. These are representative of the Future Factors that could cause a difference between an ultimate actual outcome and a forward-looking statement.

Introduction

The following discussion compares the financial condition of Mercantile Bank Corporation and its consolidated subsidiaries, Mercantile Bank of Michigan (our bank), our bank s three subsidiaries, Mercantile Bank Mortgage Company, LLC (our mortgage company), Mercantile Bank Real Estate Co., LLC (our real estate company) and Mercantile Insurance Center, Inc. (our insurance company), at June 30, 2010 to December 31, 2009 and the results of operations for the three and six months ended June 30, 2010 and June 30, 2009. This discussion should be read in conjunction with the interim consolidated financial statements and footnotes included in this report. Unless the text clearly suggests otherwise, references in this report to us, we, our or the company include Mercantile Bank Corporation and its consolidated subsidiaries referred to above.

Critical Accounting Policies

Accounting principles generally accepted in the United States of America are complex and require us to apply significant judgment to various accounting, reporting and disclosure matters. We must use assumptions and estimates to apply these principles where actual measurements are not possible or practical. Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our unaudited financial statements included in this report. For a discussion of our significant accounting policies, see footnotes to our Consolidated Financial Statements included on pages F-42 through F-49 in our Form 10-K for the fiscal year ended December 31, 2009 (Commission file number 000-26719). Our allowance for loan and lease losses policy and accounting for income taxes are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements, and actual results may differ from those estimates. We have reviewed the application of these policies with the Audit Committee of our Board of Directors.

MERCANTILE BANK CORPORATION

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

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

Income Tax Accounting: Current income tax liabilities or assets are established for the amount of taxes payable or refundable for the current year. In the preparation of income tax returns, tax positions are taken based on interpretation of federal and state income tax laws for which the outcome may be uncertain. We periodically review and evaluate the status of our tax positions and make adjustments as necessary. Deferred income tax liabilities and assets are also established for the future tax consequences of events that have been recognized in our financial statements or tax returns. A deferred income tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences that can be carried forward (used) in future years. The valuation of our net deferred income tax asset is considered critical as it requires us to make estimates based on provisions of the enacted tax laws. The assessment of the realizability of the net deferred income tax asset involves the use of estimates, assumptions, interpretations and judgments concerning accounting pronouncements, federal and state tax codes and the extent of future taxable income. There can be no assurance that future events, such as court decisions, positions of federal and state tax authorities, and the extent of future taxable income will not differ from our current assessment, the impact of which could be significant to the consolidated results of operations and reported earnings.

MERCANTILE BANK CORPORATION

Accounting guidance requires that we assess whether a valuation allowance should be established against our deferred tax asset based on the consideration of all available evidence using a more likely than not standard. In making such judgments, we consider both positive and negative evidence and analyze changes in near-term market conditions as well as other factors which may impact future operating results. Significant weight is given to evidence that can be objectively verified. Despite improvements in key areas such as an expanded net interest margin, increased regulatory capital levels, a continued shift to local funding sources and reduced controllable overhead costs, the increased loan and lease provision expense and problem asset administrative costs have been sizable. The continuing recent losses resulting from the distressed operating environment have significantly restricted our ability to rely on projections of future taxable income to support the recovery of our deferred tax assets. Consequently, we have determined it necessary to establish and maintain a valuation allowance against our entire net deferred tax asset. We will continue to monitor our deferred tax asset quarterly for changes affecting its realizability.

Financial Overview

Our earnings performance has been negatively impacted by substantial provisions to the allowance for loan and lease losses. Ongoing state, regional and national economic struggles have negatively impacted some of our borrowers cash flows and underlying collateral values, leading to an elevated level of nonperforming assets, higher loan and lease charge-offs and increased overall credit risk within our loan portfolio. We continue to work with our borrowers to develop constructive dialogue to strengthen our relationships and enhance our ability to resolve complex issues; however, with the environment for the banking industry likely to remain stressed until economic conditions improve, credit quality will continue to be our major concern. We will remain vigilant in the identification and administration of problem assets, but provisions to the allowance will likely remain above historical levels for some period of time, dampening future earnings performance.

Our earnings performance also reflects positive steps we have taken to not only partially mitigate the impact of asset quality-related costs in the near term, but to benefit us on a longer-term basis as well. First, our net interest margin has been expanding as we have replaced maturing high-rate deposits and borrowed funds with lower-cost funds, while at the same time our commercial loan pricing initiatives offset the negative impact of an increase in nonaccrual loans. Despite a substantial reduction in total loans and leases, our net interest income has been on an increasing trend due to the improving net interest margin. Next, our regulatory risk-based capital ratios are also increasing, as the sale of preferred stock under the Department of Treasury s Capital Purchase Program and the reduction of loans and leases outstanding have more than offset the impact of our net losses. In addition, we are increasing our local deposit balances, reflecting the successful implementation of various initiatives, campaigns and product enhancements. The local deposit growth, combined with the reduction of loans and leases outstanding, are providing for a substantial reduction of, and reliance on, wholesale funds. Lastly, we are seeing the positive effect of our branch consolidation and other overhead cost reduction initiatives, as we continue to make strides to reduce controllable noninterest expense.

Financial Condition

During the first six months of 2010, our total assets decreased $102.1 million, and totaled $1.80 billion as of June 30, 2010. The decline in total assets was comprised primarily of a $129.1 million reduction in total loans and leases and a $24.6 million decrease in securities, more than offsetting a $58.1 million increase in cash and cash equivalents. Total deposits declined $61.5 million, while Federal Home Loan Bank (FHLB) advances decreased $45.0 million.

Commercial loans and leases declined $123.1 million during the first six months of 2010, and at June 30, 2010 totaled $1.29 billion, or 91.2% of the total loan and lease portfolio. The decline in outstanding balances primarily reflects the slowdown in business activity in our markets and the impact of a concerted effort on our part to reduce exposure to certain non-owner occupied commercial real estate (CRE) and automotive-related businesses. The largest decline occurred in the commercial and industrial (C&I) loan portfolio, where total outstanding balances were reduced by $52.6 million, in large part reflecting the slowdown in business activity and a corresponding reduction in accounts receivable and inventory financings. We would expect to see an increase in commercial line of credit usage when economic conditions improve. During the first six months of 2010, commercial loans collateralized by non-owner occupied real estate declined by $45.0 million. Our systematic approach to reducing our exposure to certain CRE lending will be pro-longed, given the nature of CRE lending and the current depressed economic conditions; however, we believe that such a reduction is in our best interest when taking into account the increased inherent credit risk, relatively low loan rates and nominal deposit balances associated with targeted borrowing relationships.

The commercial loan and lease portfolio represents loans to businesses generally located within our market areas. Approximately 75% of the commercial loan and lease portfolio is primarily secured by real estate properties, with the remaining generally secured by other business assets such as accounts receivable, inventory and equipment. The continued significant concentration of the loan and lease portfolio in commercial loans and leases is consistent with our strategy of focusing a substantial amount of our efforts on commercial banking. Corporate and business lending is an area of expertise for our senior management team, and our commercial lenders have extensive commercial lending experience, with most having at least ten years experience. Of each of the loan categories that we originate, commercial loans and leases are most efficiently originated and managed, thus limiting overhead costs by necessitating the attention of fewer employees. Our commercial lending business generates the largest portion of local deposits and is our primary source of demand deposits.

MERCANTILE BANK CORPORATION

The following table summarizes our loans secured by real estate, excluding residential mortgage loans representing permanent financing of owner occupied dwellings and home equity lines of credit:

LOANS SECURED BY REAL ESTATE

	6/30/10	3/31/10	12/31/09	9/30/09	6/30/09
Residential-Related:					
Vacant Land	$ 20,351,000	$ 20,871,000	$ 19,465,000	$ 20,630,000	$ 21,400,000
Land Development	29,627,000	32,199,000	34,027,000	33,862,000	42,053,000
Construction	6,627,000	7,872,000	7,199,000	9,446,000	11,157,000
	56,605,000	60,942,000	60,691,000	63,938,000	74,610,000
Comm l Non-Owner Occupied:					
Vacant Land	19,812,000	22,304,000	25,549,000	25,564,000	29,005,000
Land Development	18,585,000	19,058,000	19,402,000	22,412,000	23,469,000
Construction	52,295,000	52,107,000	65,697,000	79,339,000	94,225,000
Commercial Buildings	512,816,000	539,284,000	537,891,000	528,727,000	545,501,000
	603,508,000	632,753,000	648,539,000	656,042,000	692,200,000
Comm l Owner Occupied:					
Construction	1,360,000	1,651,000	1,404,000	5,456,000	7,407,000
Commercial Buildings	302,768,000	316,302,000	324,451,000	349,335,000	359,610,000
	304,128,000	317,953,000	325,855,000	354,791,000	367,017,000
Total	$ 964,241,000	$ 1,011,648,000	$ 1,035,085,000	$ 1,074,771,000	$ 1,133,827,000

Residential mortgage loans and consumer loans declined in aggregate $6.0 million during the first six months of 2010, and at June 30, 2010, totaled $124.8 million, or 8.8% of the total loan and lease portfolio. Although residential mortgage loan and consumer loan portfolios may increase in future periods, we expect the commercial sector of the lending efforts and resultant assets to remain the dominant loan portfolio category.

Our credit policies establish guidelines to manage credit risk and asset quality. These guidelines include loan review and early identification of problem loans and leases to provide appropriate loan and lease portfolio administration. The credit policies and procedures are meant to minimize the risk and uncertainties inherent in lending. In following these policies and procedures, we must rely on estimates, appraisals and evaluations of loans and leases and the possibility that changes in these could occur quickly because of changing economic conditions. Identified problem loans and leases, which exhibit characteristics (financial or otherwise) that could cause the loans and leases to become nonperforming or require restructuring in the future, are included on the internal watch list . Senior management and the Board of Directors review this list regularly. Market value estimates of collateral on impaired loans, as well as on foreclosed and repossessed assets, are reviewed periodically; however, we have a process in place to monitor whether value estimates at each quarter-end are reflective of current market conditions. Our credit policies establish criteria for obtaining appraisals and determining internal value estimates. We may also adjust outside and internal valuations based on identifiable trends within our markets, such as recent sales of similar properties or assets, listing prices and offers received. In addition, we may discount certain appraised and internal value estimates to address current distressed market conditions.

Table of Contents

MERCANTILE BANK CORPORATION

The levels of net loan and lease charge-offs and nonperforming assets have increased since early 2007. Although we were never directly involved in the underwriting of or the investing in subprime residential real estate loans, the apparent substantial and rapid collapse of this line of business during 2007 throughout the United States had a significant negative impact on the residential real estate development lending portion of our business. The resulting decline in real estate prices and slowdown in sales has stretched the cash flow of our local developers and eroded the value of our underlying collateral, which caused elevated levels of nonperforming assets and net loan and lease charge-offs. Since that time, we have witnessed rapidly deteriorating economic conditions in Michigan and throughout the country. The resulting decline in business revenue has negatively impacted the cash flows of many of our borrowers, some to the point where loan payments have become past due or will likely become delinquent in future periods. In addition, real estate prices have fallen significantly, thereby exposing us to larger-than-typical losses in those instances where the sale of collateral is the primary source of repayment. Also during this time, we have seen deterioration in guarantors financial capacities to fund deficient cash flows and reduce or eliminate collateral deficiencies. It is likely that the net loan and lease charge-offs and nonperforming assets will remain elevated in comparison to our historical levels until economic conditions improve.

As of December 31, 2007, nonperforming assets totaled $35.7 million, or 1.68% of total assets, an increase from the $9.6 million, or 0.46% of total assets, as of December 31, 2006. Nonperforming loans and leases totaled $29.8 million and foreclosed properties/repossessed assets equaled $5.9 million at year-end 2007, compared to $8.6 million and $1.0 million, respectively, at year-end 2006. As of December 31, 2007, nonperforming loans secured by real estate, combined with all foreclosed properties, totaled $28.6 million, or about 80% of total nonperforming assets. Nonperforming loans and foreclosed properties associated with the development of residential real estate totaled $11.1 million, with another $3.2 million in nonperforming loans secured by, and foreclosed properties consisting of, residential properties. Net loan and lease charge-offs during 2007 totaled $6.7 million, or 0.38% of average total loans and leases. During 2006, net loan and lease charge-offs totaled $4.9 million, or 0.29% of average total loans and leases.

Throughout most of 2008, we experienced a rapid deterioration in a number of commercial loan relationships which previously had been performing satisfactorily. Analysis of certain commercial borrowers revealed a reduced capability on the part of these borrowers to make required payments as indicated by factors such as delinquent loan payments, diminished cash flow, deteriorating financial performance, or past due property taxes, and in the case of commercial and residential development projects slow absorption or sales trends. In addition, commercial real estate is the primary source of collateral for many of these borrowing relationships and updated evaluations and appraisals in many cases reflected significant declines from the original estimated values.

During the latter part of 2008, throughout 2009 and during the first six months of 2010, we saw a continuation of the stresses caused by the poor economic conditions, especially in the CRE markets. High vacancy rates or slow absorption have resulted in inadequate cash flow generated from some real estate projects we have financed, and have required guarantors to provide personal funds to make full contractual loan payments and pay other operating costs. In some cases, the guarantors cash and other liquid reserves have become seriously diminished. In other cases, sale of the collateral, either by the borrower or us, is our primary source of repayment.

Table of Contents

As of December 31, 2008, nonperforming assets totaled $57.4 million, or 2.60% of total assets. Nonperforming loans and leases totaled $49.3 million and foreclosed properties/repossessed assets equaled $8.1 million at year-end 2008, compared to $29.8 million and $5.9 million, respectively, at year-end 2007. As of December 31, 2008, nonperforming loans secured by real estate, combined with all foreclosed properties, totaled $52.3 million, or about 91% of total nonperforming assets. Nonperforming loans and foreclosed properties associated with the development of residential real estate totaled $25.3 million, with another $4.2 million in nonperforming loans secured by, and foreclosed properties consisting of, residential properties. Net loan and lease charge-offs during 2008 totaled $19.9 million, or 1.09% of average total loans and leases. The increase in net loan and lease charge-offs during 2008 over prior periods primarily reflects a combination of a higher level of nonperforming loans and leases and the significant decline in property values.

As of December 31, 2009, nonperforming assets totaled $111.7 million, or 5.86% of total assets. Nonperforming loans and leases totaled $85.1 million and foreclosed properties/repossessed assets equaled $26.6 million at year-end 2009. As of December 31, 2009, nonperforming loans secured by CRE, combined with all foreclosed properties, totaled $62.6 million. Nonperforming loans and foreclosed properties associated with the development of residential-related real estate totaled $31.8 million, with another $7.5 million in nonperforming loans secured by, and foreclosed properties consisting of, residential properties. Nonperforming C&I loans and repossessed assets totaled $9.8 million. Net loan and lease charge-offs during 2009 totaled $38.2 million, or 2.24% of average total loans and leases. The increase in net loan and lease charge-offs during 2009 over prior periods primarily reflects a combination of a higher level of nonperforming loans and leases and the continued significant decline in property values.

As of June 30, 2010, nonperforming assets totaled $110.5 million, or 6.13% of total assets. Nonperforming loans and leases totaled $87.5 million and foreclosed properties/repossessed assets equaled $23.0 million. As of June 30, 2010, nonperforming loans secured by CRE, combined with all foreclosed properties, totaled $65.5 million. Nonperforming loans and foreclosed properties associated with the development of residential-related real estate totaled $31.8 million, with another $6.2 million in nonperforming loans secured by, and foreclosed properties consisting of, residential properties. Nonperforming C&I loans and repossessed assets totaled $7.0 million. Net loan and lease charge-offs during the second quarter of 2010 totaled $8.6 million, or an annualized 2.35% of average total loans and leases, and totaled $14.7 million during the first six months of 2010, or an annualized 1.99% of average total loans and leases. Net loan and lease charge-offs in at least the next few quarters are expected to remain elevated compared to historical averages due to a higher volume of nonperforming loans and leases and significant declines in property values.

Table of Contents

MERCANTILE BANK CORPORATION

The following table provides a breakdown of nonperforming assets by property type:

NONPERFORMING ASSETS

	6/30/10	3/31/10	12/31/09	9/30/09	6/30/09
Residential Real Estate:					
Land Development	$ 21,551,000	$ 22,781,000	$ 19,722,000	$ 13,645,000	$ 10,422,000
Construction	10,231,000	11,425,000	12,103,000	13,021,000	12,882,000
Owner Occupied / Rental	6,159,000	5,908,000	7,493,000	6,830,000	4,910,000
	37,941,000	40,114,000	39,318,000	33,496,000	28,214,000
Commercial Real Estate:					
Land Development	2,050,000	3,031,000	2,971,000	4,621,000	2,292,000
Construction	571,000	1,238,000	1,268,000	228,000	0
Owner Occupied	16,216,000	17,311,000	19,918,000	21,429,000	17,378,000
Non-Owner Occupied	46,706,000	46,552,000	38,417,000	36,473,000	28,110,000
	65,543,000	68,132,000	62,574,000	62,751,000	47,780,000
Non-Real Estate:					
Commercial Assets	7,049,000	9,303,000	9,758,000	14,510,000	10,629,000
Consumer Assets	0	8,000	8,000	8,000	8,000
	7,049,000	9,311,000	9,766,000	14,518,000	10,637,000
Total	$ 110,533,000	$ 117,557,000	$ 111,658,000	$ 110,765,000	$ 86,631,000

Table of Contents

MERCANTILE BANK CORPORATION

The following table provides a breakdown of net loan and lease charge-offs by collateral type:

NET LOAN CHARGE-OFFS

	2nd Qtr 2010	1st Qtr 2010	4th Qtr 2009	3rd Qtr 2009	2nd Qtr 2009
Residential Real Estate:					
Land Development	$ 1,254,000	$ 565,000	$ 2,204,000	$ 467,000	$ 1,060,000
Construction	649,000	587,000	733,000	3,208,000	1,023,000
Owner Occupied / Rental	407,000	326,000	946,000	530,000	729,000
	2,310,000	1,478,000	3,883,000	4,205,000	2,812,000
Commercial Real Estate:					
Land Development	674,000	617,000	45,000	0	74,000
Construction	660,000	0	0	0	0
Owner Occupied	726,000	1,091,000	1,140,000	1,254,000	593,000
Non-Owner Occupied	2,551,000	1,945,000	3,009,000	3,265,000	2,347,000
	4,611,000	3,653,000	4,194,000	4,519,000	3,014,000
Non-Real Estate:					
Commercial Assets	1,670,000	1,012,000	2,788,000	2,232,000	4,918,000
Consumer Assets	(3,000)	9,000	(1,000)	7,000	35,000
	1,667,000	1,021,000	2,787,000	2,239,000	4,953,000
Total	$ 8,588,000	$ 6,152,000	$ 10,864,000	$ 10,963,000	$ 10,779,000

The following table summarizes nonperforming loans and leases, including troubled debt restructurings:

NONPERFORMING LOANS

	6/30/10	3/31/10	12/31/09	9/30/09	6/30/09
Past due 90 days or more and accruing interest	$ 24,000	$ 0	$ 243,000	$ 3,040,000	$ 48,000
Nonaccrual	81,543,000	88,450,000	81,818,000	87,190,000	73,623,000
Troubled debt restructurings	5,946,000	6,011,000	2,989,000	1,012,000	0
Total	$ 87,513,000	$ 94,461,000	$ 85,050,000	$ 91,242,000	$ 73,671,000

MERCANTILE BANK CORPORATION

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

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

As specified in our Loan Administration Policy, we complete a migration analysis quarterly to assist us in determining appropriate reserve allocation factors for commercial loans and leases. Our migration takes into account four different time periods, including four, eight, twelve and twenty-quarter time periods, and while we generally place most weight on the eight-quarter time frame as that period is close to the average duration of our loan and lease portfolio, consideration is given to the other time periods as part of our assessment. Although the migration analysis provides an accurate historical accounting of our loan and lease losses, it is not able to fully account for environmental factors that will also very likely impact the collectability of our commercial loans and leases as of any quarter-end date.

Environmental factors include both internal and external items. We believe the most significant internal environmental factor is our credit culture and the relative aggressiveness in assigning and revising commercial loan and lease risk ratings. Although we have been consistent in our approach to commercial loan and lease ratings, ongoing stressed economic conditions have resulted in an even higher sense of aggressiveness with regards to the downgrading of lending relationships. In addition, we made revisions to our grading paradigms in early 2009 that mathematically resulted in commercial loan and lease relationships being more quickly downgraded when signs of stress were noted, such as slower sales activity for construction and land development CRE relationships and reduced operating performance/cash flow coverage for C&I relationships. These changes, coupled with the troubled economic environment, have resulted in significant downgrades and the need for substantial provisions to the allowance. To more effectively manage our commercial loan and lease portfolio, also in early 2009 we created two specific groups tasked with managing our higher exposure lending relationships. One team manages the most distressed credits, while the other team manages our larger monitor-related credit relationships.

The most significant external environmental factor is the assessment of the current economic environment and the resulting implications on our commercial loan and lease portfolio. Currently, we believe conditions remain stressed for CRE; however, recent data and performance reflect a level of stability in the C&I segment of our loan and lease portfolio.

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

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

Securities decreased by $24.6 million during the first six months of 2010, totaling $232.8 million as of June 30, 2010. The decline in the securities portfolio primarily reflects the sale of certain tax-exempt municipal bonds with an aggregate book value of $20.0 million, which were sold in late March after analyzing our current and forecasted federal income tax position. A vast majority of the sales proceeds were used to purchase U.S. Government agency bonds during April and early May. Proceeds from matured and called U.S. Government agency bonds during the first six months of 2010 totaled $33.2 million, with another $7.9 million received from principal paydowns on mortgage-backed securities, $3.8 million from matured and called tax-exempt municipal bonds and $0.9 million from matured Michigan Strategic Fund bonds. Purchases during the first six months of 2010, consisting almost exclusively of U.S. Government agency bonds, totaled $37.5 million. At June 30, 2010, the portfolio was comprised of U.S. Government agency bonds (44%), U.S. Government agency issued or guaranteed mortgage-backed securities (25%), tax-exempt municipal general obligation and revenue bonds (15%), Michigan Strategic Fund bonds (8%), Federal Home Loan Bank stock (7%) and mutual funds (1%). All of our securities are currently designated as available for sale. Historically, we had designated our tax-exempt municipal bonds as held to maturity; however, we changed the designation to available for sale immediately after the sale of certain of our tax-exempt municipal bonds in late March. We maintain the securities portfolio at levels to provide adequate pledging and secondary liquidity for our daily operations.

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

Federal funds sold, consisting of excess funds sold overnight to a correspondent bank, along with investments in interest-bearing deposits at correspondent banks, are used to manage daily liquidity needs and interest rate sensitivity. During the first six months of 2010, the average balance of these funds equaled $63.6 million, or 3.5% of average earning assets. This level is similar to that during all of 2009, but considerably higher than the historical average of less than 1.0%. Given the stressed market and economic conditions, in early 2009 we made the decision to operate with a higher than traditional balance of federal funds sold and interest-bearing deposits. We expect to maintain the higher balance of federal funds sold and other interest-bearing deposits, likely 2.5% to 3.5% of average earning assets, until market and economic conditions return to more normalized levels.

MERCANTILE BANK CORPORATION

Premises and equipment at June 30, 2010 equaled $28.6 million, a decrease of $1.1 million over the past six months. Purchases of premises and equipment during the first six months of 2010 were nominal, while depreciation expense totaled $1.1 million. On December 30, 2009, all FDIC-insured financial institutions were required to pre-pay estimated FDIC deposit insurance assessments for the fourth quarter of 2009 and the years 2010, 2011 and 2012. The amount we paid equaled $16.3 million, which will be expensed over the future quarterly assessment periods. As of June 30, 2010, the balance of this prepaid asset was $14.0 million.

Foreclosed and repossessed assets totaled $23.0 million at June 30, 2010, compared to $26.6 million on December 31, 2009. The $3.6 million net decline consisted of $8.0 million in sales proceeds, $1.5 million in valuation write-downs, and $5.9 million in transfers from the loan and lease portfolio. We expect foreclosed and repossessed assets to remain at elevated levels as we move through the difficult economic environment and in certain situations elect to foreclose or repossess collateral. The State of Michigan has a relatively protracted foreclosure process that generally takes six to twelve months before deed is obtained. While we expect further transfers from loans and leases to foreclosed and repossessed assets in future periods reflecting our collection efforts on impaired lending relationships, we are hopeful that the increased sales activity we witnessed during the first six months of 2010 and the latter part of 2009 will continue and limit the overall increase in this nonperforming asset category.

Deposits decreased $61.5 million during the first six months of 2010, totaling $1.34 billion at June 30, 2010. Local deposits increased $4.2 million, while out-of-area deposits decreased $65.7 million. As a percent of total deposits, local deposits equaled 50.8% on June 30, 2010, compared to 48.3% at December 31, 2009. In comparing balances as of June 30, 2010 to those at December 31, 2008, total deposits have declined by $259.4 million, consisting of a $210.6 million increase in local deposits and a $470.0 million decrease in out-of-area deposits. The decline in out-of-area deposits primarily results from the decline in total loans and leases and the increase in local deposits. The increase in local deposits reflects various programs and initiatives we have implemented over the past 18 months, including: certificate of deposit campaign; implementation of several deposit-gathering initiatives in our commercial lending function; introduction of new deposit-related products and services; and the continuation of providing our customers with the latest in technological advances that give improved information, convenience and timeliness.

Noninterest-bearing checking deposit accounts remain relatively stable, averaging between $110.0 million and $120.0 million over the past several years, and $117.5 million during the first six months of 2010. Local interest-bearing checking accounts, in large part reflecting the strong success of our executive banking product, increased $42.0 million during the first six months of 2010, and are up $78.0 million since year-end 2008. Money market deposit accounts increased $47.2 million during the first six months of 2010, and are up $54.3 million since year-end 2008. Certificates of deposit purchased by customers located within our market areas declined $86.3 million during the first six months of 2010, after increasing $164.1 million during 2009. During the first quarter of 2009, we ran a high-rate one-year certificate of deposit campaign that raised about $65.0 million, with most of the dollars representing new deposits to our bank. As these certificates of deposit matured during the first quarter of 2010, we were able to retain about 70% of the maturing funds. A majority of the funds that remained in our bank were deposited into either our executive banking product or a money market deposit account. During the second quarter of 2010, we continued to see funds from maturing certificates of deposit being transferred to interest-bearing checking and money market deposit accounts, and we expect that trend to continue in future periods.

MERCANTILE BANK CORPORATION

Deposits obtained from customers located outside of our market areas decreased $65.7 million during the first six months of 2010, and have declined $470.0 million since year-end 2008. As of June 30, 2010, out-of-area deposits totaled $659.2 million. Out-of-area deposits consist of certificates of deposit and interest-bearing checking accounts obtained from depositors located outside our market areas and placed by deposit brokers for a fee, but also include certificates of deposit obtained from the deposit owners directly. The owners of out-of-area deposits include individuals, businesses and municipal governmental units located throughout the United States. The significant decline in out-of-area deposits since year-end 2008 primarily reflects the influx of cash resulting from the reduction in total loans and leases and from the increase in local deposits.

Repurchase agreements increased $8.5 million during the first six months of 2010, totaling $108.3 million as of June 30, 2010. As part of our sweep account program, collected funds from certain business noninterest-bearing checking accounts are invested into over-night interest-bearing repurchase agreements. Such repurchase agreements are not deposit accounts and are not afforded federal deposit insurance.

FHLB advances declined $45.0 million during the first six months of 2010, and are down $110.0 million since year-end 2008. As of June 30, 2010, FHLB advances totaled $160.0 million. The decline in FHLB advances since year-end 2008 primarily reflects the influx of cash resulting from the reduction in total loans and leases and from the increase in local deposits. The FHLB advances are collateralized by residential mortgage loans, first mortgage liens on multi-family residential property loans, first mortgage liens on commercial real estate property loans, and substantially all other assets of our bank, under a blanket lien arrangement. Our borrowing line of credit as of June 30, 2010 totaled about $220.0 million, with availability approximating $56.0 million.

Liquidity

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

To assist in providing needed funds, we have regularly obtained monies from wholesale funding sources. Wholesale funds, comprised primarily of deposits from customers outside of our market areas and advances from the FHLB, totaled $834.2 million, or 51.4% of combined deposits and borrowed funds as of June 30, 2010, compared to $947.5 million, or 55.0% of combined deposits and borrowed funds as of December 31, 2009, and $1.41 billion, or 71.5% of combined deposits and borrowed funds as of December 31, 2008.

Although local deposits have generally increased as new business, municipal governmental unit and individual deposit relationships are established and as existing customers increase the balances in their accounts, and we witnessed significant local deposit growth during the first six months of 2010 and all of 2009, the relatively high reliance on wholesale funds will likely remain. As part of our interest rate risk management strategy, a majority of our wholesale funds have a fixed interest rate and mature within one year, reflecting the fact that a majority of our loans and leases have a floating rate tied to either the Mercantile Bank Prime Rate or LIBOR rates. While this maturity strategy increases inherent liquidity risk, we believe the increased liquidity risk is sufficiently mitigated by the benefits derived from an interest rate risk management standpoint. In addition, we have developed a comprehensive contingency funding plan which we believe further mitigates the increased liquidity risk.

MERCANTILE BANK CORPORATION

Wholesale funds are generally a lower all-in cost source of funds when compared to the interest rates that would have to be offered in our local markets to generate a commensurate level of funds. Interest rates paid on new out-of-area deposits and FHLB advances have historically been similar to interest rates paid on new certificates of deposit issued to local customers, although during the latter part of 2009 and the first six months of 2010, they have been notably lower. In addition, the overhead costs associated with wholesale funds are considerably less than the overhead costs that would be incurred to attract and administer a similar level of local deposits, especially if the estimated costs of a needed expanded branching network were taken into account. We believe the relatively low overhead costs reflecting our limited branch network mitigate our high reliance on wholesale funds and resulting relatively low net interest margin.

As a member of the Federal Home Loan Bank of Indianapolis, we have access to the FHLB advance borrowing programs. Advances totaled $160.0 million at June 30, 2010, compared to $205.0 million and $270.0 million outstanding at December 31, 2009 and December 31, 2008, respectively. Based on available collateral at June 30, 2010, we could borrow an additional $56.0 million. We also have the ability to borrow up to $30.0 million on a daily basis through a correspondent bank using an established unsecured federal funds purchased line of credit. During the first six months of 2010, our federal funds purchased position averaged less than $0.1 million, compared to an average federal funds sold position of $54.8 million and another $8.8 million invested in interest-bearing deposits at correspondent banks. During 2009, our federal funds purchased position averaged only $0.1 million, compared to an average federal funds sold position of $53.8 million and another $6.7 million invested in interest-bearing deposits at correspondent banks. Given the volatile market and stressed economic conditions, we have been operating with a higher than normal balance of federal funds sold and other short-term investments. It is expected that we will maintain a higher than historical level of liquid funds, likely to average 2.5% to 3.5% of average earning assets, until market and economic conditions return to more normalized levels. As a result, we expect the use of our federal funds purchased line of credit, in at least the near future, will be rare, if at all.

We have a line of credit through the Discount Window of the Federal Reserve Bank of Chicago. Using a majority of our tax-exempt municipal securities as collateral, at June 30, 2010 we could have borrowed up to about $30.4 million for terms of 1 to 28 days. We did not utilize this line of credit during the first six months of 2010 or at any time during 2009, and do not plan to access this line of credit in future periods.

In addition to normal loan funding and deposit flow, we must maintain liquidity to meet the demands of certain unfunded loan commitments and standby letters of credit. As of June 30, 2010, we had a total of $221.0 million in unfunded loan commitments and $27.6 million in unfunded standby letters of credit. Of the total unfunded loan commitments, $209.8 million were commitments available as lines of credit to be drawn at any time as customers cash needs vary, and $11.2 million were for loan commitments expected to close and become funded within the next twelve months. The level of commitments to make loans has declined significantly when compared to historical levels, primarily reflecting poor economic conditions. We monitor fluctuations in loan balances and commitment levels, and include such data in our overall liquidity management.

We monitor our liquidity position and funding strategies on an ongoing basis, but recognize that unexpected events, changes in economic or market conditions, reduction in earnings performance, declining capital levels or situations beyond our control could cause liquidity challenges. While we believe it is unlikely that a funding crisis of any significant degree is likely to materialize, we have developed a comprehensive contingency funding plan that provides a framework for meeting liquidity disruptions.

Table of Contents

MERCANTILE BANK CORPORATION

Capital Resources

Shareholders equity is a noninterest-bearing source of funds that generally provides support for asset growth and the absorption of operating losses. Shareholders equity was $139.0 million at June 30, 2010, compared to $140.1 million at December 31, 2009. The $1.1 million decline during the first six months of 2010 is primarily due to the loss attributable to common shares of $3.6 million. Positively impacting shareholders equity during the first six months of 2010 was a $2.3 million tax-adjusted increase in the market value of our available for sale securities portfolio.

Despite the reduction in shareholders equity during the first six months of 2010, our and our bank s regulatory capital ratios increased, and our bank remains well capitalized . As of June 30, 2010, our bank s total risk-based capital ratio was 11.9%, compared to 11.1% at December 31, 2009. Our bank s total regulatory capital, consisting of shareholders equity plus a portion of the allowance, declined by $4.5 million during the first six months of 2010, reflecting a net loss of $1.6 million, a reduction of $1.9 million in eligible allowance due to a decline in total risk-weighted assets, and cash dividends totaling $1.1 million. Despite the reduction in total regulatory capital, our bank s total risk-based capital ratio increased due to a decline of $150.7 million in total risk-weighted assets, primarily resulting from a reduction in commercial loans. As of June 30, 2010, our bank s total regulatory capital equaled $186.7 million, or $29.2 million in excess of the 10.0% minimum which is among the requirements to be categorized as well capitalized . Our and our bank s capital ratios as of June 30, 2010 and December 31, 2009 are disclosed in Note 13 of the Notes to Consolidated Financial Statements.

On July 9, 2010, we announced via a Form 8-K filed with the SEC that we are deferring regularly scheduled quarterly interest payments on our subordinated debentures beginning with the quarterly interest payment scheduled to be paid on July 18, 2010. The deferral of interest payments on the subordinated debentures results in the deferral of distributions on our trust preferred securities. We also announced that we are deferring regularly scheduled quarterly dividend payments on our preferred stock beginning with the quarterly dividend payment scheduled to be paid on August 15, 2010. We have not determined the duration of the deferral period.

We and our bank are subject to regulatory capital requirements administered by state and federal banking agencies. Failure to meet the various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements. Our bank s ability to pay cash and stock dividends is subject to limitations under various laws and regulations, to prudent and sound banking practices, and to contractual provisions relating to our subordinated debentures and participation in the Capital Purchase Program. On January 14, 2010, we declared a $0.01 per share cash dividend on our common stock that was paid on March 10, 2010 to shareholders of record on February 10, 2010. In April 2010, we suspended future payments of cash dividends on our common stock until economic conditions and our financial condition improve. In addition, we are precluded from paying dividends on our common stock and preferred stock because, under the terms of our subordinated debentures, we cannot pay dividends during periods when we have deferred the payment of interest on our subordinated debentures, and, we are now deferring such interest payments. Also, pursuant to our articles of incorporation, we are precluded from paying dividends on our common stock while any dividends accrued on our preferred stock have not been declared and paid. Because we have suspended the payment of dividends on our preferred stock, we are precluded from paying dividends on our common stock.

MERCANTILE BANK CORPORATION

Results of Operations

We recorded a net loss attributable to common shares of $0.7 million for the second quarter of 2010 ($0.08 per basic and diluted share), compared with a net loss of $6.4 million ($0.75 per basic and diluted share) recorded during the second quarter of 2009. We recorded a net loss attributable to common shares for the first six months of 2010 of $3.6 million ($0.43 per basic and diluted share), compared with a net loss of $10.9 million ($1.28 per basic and diluted share) recorded during the first six months of 2009.

The establishment of a valuation allowance against our net deferred tax asset in the fourth quarter of 2009 distorts 2010 after-tax operating result comparisons with earlier reporting periods. On a pre-tax basis, our net loss was $1.2 million in the second quarter of 2010 and $4.3 million for the first six months of 2010, compared to $9.6 million and $16.9 million in the respective 2009 periods. The 87.2% improvement in pre-tax earnings performance in the second quarter of 2010 and the 74.5% improvement in pre-tax earnings performance in the first six months of 2010 compared to the respective 2009 timeframes are mainly attributable to increased levels of net interest income and lower provisions to the allowance for loan and lease losses. The increase in net interest income is the result of an improved net interest margin, which has been positively impacted by a substantial reduction in our cost of funds, while the decreased provision expense is mainly due to a lower volume of commercial loan and lease downgrades, improved real estate market conditions, and a reduction in total loans and leases. Excluding the impact of nonrecurring items on 2010 and 2009 earnings performance, including $0.7 million in pre-tax gains from the sales of tax-exempt securities and guaranteed portions of certain Small Business Administration-guaranteed commercial loans recorded in the first quarter of 2010 and $2.1 million in pre-tax charges related to the branch consolidations and the industry-wide FDIC special assessment incurred in the second quarter of 2009, the 2010 second quarter and six-month pre-tax operating losses were $1.2 million and $5.0 million, respectively, compared to pre-tax operating losses of $7.5 million and $14.8 million for the comparable 2009 periods.

The net losses recorded during the second quarter of 2010 and the first six months of 2010 are primarily the result of substantial provisions for loan and lease losses and costs associated with the administration and resolution of problem assets, reflecting continuing difficulties in the loan portfolio, most notably in the CRE and C&D segments. Continued state, regional and national economic struggles have significantly hampered certain commercial borrowers cash flows and negatively impacted real estate values, resulting in elevated levels of nonperforming assets and net loan and lease charge-offs when compared to pre-2007 reporting periods.

Interest income during the second quarter of 2010 was $22.7 million, a decrease of $4.2 million, or 15.5%, from the $26.9 million earned during the second quarter of 2009. Interest income during the first six months of 2010 was $45.9 million, a decrease of $9.0 million, or 16.4%, from the $54.9 million earned during the first six months of 2009. The reduction in interest income is primarily attributable to a significant decrease in earning assets, and to a much lesser extent, a declining yield on earning assets. During the second quarter of 2010, earning assets averaged $1.77 billion, a decline of $279.7 million, or 13.6%, from the $2.05 billion in average earning assets during the second quarter of 2009. Average loans and leases were down $284.3 million, average short-term investments increased $5.6 million, average federal funds sold decreased $3.7 million, and average securities increased $2.7 million. During the first six months of 2010, earning assets averaged $1.80 billion, $305.4 million lower than average earning assets of $2.10 billion during the same time period in 2009. Average loans and leases were down $294.4 million, average federal funds sold decreased $13.9 million, average securities increased $4.8 million, and average short-term investments decreased $1.9 million.

Table of Contents

MERCANTILE BANK CORPORATION

During the second quarter of 2010 and 2009, earning assets had an average yield (tax equivalent-adjusted basis) of 5.18% and 5.32%, respectively. During the first six months of 2010 and 2009, earning assets had an average yield of 5.20% and 5.33%, respectively. The decline in earning asset yield in the 2010 periods compared to the respective 2009 timeframes primarily resulted from decreased yields on average loans and leases and average securities. The yield on average loans and leases equaled 5.49% in the second quarter of 2010 and 5.47% for the first six months of 2010, compared to 5.52% and 5.56% for the respective 2009 periods. A higher level of nonperforming loans, which equaled $87.5 million as of June 30, 2010 compared to $73.7 million as of June 30, 2009, negatively impacted the yield on average loans and leases during 2010. The yield on average securities was 4.69% in the second quarter of 2010 and 4.79% for the first six months of 2010, compared to 5.25% and 5.19% in the respective 2009 periods. The lower yield on average securities in the 2010 periods compared to the respective 2009 periods primarily resulted from a decreased yield on U.S. Government Agency bonds, reflecting a decrease in market rates, and a shift in the securities portfolio mix from higher-yielding municipal securities to lower-yielding U.S. Government Agency bonds. After analyzing our current and forecasted federal income tax position, we decided to sell certain tax-exempt municipal bonds with an aggregate book value of $20.0 million in late March 2010. A vast majority of the sales proceeds were used to purchase U.S. Government agency bonds during April and early May.

Interest expense during the second quarter of 2010 was $8.3 million, a decrease of $6.1 million, or 42.6%, from the $14.4 million expensed during the second quarter of 2009. Interest expense during the first six months of 2010 was $17.2 million, a decrease of $13.4 million, or 44.0%, from the $30.6 million expensed during the first six months of 2009. The reduction in interest expense is primarily attributable to a decline in the weighted average cost of interest-bearing liabilities and a decrease in the volume of interest-bearing liabilities. During the second quarter of 2010 and 2009, interest-bearing liabilities had a weighted average rate of 2.08% and 3.15%, respectively. During the first six months of 2010 and 2009, interest-bearing liabilities had an average rate of 2.12% and 3.26%, respectively. The lower weighted average cost of interest-bearing liabilities is primarily due to the decline in market interest rates that began late in the third quarter of 2007 and continued through December of 2008. Maturing fixed-rate liabilities were replaced with lower-costing funds throughout 2009 and during the first six months of 2010. During the second quarter of 2010, interest-bearing liabilities averaged $1.60 billion, or $241.1 million lower than average interest-bearing liabilities of $1.84 billion during the same time period in 2009. Average interest-bearing deposits were down $172.9 million, while average FHLB advances decreased $73.5 million, average short-term borrowings increased $5.3 million, and average other borrowings remained at $49.8 million. During the first six months of 2010, interest-bearing liabilities averaged $1.63 billion, $269.0 million lower than average interest-bearing liabilities of $1.90 billion during the same time period in 2009. Average interest-bearing deposits decreased $202.9 million, while average FHLB advances decreased $72.0 million, average short-term borrowings increased $6.8 million, and average long-term borrowings decreased $0.9 million.

MERCANTILE BANK CORPORATION

Net interest income during the second quarter of 2010 was $14.4 million, an increase of $2.0 million, or 15.8%, from the $12.4 million earned during the second quarter of 2009. Net interest income during the first six months of 2010 was $28.7 million, an increase of $4.5 million, or 18.4%, from the $24.2 million earned during the same time period in 2009. The increase in net interest income was due to an increase in the net interest margin, which more than offset a decrease in earning assets. The net interest margin during the second quarter of 2010 was 3.31%, compared to 2.50% during the second quarter of 2009. During the first six months of 2010, the net interest margin was 3.28%, compared to 2.39% during the same time period in 2009. The improved net interest margin in the 2010 periods compared to the prior-year periods primarily reflects a reduction in our cost of funds, which more than offset the decreased yield on earning assets. Although our yield on earning assets declined in the second quarter of 2010 and the first six months of 2010 compared to the prior-year periods mainly due to decreased yields on loans and leases and securities, our cost of funds declined at a significantly greater rate, resulting in the improved net interest margins. The cost of funds primarily decreased as a result of higher-costing matured wholesale funds, consisting of certificates of deposit and FHLB advances, being replaced by lower-costing funds.

Given the multitude of factors that impact the net interest margin, it is difficult to predict future net interest margins. However, in light of the current interest rate environment, our net interest margin during the remainder of 2010 should benefit from a continued reduction in our cost of funds and the loan pricing initiatives instituted in 2008 and 2009. While we expect further reductions in our cost of funds during the remainder of 2010, the magnitude of the reductions will likely be at a much lower level than during the past several quarters. With respect to our cost of funds, we have about $280 million in wholesale funds at an average rate of 1.80% scheduled to mature during the remainder of 2010. Current rates on wholesale instruments generally range from 0.30% to 3.00%, depending on the type of product and term. During the second quarter of 2010, our average rate on new wholesale funds was about 1.00%; the recent implementation of a matched-funding program involving new and existing fixed-rate loans will likely place upward pressure on the average rate of wholesale funds acquired in future periods as the duration of the wholesale funding portfolio is generally increased. While a continued reduction in our cost of funds will positively impact our net interest margin, the impact of asset quality on the net interest margin is difficult to predict.

The following table sets forth certain information relating to our consolidated average interest-earning assets and interest-bearing liabilities and reflects the average yield on assets and average cost of liabilities for the second quarter of 2010 and 2009. Such yields and costs are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the period presented. Tax-exempt securities interest income and yield have been computed on a tax equivalent basis using a marginal tax rate of 35%. Securities interest income was increased by $187,000 and $321,000 in the second quarter of 2010 and 2009, respectively, for this adjustment.

Table of Contents

MERCANTILE BANK CORPORATION

	Quarters ended June 30,					
	2010			2009		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	(dollars in thousands)					
ASSETS						
Loans and leases	$ 1,465,631	$ 20,066	5.49%	$ 1,749,919	$ 24,080	5.52%
Investment securities	236,136	2,770	4.69	233,402	3,065	5.25
Federal funds sold	59,051	37	0.25	62,755	39	0.25
Short-term investments	9,573	10	0.43	3,995	3	0.27
Total interest earning assets	1,770,391	22,883	5.18	2,050,071	27,187	5.32
Allowance for loan and lease losses	(52,394)			(35,815)		
Other assets	144,529			132,337		
Total assets	$ 1,862,526			$ 2,146,593		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing deposits	$ 1,269,886	$ 5,992	1.89%	$ 1,442,815	$ 11,220	3.12%
Short-term borrowings	101,167	353	1.40	95,828	475	1.99
Federal Home Loan Bank advances	176,044	1,576	3.54	249,505	2,295	3.64
Other borrowings	49,815	354	2.81	49,819	426	3.38
Total interest-bearing liabilities	1,596,912	8,275	2.08	1,837,967	14,416	3.15
Noninterest-bearing deposits	120,511			115,391		
Other liabilities	6,196			17,046		
Shareholders equity	138,907			176,189		
Total liabilities and shareholders equity	$ 1,862,526			$ 2,146,593		
Net interest income		$ 14,608			$ 12,771	
Net interest rate spread			3.10%			2.17%

Net interest rate margin on average assets	3.15%	2.39%
Net interest margin on earning assets	3.31%	2.50%

Provisions for loan and lease losses during the second quarter of 2010 were $6.2 million, compared to $11.5 million during the second quarter of 2009. Provisions for loan and lease losses during the first six months of 2010 were $14.6 million, compared to $21.9 million during the same time period in 2009. The significant provision expense incurred in both the 2009 and 2010 periods is in response to the deterioration of the quality of our loan portfolio; continued state, regional, and national economic struggles have negatively impacted some of our borrowers cash flows and underlying collateral values, leading to increased nonperforming assets, elevated net loan and lease charge-offs, and increased overall credit risk within our loan and lease portfolio.

47

Table of Contents

MERCANTILE BANK CORPORATION

Net loan and lease charge-offs of $8.6 million were recorded during the second quarter of 2010, compared to $10.8 million during the second quarter of 2009. During the first six months of 2010, net loan and lease charge-offs totaled $14.7 million, compared to $16.4 million during the same time period in 2009. Of the $9.9 million in gross loans and leases charged-off during the second quarter of 2010, $5.1 million, or about 51%, represents the elimination of specific reserves that were established in earlier periods. The remaining $4.8 million, while in part covered through general reserve allocations via our loan grading system, is included in the $6.2 million provision that was expensed during the second quarter of 2010. Provision expense during the first six months of 2010 allocated to CRE loans totaled $9.3 million, with another $6.4 million allocated to C&D loans, $1.5 million allocated to residential mortgage loans, including permanent financing of owner-occupied dwellings and home equity lines of credit, and $0.8 million allocated to C&I loans. Recoveries and a reduction in total loans and leases outstanding during the first six months of 2010 mitigated the necessary provision expense by $3.4 million. The allowance, as a percentage of total loans and leases outstanding, was 3.38% as of June 30, 2010, compared to 3.11% as of December 31, 2009 and 1.91% as of June 30, 2009.

Noninterest income during the second quarter of 2010 was $2.0 million, an increase of 7.1% from the $1.9 million earned during the second quarter of 2009. Noninterest income during the first six months of 2010 was $4.7 million, an increase of 19.4% from the $3.9 million earned during the same time period in 2009. Noninterest income during the first six months of 2010 includes gains totaling $0.7 million from the sales of tax-exempt municipal bonds and guaranteed portions of certain Small Business Administration-guaranteed loans during the first quarter. Excluding these gains, noninterest income increased 1.4% during the first six months of 2010 compared to the same time period in 2009. Increased rental income from foreclosed properties and earnings on bank-owned life insurance, which more than offset declines in mortgage banking income and overdraft service charges, resulted in the higher levels of noninterest income in the 2010 time periods compared to the respective 2009 timeframes.

Noninterest expense during the second quarter of 2010 was $11.4 million, a decrease of 7.5% from the $12.4 million expensed during the second quarter of 2009. Noninterest expense during the first six months of 2010 was $23.1 million, down approximately $0.1 million from the amount expensed during the same time period in 2009. Overhead costs during the second quarter of 2009 and the first six months of 2009 include a $1.2 million charge for the consolidation of the mid- and eastern regions of our Michigan banking activities and a $0.9 million charge for the bank industry-wide FDIC special assessment. Excluding these one-time charges, noninterest expense during the second quarter of 2009 totaled $10.3 million, or $1.1 million lower than the second quarter of 2010; for the first six months of 2009, noninterest expense equaled $21.1 million, or $2.0 million lower than the first six months of 2010. Noninterest expense, excluding the impact of the one-time charges in the 2009 periods, increased in the 2010 periods primarily due to higher costs associated with the administration and resolution of nonperforming assets, including legal expenses, property tax payments, appraisal fees, and write-downs on foreclosed properties, and increased FDIC insurance premiums.

Nonperforming asset administration and resolution costs totaled $2.5 million during the second quarter of 2010, an increase of $1.4 million from the $1.1 million in costs incurred during the second quarter of 2009; these costs totaled $5.0 million during the first six months of 2010, an increase of $2.9 million from the $2.1 million in costs incurred during the same time period in 2009. FDIC insurance premiums were $1.2 million in the second quarter of 2010, compared to $0.9 million, excluding the one-time special assessment, in the prior-year second quarter; these premiums totaled $2.4 million during the first six months of 2010, compared to $1.5 million, excluding the one-time special assessment, during the same time period in 2009. While it is difficult to predict future FDIC deposit insurance assessments given the enormous stress on the Deposit Insurance Fund from the significant losses incurred from bank failures, it is very likely that the expense will remain at elevated levels until economic conditions improve and the rate of bank failures declines substantially.

MERCANTILE BANK CORPORATION

Controllable operating expenses, including salaries and benefits, occupancy, and furniture and equipment costs, declined $0.9 million, or 13.9%, in the second quarter of 2010, compared to the same 2009 time period; these costs decreased $2.0 million, or 15.0%, during the first six months of 2010, compared to the same time period in 2009. Salary and benefit costs were down $1.6 million during the first six months of 2010 compared to the respective 2009 timeframe, primarily resulting from a reduction in full-time equivalent employees from 278 at second quarter-end 2009 to 248 at second quarter-end 2010. Occupancy and furniture and equipment costs declined by $0.4 million in the first six months of 2010 compared to the respective 2009 period, primarily resulting from an aggregate reduction in rent and depreciation expenses. Beginning in the fourth quarter of 2009, overhead cost savings of approximately $0.2 million per month were achieved as a result of the consolidation of the mid- and eastern regions of our Michigan banking activities that was completed in August of 2009.

During the second quarter of 2010, we recorded a loss before federal income tax of $1.2 million and a federal income tax benefit of $0.9 million, compared to a loss before federal income tax of $9.6 million and a federal income tax benefit of $3.3 million during the second quarter of 2009. During the first six months of 2010, we recorded a loss before federal income tax of $4.3 million and a federal income tax benefit of $1.3 million, compared to a loss before federal income tax of $16.9 million and a federal income tax benefit of $6.2 million during the first six months of 2009. Our ability to recognize federal income tax benefits during periods in which net losses are recorded is significantly limited due to the establishment of a valuation allowance against the entire balance of our net deferred tax asset in the fourth quarter of 2009. Generally, the calculation for the federal income tax provision (benefit) does not consider the tax effects of changes in other comprehensive income (OCI), which is a component of shareholders equity on the balance sheet. However, an exception is provided in certain circumstances, such as when there is a pre-tax loss from continuing operations. In such cases, pre-tax income from other categories (such as changes in OCI) is included in the calculation of the federal income tax provision (benefit) for the current year. This resulted in the recognition of a $0.9 million federal income tax benefit in the second quarter of 2010 and a $1.3 million federal income tax benefit during the first six months of 2010.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of our transactions are denominated in U.S. dollars with no specific foreign exchange exposure. We have only limited agricultural-related loan assets and therefore have no significant exposure to changes in commodity prices. Any impact that changes in foreign exchange rates and commodity prices would have on interest rates is assumed to be insignificant. Interest rate risk is the exposure of our financial condition to adverse movements in interest rates. We derive our income primarily from the excess of interest collected on our interest-earning assets over the interest paid on our interest-bearing liabilities. The rates of interest we earn on our assets and owe on our liabilities generally are established contractually for a period of time. Since market interest rates change over time, we are exposed to lower profitability if we cannot adapt to interest rate changes. Accepting interest rate risk can be an important source of profitability and shareholder value; however, excessive levels of interest rate risk could pose a significant threat to our earnings and capital base. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to our safety and soundness.

Evaluating the exposure to changes in interest rates includes assessing both the adequacy of the process used to control interest rate risk and the quantitative level of exposure. Our interest rate risk management process seeks to ensure that appropriate policies, procedures, management information systems and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. In evaluating the quantitative level of interest rate risk, we assess the existing and potential future effects of changes in interest rates on our financial condition, including capital adequacy, earnings, liquidity and asset quality.

Table of Contents

MERCANTILE BANK CORPORATION

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

The following table depicts our GAP position as of June 30, 2010:

	Within Three Months	Three to Twelve Months	One to Five Years	After Five Years	Total
Assets:					
Commercial loans (1)	$ 469,752,000	$ 216,374,000	$ 569,305,000	$ 29,886,000	$ 1,285,317,000
Leases	3,000	134,000	493,000	0	630,000
Residential real estate loans	46,965,000	9,849,000	50,205,000	12,158,000	119,177,000
Consumer loans	2,561,000	294,000	2,555,000	176,000	5,586,000
Securities (2)	39,564,000	636,000	49,882,000	142,716,000	232,798,000
Federal funds sold	53,892,000	0	0	0	53,892,000
Short-term investments	9,470,000	0	0	0	9,470,000
Allowance for loan and lease losses	0	0	0	0	(47,738,000)
Other assets	0	0	0	0	144,930,000
Total assets	622,207,000	227,287,000	672,440,000	184,936,000	$ 1,804,062,000
Liabilities:					
Interest-bearing checking	128,293,000	0	0	0	128,293,000
Savings deposits	34,595,000	0	0	0	34,595,000
Money market accounts	79,210,000	0	0	0	79,210,000
Time deposits under $100,000	26,247,000	66,455,000	33,282,000	0	125,984,000
Time deposits $100,000 & over	226,998,000	348,041,000	270,467,000	0	845,506,000
Short-term borrowings	108,271,000	0	0	0	108,271,000
Federal Home Loan Bank advances	0	105,000,000	55,000,000	0	160,000,000
Other borrowed money	39,826,000	10,000,000	0	0	49,826,000
Noninterest-bearing checking	0	0	0	0	126,572,000
Other liabilities	0	0	0	0	6,762,000
Total liabilities	643,440,000	529,496,000	358,749,000	0	1,665,019,000
Shareholders equity	0	0	0	0	139,043,000
Total liabilities & shareholders equity	643,440,000	529,496,000	358,749,000	0	$ 1,804,062,000

Net asset (liability) GAP	$ (21,233,000)	$ (302,209,000)	$ 313,691,000	$ 184,936,000
Cumulative GAP	$ (21,233,000)	$ (323,442,000)	$ (9,751,000)	$ 175,185,000
Percent of cumulative GAP to total assets	(1.2%)	(17.9%)	(0.5%)	9.7%

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

(2) Mortgage-backed securities are categorized by average life calculations based upon prepayment trends as of June 30, 2010.

MERCANTILE BANK CORPORATION

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

We conducted multiple simulations as of June 30, 2010, in which it was assumed that changes in market interest rates occurred ranging from up 300 basis points to down 300 basis points in equal quarterly installments over the next twelve months. The following table reflects the suggested impact on net interest income over the next twelve months in comparison to estimated net interest income based on our balance sheet structure, including the balances and interest rates associated with our specific loans, securities, deposits and borrowed funds, as of June 30, 2010. The resulting estimates are well within our policy parameters established to manage and monitor interest rate risk.

Interest Rate Scenario	Dollar Change In Net Interest Income	Percent Change In Net Interest Income
Interest rates down 300 basis points	$ 285,000	0.5%
Interest rates down 200 basis points	820,000	1.5
Interest rates down 100 basis points	1,350,000	2.5
No change in interest rates	1,885,000	3.4
Interest rates up 100 basis points	210,000	0.4
Interest rates up 200 basis points	40,000	0.1
Interest rates up 300 basis points	1,200,000	2.2

The resulting estimates have been significantly impacted by the current interest rate and economic environments, as adjustments have been made to critical model inputs with regards to traditional interest rate relationships. This is especially important as it relates to floating rate commercial loans and brokered certificates of deposit, which comprise a substantial portion of our balance sheet. As of June 30, 2010, the Mercantile Bank Prime Rate is 4.50% as compared to the Wall Street Journal Prime Rate of 3.25%. Historically, the two indices have been equal; however, we elected not to reduce the Mercantile Bank Prime Rate in late October and mid-December of 2008 when the Wall Street Journal Prime Rate declined by 50 and 75 basis points, respectively. In conducting our simulations at June 30, 2010, we have made the assumption that the Mercantile Bank Prime Rate will remain unchanged until the Wall Street Journal Prime Rate exceeds the Mercantile Bank Prime Rate, at which time the two indices will remain equal in the increasing interest rate scenarios. Also, brokered certificate of deposit rates have substantially decreased since December of 2008, with part of the decline attributable to a significant imbalance whereby the supply of available funds far outweighs the demand from banks looking to raise funds. As a result, we have substantially limited further reductions in brokered certificate of deposit rates in the declining interest rate scenarios.

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

Item 4. Controls and Procedures

As of June 30, 2010, an evaluation was performed under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of June 30, 2010. There have been no significant changes in our controls over financial reporting during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents

MERCANTILE BANK CORPORATION

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

We disclosed risk factors on Form 10-K for the year ended December 31, 2009 that could affect our business, financial condition or results of operations. Set forth below is an additional risk factor that could affect us. The risks highlighted in our annual report and set forth below are not the only ones we face.

The Dodd-Frank Wall Street Reform and Consumer Protection Act may adversely impact our business.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) was signed into law. It provides for a broad range of financial reform and will result in a number of new regulations that could significantly impact regulatory compliance costs and the operations of community banks. The Act includes, among other things, provisions establishing a Bureau of Consumer Financial Protection, which will have broad authority to develop and implement rules regarding most consumer financial products; provisions affecting corporate governance and executive compensation at publicly-traded companies; provisions that would broaden the base for FDIC insurance assessments and permanently increase FDIC deposit insurance to $250,000; and new restrictions on how mortgage brokers and loan originators may be compensated. These provisions, or other aspects of the Act, or regulations that are adopted and implemented pursuant to the Act, may impact the profitability of our business activities or change certain of our business practices, including our ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to our operations in order to comply, and could therefore also adversely affect our business, financial condition, and results of operations.

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

We made no unregistered sale of equity securities, nor did we purchase our equity securities, during the quarter ended June 30, 2010.

In April 2010, our Board of Directors suspended future payments of cash dividends on our common stock until economic conditions and our financial performance improve. Holders of our common stock are entitled to receive cash dividends to the extent that they are declared from time to time by our Board of Directors. Holders of our preferred stock are entitled to receive cash dividends in the amount provided for in our articles of incorporation, to the extent that they are declared by the Board of Directors. We may only pay cash dividends out of funds that are legally available for that purpose. We are a holding company and substantially all of our assets are held by our subsidiaries. Our ability to pay cash dividends to our shareholders depends primarily on our bank s ability to pay cash dividends to us. Cash dividend payments and extensions of credit to us from our bank are subject to legal and regulatory limitations, generally based on capital levels and current and retained earnings, imposed by law and regulatory agencies with authority over our bank. The ability of our bank to pay cash dividends is also subject to its profitability, financial condition, capital expenditures and other cash flow requirements.

MERCANTILE BANK CORPORATION

In addition, under the terms of the subordinated debentures that we issued to the trust, we are precluded from paying cash dividends on our common stock or preferred stock if an event of default has occurred and is continuing under the subordinated debentures, or if we have exercised our right to defer payments of interest on the subordinated debentures, until the deferral ends. On July 9, 2010, we gave notice that we were deferring the regularly scheduled quarterly interest payments on our subordinated debentures beginning with the quarterly interest payment that was scheduled to be paid on July 18, 2010. So until the deferral ends, the terms of the subordinated debentures preclude us from paying any dividends on our common stock or preferred stock.

Our outstanding preferred stock was issued on May 15, 2009 pursuant to the United State Treasury Department s Capital Purchase Program. The provisions of our articles of incorporation relating to our preferred stock preclude us from paying any cash dividends on our common stock while any dividends accrued on our preferred stock have not been declared and paid. We have suspended the payment of dividends on our preferred stock, beginning with the dividend that would have been paid on August 15, 2010. Accordingly, the provisions of our articles of incorporation relating to our preferred stock preclude us from paying dividends on our common stock until all accrued and unpaid dividends on our preferred stock have been paid.

Also, in connection with our participation in the Capital Purchase Program, we agreed that we would not, without the Treasury Department s consent, pay a cash dividend on our common stock, other than a regular quarterly dividend of not more than $0.04 per share. This limit on paying dividends without the Treasury Department s consent remains in effect until the earlier of (i) May 15, 2012, or (ii) when all of the preferred stock that we sold to the Treasury Department has been redeemed by us or transferred by the Treasury Department to third parties.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Reserved

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits

EXHIBIT NO.	EXHIBIT DESCRIPTION
3.1	Our Articles of Incorporation are incorporated by reference to Exhibit 3.1 of our Form 10-Q for the quarter ended June 30, 2009
3.2	Our Amended and Restated Bylaws dated as of January 16, 2003 are incorporated by reference to Exhibit 3.2 of our Registration Statement on Form S-3 (Commission File No. 333-103376) that became effective on February 21, 2003
31	Rule 13a-14(a) Certifications
32.1	Section 1350 Chief Executive Officer Certification
32.2	Section 1350 Chief Financial Officer Certification

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on August 9, 2010.

MERCANTILE BANK CORPORATION

By: /s/ Michael H. Price
Michael H. Price
Chairman of the Board, President and Chief Executive Officer
(Principal Executive Officer)

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

Table of Contents

EXHIBIT INDEX

EXHIBIT NO.	EXHIBIT DESCRIPTION
3.1	Our Articles of Incorporation are incorporated by reference to Exhibit 3.1 of our Form 10-Q for the quarter ended June 30, 2009
3.2	Our Amended and Restated Bylaws dated as of January 16, 2003 are incorporated by reference to Exhibit 3.2 of our Registration Statement on Form S-3 (Commission File No. 333-103376) that became effective on February 21, 2003
31	Rule 13a-14(a) Certifications
32.1	Section 1350 Chief Executive Officer Certification
32.2	Section 1350 Chief Financial Officer Certification