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MACATAWA BANK CORP
Form S-2
May 14, 2001

As filed with the Securities and Exchange Commission on May 14, 2001
Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

MACATAWA BANK CORPORATION

Michigan
(State or other
jurisdiction of
incorporation or
organization)

6712
(Primary Standard
Industrial
Classification Code
Number)

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

348 South Waverly Road
Holland, Michigan 49423
(616) 820-1444

(Address, including zip code, and telephone number, including area code, of
Registrant's principal executive offices)

Benj. A. Smith, III
Chairman and Chief Executive Officer
106 E. 8th Street
Holland, Michigan 49423
(616) 396-0119

(Name, address, including zip code, and telephone number, including area code,
of agent for service)

Copy to:

Donald L. Johnson
Varnum, Riddering, Schmidt & Howlett
llp
Suite 1700
333 Bridge Street, N.W.
Grand Rapids, Michigan 49504
(616) 336-6000

John E. Freechack
Barack Ferrazzano Kirschbaum
Perlman & Nagelberg
Suite 2700
333 W. Wacker Drive
Chicago, Illinois 60606
(312) 984-3100

Approximate date of commencement of proposed sale to the public:
As soon as practicable after the effective date of this registration
statement.

If this form is filed to register additional securities for an offering
pursuant to Rule 462(b) under the Securities Act, check the following box and

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list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

CALCULATION OF REGISTRATION FEE

| Title of Each Class of Securities Being Registered | Amount to be Registered | Proposed Maximum Offering Price Per Share | Proposed Maximum Aggregate Offering Price | Amount of Registration Fee |
|--|-------------------------|---|---|----------------------------|
| Common stock (no par value)..... | 1,610,000 shares | \$17.40 | \$28,014,000 | \$7,004 |

We hereby amend this registration statement on this date or dates as may be necessary to delay its effective date until we shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on the date as the Securities and Exchange Commission, acting pursuant to Section 8(a) of the Securities Act of 1933, may determine.

+++++
 +The information in this prospectus is not complete and may be changed. We +
 +cannot sell these securities until the Securities and Exchange Commission +
 +declares our registration statement effective. This prospectus is not an +
 +offer to sell these securities and is not soliciting an offer to buy these +
 +securities in any state where the offer or sale is not permitted. +
 +++++
 Subject To Completion, dated , 2001

PROSPECTUS

1,400,000 Shares

MACATAWA BANK CORPORATION [logo]

Common Stock

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Macatawa Bank Corporation is offering 1,400,000 shares of common stock.

Macatawa Bank Corporation common stock is listed on the Nasdaq SmallCap Market under the symbol "MCBC." On May , 2001, the last reported sale price of our shares as reported on the Nasdaq SmallCap Market was \$ per share. We have applied for listing on the Nasdaq National Market System.

Investing in our common stock involves risks that are described in the "Risk Factors" section beginning on page of this prospectus.

PRICE \$ PER SHARE

| | Per Share | Total |
|--|-----------|-------|
| | ----- | ----- |
| Public offering price..... | \$ | \$ |
| Underwriting discount..... | \$ | \$ |
| Proceeds, before expenses, to Macatawa Bank Corporation..... | \$ | \$ |

The underwriters may also purchase up to an additional 210,000 shares from Macatawa Bank Corporation at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus to cover over-allotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The shares of common stock will be ready for delivery on or about , 2001.

Dain Rauscher Wessels

Incorporated

Stifel, Nicolaus & Company

, 2001

ABOUT THIS PROSPECTUS

You should rely only on the information provided or incorporated by reference in this prospectus. We are not making an offer to sell our common stock in any state where an offer to sell our common stock is not permitted. The information in this prospectus is accurate only as of the date of this prospectus.

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FORWARD-LOOKING STATEMENTS

This prospectus includes "forward-looking statements" as that term is used in the securities laws. All statements regarding our expected financial position, business and strategies are forward-looking statements. In addition, the words "anticipates," "believes," "estimates," "seeks," "expects," "plans," "intends," and similar expressions, as they relate to us or our management, are intended to identify forward-looking statements. Although we believe that the expectations reflected in these forward-looking statements are reasonable, and have based these expectations on our beliefs as well as assumptions we have made, these expectations may prove to be incorrect. Important factors that could cause actual results to differ materially from our expectations include, without limitation, factors like the failure of a significant number of borrowers to repay their loans, general changes in economic conditions and interest rates, and restrictions imposed on us by regulations or regulators of the banking industry. For information about factors that could cause our actual results to differ from the expectations stated in the forward-looking statements, see the text under the captions "Risk Factors," "Business," and "Management Discussion and Analysis of Financial Conditions and Results of

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Operations." We urge you to consider these factors carefully in evaluating the forward-looking statements contained in this prospectus. All subsequent written or oral forward-looking statements attributable to us or persons acting in our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements included in this prospectus are made only as of the date of this prospectus. We do not intend, and undertake no obligation, to update these forward-looking statements. Further information concerning us and our business, including additional factors that could materially affect our financial results, is included in our filings with the Securities and Exchange Commission.

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PROSPECTUS SUMMARY

You should read the following summary together with the more detailed information and consolidated financial statements appearing elsewhere in this prospectus. Unless otherwise noted, all information in this prospectus assumes that the underwriters do not exercise the option to purchase additional shares from us in the offering. All information in this prospectus reflects the 3% stock dividend distributed to our shareholders on May 4, 2001. In addition, unless the text clearly suggests otherwise, references in this prospectus to "us," "we," "our," or "the company" include Macatawa Bank Corporation and its wholly-owned subsidiary Macatawa Bank.

This prospectus contains forward-looking statements. The outcome of the events described in these forward-looking statements is subject to risks and actual results could differ materially. The sections entitled "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Business" contain a discussion of some of the factors that could contribute to those differences.

Macatawa Bank Corporation

We are a bank holding company headquartered in Holland, Michigan and own Macatawa Bank. Our bank provides a wide range of commercial and consumer banking services through 13 full service branches located in Ottawa County, northern Allegan County and southwestern Kent County, Michigan. We offer commercial and personal banking services, including checking and savings accounts, certificates of deposit, safe deposit boxes, travelers' checks, money orders, trust services and commercial, mortgage and consumer loans. Since our formation in November 1997, we have grown very rapidly while maintaining excellent asset quality and attaining and improving profitability. We became profitable in 1999 with net income of \$693 thousand. Our net income increased to \$3.3 million in 2000. In the first quarter of 2001, we earned \$1.1 million as compared to \$527 thousand in the first quarter of 2000. At March 31, 2001, we had total assets of \$528.3 million, total deposits of \$418.7 million, total loans of \$438.5 million, and shareholders' equity of \$39.3 million.

The following table summarizes our growth from the start of our operations:

| | At March 31, 2001 | ----- 2000 | At December 31, ----- | | |
|-------------|----------------------|---------------|--------------------------|-----------|----------|
| | (unaudited) | | 1999 | 1998 | 1997 |
| | | | (Dollars in thousands) | | |
| Assets..... | \$528,257 | \$499,813 | \$344,921 | \$189,229 | \$10,722 |
| Loans..... | \$438,455 | \$410,676 | \$285,374 | \$137,882 | \$ 498 |

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| | | | | | |
|---------------------------|-----------|-----------|-----------|-----------|----------|
| Deposits..... | \$418,712 | \$398,617 | \$279,370 | \$166,989 | \$ 2,712 |
| Borrowed Funds..... | \$ 66,588 | \$ 61,200 | \$ 30,000 | \$ 2,000 | \$ 0 |
| Shareholders' equity..... | \$ 39,335 | \$ 38,128 | \$ 34,526 | \$ 19,611 | \$ 7,972 |
| Deposit Accounts(1)..... | 41,773 | 38,129 | 26,622 | 14,340 | 471 |
| Branch Locations(1)..... | 13 | 13 | 13 | 8 | 1 |

(1) Unaudited

We have achieved this rapid growth by opening de novo branches, hiring experienced bankers with existing customer relationships in our local market, providing outstanding customer service and capitalizing on customer dissatisfaction resulting from bank acquisitions in our markets.

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Strategy

Our goal is to continue to build a highly profitable, customer-focused banking organization that generates attractive returns for our shareholders while also being a positive contributor to the communities in which we operate. Our strategy for achieving this objective includes:

- . Building Our Retail and Commercial Deposit Base Through an Expanding Branch Network. Through our 13 full-service branches, we actively solicit retail and commercial customers and compete for deposits by offering personal attention, professional service and competitive interest rates. We also emphasize our local management and their strong ties with, and active commitment to, the community. In the first quarter of 2001, we opened over 3,600 net new deposit accounts, an increase of 9.6% over the number of deposit accounts at December 31, 2000. To facilitate the continued growth of our deposit base, we expect to open at least two new branches per year for the next several years in Grand Rapids or other areas of western Michigan. This expansion will enable us to serve adjacent geographic markets, and will make banking with us more convenient for existing and future customers.
- . Focusing on Commercial and Commercial Real Estate Lending. While we offer a full range of consumer loan products, our primary lending focus will continue to be commercial loans and commercial real estate loans to small to medium-sized businesses. We believe that commercial customers prefer to conduct business with financial institutions like ours which demonstrate an active interest in their business and personal financial affairs, offer local decision-making by experienced loan officers, and offer a sophisticated product portfolio to meet their banking needs. At March 31, 2001, commercial loans comprised 53.2% of our loan portfolio and commercial real estate loans accounted for 19.3% of our loan portfolio.
- . Hiring Experienced Employees With a Customer Service Focus. We are a customer-driven financial institution, and our ability to continue to attract and retain employees who share our customer service focus is key to our success. We believe that our ability to deliver products and services in a highly personalized manner helps differentiate us from larger, regional banks operating in our market areas. In addition, throughout our organization we emphasize the recruitment of banking professionals with significant experience in, and knowledge of, our markets. We believe this emphasis both facilitates our growth and partially mitigates the credit risks associated with our rapidly growing loan portfolio.

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- . Expanding our Product Offerings to Leverage Customer Relationships. A key component of our strategy is to continue to add new products and services in order to expand our customer relationships, diversify our revenue base and increase our noninterest income. For example, we began operating a trust department in January 1999, and started to offer internet banking services in the fourth quarter of 1999. While our trust department currently operates at a break-even or slightly negative net income level, we believe that our trust department will contribute to our net income as our trust business matures. We are also investigating the possibility of offering our customers additional products in the future including investment brokerage services, title insurance, casualty and life insurance, mutual funds and annuities.
- . Capitalizing on Opportunities Resulting From Consolidation in our Markets. At the time of our formation in 1997, the largest bank in Ottawa County had recently been acquired by an out-of-state regional banking organization. This transaction and the ensuing employee and

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customer disruptions resulted in many opportunities for us to attract experienced personnel and establish relationships with customers wishing to conduct business with a locally-managed institution with strong ties to the community. The consolidation and disruption in our markets has continued. In August 2000, Ottawa Financial, the parent of a thrift headquartered in Holland with \$1.0 billion in assets, and more recently, Old Kent Financial, a bank holding company with the leading market share in both the Holland/Zeeland and Grand Rapids markets, were acquired by an out-of-state bank holding company. We intend to position ourselves to capitalize on any business opportunities that may result from customer dislocation associated with these transactions.

- . Using Technology Effectively. We strive to use technology to increase the effectiveness and efficiency of our employees, while also providing expanded products and services to our customers. For example, we have entered into agreements with third-party service providers to provide our customers with credit cards, debit cards, ATM cards, automated telephone banking and internet banking services. In addition, in the second quarter of 2001, we expect to implement a new customer information system, which will enable us to target our marketing initiatives more effectively and help us cross-sell additional products. In general, we believe that using third-party service providers allows us to remain at the forefront of technology while minimizing the costs of delivery.

A Description of Our Market Area

Our market area includes the cities of Holland and Zeeland and their surrounding communities, as well as the Interstate I-196 corridor from Holland to metropolitan Grand Rapids. Most of our market area is located in the southern half of Ottawa County, Michigan. The Holland/Zeeland metropolitan area has a population of approximately 150,000, and Ottawa County has a population of approximately 238,000. The Holland/Zeeland area enjoys a stable and diverse economy and had an estimated median household income in 1999 of approximately \$51,000. Over 300 manufacturers operate in the Holland/Zeeland area, including major manufacturers in the office furniture industry as well as significant Tier 1 automotive parts manufacturers. Major Ottawa County employers include Donnelly Corporation, Herman Miller, Inc., Haworth, Inc., Gentex, Inc., and Johnson Controls. We believe that our market area's diverse commercial base provides significant opportunities for business banking services as well as

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personal banking services for the owners and employees of the area's businesses.

Our future plans for growth include further expansion into the metropolitan Grand Rapids area. Currently we have two branches operating in the southwestern portion of metropolitan Grand Rapids, with a third scheduled to open in the summer of 2001. Grand Rapids, which is located in Kent County, has a population of approximately 198,000, the metropolitan Grand Rapids area has a population of approximately 467,000, and Kent County has a population of approximately 550,000. In 1999, Grand Rapids had an estimated median household income of approximately \$50,000. Over 1,200 manufacturers operate in Kent County. Major Kent County employers include Alticor (formerly known as Amway Corporation), Steelcase, Wolverine World Wide, and Meijer, Inc.

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About Us

Macatawa Bank was organized as a Michigan bank and opened for business on November 25, 1997. We have 13 full service branch offices, a trust office, a lending administration office, and an operations center. We are presently constructing an additional branch in the southwestern portion of the Grand Rapids metropolitan area, and expect it to open in the summer of 2001. We have also secured a site for the relocation of our Hudsonville branch into a new full service facility and are planning a new branch in north Holland. Construction of a new corporate headquarters building to be located between Holland and Zeeland is also being planned. The proposed new headquarters will allow us to consolidate our administration, human resources, trust, loan underwriting and processing, and proof and deposit operations at one location. Our bank's deposit accounts are insured by the Federal Deposit Insurance Corporation to the extent permitted by law. Our administrative office is located at 348 South Waverly Road, Holland, Michigan 49423, and our telephone number is (616) 820-1444.

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The Offering

Common stock offered by
Macatawa Bank
Corporation..... 1,400,000 shares

Offering price per
share..... \$ per share

Common stock to be
outstanding after this
offering..... 5,096,789 shares(1)

Use of proceeds..... We will use the net proceeds from this offering to strengthen our capital position in anticipation of future growth, to repay \$4.0 million of indebtedness and for other general corporate purposes. After repaying the \$4.0 million of indebtedness, we will immediately contribute approximately \$3.0 million to Macatawa Bank to strengthen its capital position. The remaining net proceeds will be available for general corporate purposes, including additional

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contributions to Macatawa Bank's capital.

Risk factors..... See "Risk Factors" beginning on page 7 and other information included in this prospectus for a discussion of factors you should consider carefully before deciding to invest in our common stock.

Nasdaq SmallCap Market MCBC. We have applied for listing on the Nasdaq
Symbol..... National Market System.

(1) The number of shares outstanding after this offering excludes 167,787 shares issuable upon the exercise of outstanding options and 78,641 shares reserved for future issuance under our stock option and purchase plans. This number also assumes that the underwriters' over-allotment option is not exercised. If the over-allotment option is exercised in full, we will issue and sell an additional 210,000 shares.

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SELECTED CONSOLIDATED FINANCIAL DATA

The following summary presents our selected consolidated financial data for the years ended December 31, 2000, 1999 and 1998. The balance sheet and income statement data has been derived from our audited consolidated financial statements. The following summary also presents our selected consolidated financial data at or for the three months ended March 31, 2001 and 2000. The balance sheet and income statement data has been derived from our unaudited consolidated quarterly financial statements which, in our opinion, include all adjustments (consisting of only normal, recurring adjustments) considered necessary for a fair presentation. The selected consolidated financial data should be read in conjunction with our consolidated financial statements and the related notes. The selected consolidated financial data at or for the three months ended March 31, 2001 is not necessarily indicative of our operating results for the entire year.

| | At or for the three months ended March 31, | | At or for the Year ended December 31, | | |
|--|--|----------|--|-----------|----------|
| | 2001 | 2000 | 2000 | 1999 | 1998 |
| (Dollars in thousands, except per share amounts) | | | | | |
| Income Statement | | | | | |
| Summary: | | | | | |
| Net interest income..... | \$ 4,831 | \$ 3,537 | \$ 16,599 | \$ 10,572 | \$ 3,614 |
| Provision for loan losses..... | 522 | 487 | 1,931 | 1,967 | 2,023 |
| | | | | | |
| Net interest income after provision..... | 4,309 | 3,050 | 14,688 | 8,605 | 1,591 |
| Noninterest income..... | 828 | 406 | 2,052 | 1,528 | 683 |
| Noninterest expense..... | 3,500 | 2,929 | 12,672 | 9,440 | 4,763 |
| | | | | | |
| Income (loss) before taxes..... | 1,637 | 527 | 4,048 | 693 | (2,489) |
| Income tax expense..... | 546 | 0 | 699 | 0 | 0 |
| | | | | | |

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| | | | | | |
|---|------------|------------|------------|------------|------------|
| Net income (loss)..... | \$ 1,091 | \$ 527 | \$ 3,349 | \$ 693 | \$ (2,489) |
| | ===== | ===== | ===== | ===== | ===== |
| Common Share Summary: | | | | | |
| Diluted earnings (loss) per share..... | \$.29 | \$.14 | \$.90 | \$.22 | (1.18) |
| Dividends per share..... | .07 | 0 | .07 | 0 | 0 |
| Book value per share.... | 10.64 | 9.47 | 10.31 | 9.34 | 7.82 |
| Weighted average diluted shares outstanding.... | 3,720,050 | 3,717,466 | 3,711,051 | 3,216,625 | 2,103,178 |
| Balance Sheet Summary: | | | | | |
| Total assets..... | \$ 528,257 | \$ 392,709 | \$ 499,813 | \$ 344,921 | \$ 189,229 |
| Total loans..... | 438,455 | 325,953 | 410,676 | 285,374 | 137,882 |
| Securities..... | 51,818 | 29,582 | 48,669 | 28,281 | 27,007 |
| Noninterest-bearing | | | | | |
| deposits..... | 45,498 | 36,191 | 50,746 | 34,385 | 18,518 |
| Total deposits..... | 418,712 | 321,585 | 398,617 | 279,390 | 166,989 |
| Borrowed funds..... | 66,588 | 35,000 | 61,200 | 30,000 | 2,000 |
| Shareholders' equity.... | 39,335 | 35,002 | 38,128 | 34,526 | 19,611 |
| Capital Ratios: | | | | | |
| Total risk-based capital ratio..... | 9.9% | 12.2% | 10.4% | 14.0% | 12.4% |
| Tier 1 risk-based | | | | | |
| capital ratio..... | 8.7% | 10.9% | 9.1% | 12.7% | 11.3% |
| Tier 1 leverage ratio... | 7.7% | 9.8% | 8.2% | 10.8% | 11.8% |
| Shareholders' equity to assets..... | 7.4% | 8.9% | 7.6% | 10.0% | 10.4% |
| Selected Asset Quality Data: | | | | | |
| Nonperforming loans to total loans..... | .01% | .04% | .05% | .04% | .00% |
| Nonperforming assets to total assets..... | .02% | .03% | .04% | .03% | .00% |
| Allowance for loan losses as a percentage of total loans..... | | | | | |
| | 1.42% | 1.38% | 1.43% | 1.40% | 1.47% |
| Net charge-offs to average loans..... | | | | | |
| | .03% | .00% | .02% | .00% | .00% |
| Selected Financial Ratios: | | | | | |
| Return on average assets(1)..... | .86% | .58% | .80% | .26% | (2.91)% |
| Return on average shareholders' equity(1)..... | 10.27% | 6.23% | 9.31% | 2.43% | (15.15)% |
| Efficiency ratio(2).... | 61.85% | 74.28% | 67.94% | 78.02% | 110.84% |
| Net interest margin(1).. | 4.03% | 4.15% | 4.28% | 4.37% | 4.21% |

(1) Annualized for the three month periods ended March 31, 2001 and 2000.

(2) Noninterest expense divided by the sum of net interest income plus noninterest income.

RISK FACTORS

You should carefully consider the following risk factors before you decide to buy our common stock. You should also consider other information in this prospectus, as well as in other documents incorporated by reference.

Changes in economic conditions or interest rates may negatively affect our

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earnings, capital and liquidity.

The results of operations for financial institutions, including our bank, may be materially and adversely affected by changes in prevailing local and national economic conditions, including declines in real estate market values, rapid increases or decreases in interest rates and changes in the monetary and fiscal policies of the federal government. Our profitability is heavily influenced by the spread between the interest rates we earn on investments and loans and the interest rates we pay on deposits and other interest-bearing liabilities. Substantially all our loans are to businesses and individuals in western Michigan and any decline in the economy of this area could adversely affect us. Like most banking institutions, our net interest spread and margin will be affected by general economic conditions and other factors that influence market interest rates and our ability to respond to changes in these rates. At any given time, our assets and liabilities will be such that they are affected differently by a given change in interest rates. We are modestly asset sensitive at the current time. This means that the recent actions of the Open Market Committee of the Federal Reserve Board decreasing interbank interest rates will likely adversely affect our net interest income and earnings over the near term.

Our credit losses could increase and our allowance for loan losses may not be adequate to cover actual loan losses.

The risk of nonpayment of loans is inherent in all lending activities, and nonpayment, if it occurs, may have a materially adverse effect on our earnings and overall financial condition as well as the value of our common stock. Moreover, our focus on commercial lending may result in a larger concentration of loans to small businesses. As a result, we may assume greater lending risks than other banks. Additionally, we have made our loans recently, so there is no significant repayment history against which we can fully assess the adequacy of the allowance for loan losses. We make various assumptions and judgements about the collectibility of our loan portfolio and provide an allowance for potential losses based on a number of factors. If our assumptions are wrong, our allowance for loan losses may not be sufficient to cover our losses, thereby having an adverse affect on our operating results. In addition, while we have not experienced any significant charge-offs or had large numbers of nonperforming loans, due to the significant increase in loans originated since we commenced operations, we cannot assure you that we will not experience an increase in delinquencies and losses as these loans continue to mature. The actual amount of future provisions for loan losses cannot be determined at this time and may exceed the amounts of past provisions. Additions to our allowance for loan losses would decrease our net income.

Our business is subject to various lending risks depending on the nature of the borrower's business, its cash flow and our collateral.

Repayment of our commercial loans is often dependent on cash flow of the borrower, which may be unpredictable, and collateral securing these loans may fluctuate in value. Our commercial loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral is accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of

these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. Commercial loans (excluding agricultural

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loans) were \$192.7 million, or 43.9% of our total loan portfolio, at March 31, 2001.

Our commercial real estate loans involve higher principal amounts than other loans, and repayment of these loans may be dependent on factors outside our control or the control of our borrowers. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Because payments on loans secured by commercial real estate often depend upon the successful operating and management of the properties, repayment of these loans may be affected by factors outside the borrower's control, including adverse conditions in the real estate market or the economy or changes in government regulation. If the cash flow from the project is reduced, the borrower's ability to repay the loan and the value of the security for the loan may be impaired. At March 31, 2001, commercial real estate loans totaled \$84.7 million, or 19.3% of our total loan portfolio.

Our construction loans are based upon estimates of costs to construct and value associated with the completed project, and these estimates may be inaccurate. At March 31, 2001, total construction loans, including land acquisition and development, totaled \$37.4 million, or 8.5% of our total loan portfolio. Residential construction loans were \$30.7 million, of which approximately \$26.6 million were pre-sold and \$4.1 million were for future sale to unidentified buyers. Commercial construction loans comprised \$6.7 million of the total portfolio, of which 100% were pre-leased. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. Delays in completing the project may arise from labor problems, material shortages and other unpredictable contingencies. If the estimate of the cost of construction is inaccurate, we may be required to advance additional funds to complete construction. If our appraisal of the value of the completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of the project.

Our consumer loans generally have a higher risk of default than our other loans. Our consumer loans include personal loans and lines of credit available to individuals for various purposes including the purchase of automobiles, boats, other recreational vehicles, home improvements and personal investments. Consumer loans entail greater risk than our other loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans. Consumer loans, including installment, home equity, and unsecured lines of credit, were \$58.0 million, or 13.2% of our loan portfolio, at March 31, 2001.

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Our agricultural loans involve a high degree of risk, and the ability of the borrower to repay may be affected by many factors outside of the borrower's control. At March 31, 2001, agricultural loans totaled \$40.7 million, or 9.3% of our total loan portfolio. At that date, the agricultural portfolio was made up of loans to greenhouse operations totaling \$17.3 million, loans to poultry producers totaling \$9.5 million and loans to dairy operations of \$4.4 million, with the balance of \$9.5 million diversified over a wide range of agricultural businesses, including hog, cattle and cash crop production. Payments on agricultural loans are dependent on the profitable operation or management of the agribusiness. The success of the business may be affected by many factors outside the control of the agribusinessperson, including adverse weather conditions that prevent the planting of a crop or limit crop yields (like hail, drought, and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies and environmental regulations). An occurrence of any of these could affect the ability of the borrower to repay their loan indebtedness or cause a rapid decrease in the value of the collateral securing that indebtedness, and have an adverse effect on our profitability.

We may experience difficulties in managing our growth.

While our rate of growth, in percentage terms, is expected to decline as compared to historical levels, we intend to continue to pursue a growth strategy. To sustain our continued growth, we may require additional funding to support increased lending activities. Customer deposits are our principal source of funds. As part of our strategy to increase our deposits and loan growth, we intend to expand into additional communities and seek to strengthen our position in our current markets by opening additional branch offices. While we have achieved operational profitability at a few of our new branches in 6 months, we normally expect to achieve operational profitability at a new facility in 18 to 24 months. This period of initial unprofitability is due to the impact of relatively fixed overhead expenses and the lag time associated with generating loans and deposits. To the extent that we undertake growth initiatives, we are likely to continue to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse affect on our levels of net income, return on average equity and return on average assets.

In addition, we may acquire banks, related businesses or branches of other banks that we believe provide a strategic fit with our business. To the extent that we grow through acquisitions, we cannot assure you that we will be able to adequately or profitably manage this growth. Acquiring other banks, businesses, or branches involves risks commonly associated with acquisitions, including:

- . potential exposure to unknown or contingent liabilities of banks, businesses, or branches we acquire;
- . exposure to potential asset quality issues of the acquired banks, businesses, or branches;
- . difficulty and expense of integrating the operations and personnel of banks, businesses, or branches we acquire;
- . potential disruption to our business;
- . potential diversion of our management's time and attention;
- . the possible loss of key employees and customers of the banks, businesses, or branches we acquire; and

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- . the need for financial reporting purposes to record and amortize core deposit premiums and/or goodwill.

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We rely heavily on our management and other key personnel, and the loss of any of them may adversely affect our operations.

We are and will continue to be dependent upon the services of our management team, including our Chairman and Chief Executive Officer, the President and Chief Executive Officer of Macatawa Bank, and our other senior managers. Losing one or more key members of the management team could adversely affect our operations. We do not maintain key man life insurance on any of our officers or directors.

Our future success is dependent on our ability to compete effectively in the highly competitive banking industry.

We face substantial competition in all phases of our operations from a variety of different competitors. Our future growth and success will depend on our ability to compete effectively in this highly competitive environment. We compete for deposits, loans and other financial services with numerous Michigan-based and out-of-state banks, thrifts, credit unions and other financial institutions as well as other entities that provide financial services. Some of the financial institutions and financial service organizations with which we compete are not subject to the same degree of regulation as we are. Most of our competitors have been in business for many years, have established customer bases, are larger, have substantially higher lending limits than we do and offer other services which we do not, including brokerage, insurance, mutual funds and international banking services. The primary competitors in our market area are Fifth Third Bancorp, Huntington Bancshares, National City Corp., Chemical Financial Corporation, and Bank of Holland. Under the Gramm-Leach-Bliley Act of 1999, effective March 11, 2000, securities firms and insurance companies that elect to become financial holding companies may acquire banks and other financial institutions. The Gramm-Leach-Bliley Act may significantly change the competitive environment in which we conduct business. The financial services industry is also likely to become more competitive as further technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

We are subject to significant government regulation, and any regulatory changes may adversely affect us.

The banking industry is heavily regulated under both federal and state law. These regulations are primarily intended to protect customers, not our creditors or shareholders. As a bank holding company, we are also subject to extensive regulation by the Federal Reserve Board, in addition to other regulatory and self-regulatory organizations. Our ability to establish new facilities or make acquisitions is conditioned upon the receipt of the required regulatory approvals from these organizations. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of these changes, which could have a material adverse effect on our profitability or financial condition.

We continually encounter technological change, and we may have fewer resources than our competitors to continue to invest in technological improvements.

The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to

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better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as creating additional

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efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. There can be no assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

Our articles of incorporation and by-laws and the laws of Michigan contain provisions that could make a takeover more difficult.

Our articles of incorporation and by-laws, and the laws of Michigan, include provisions which are designed to provide our board of directors with time to consider whether a hostile takeover offer is in our company's best interest and the best interests of our shareholders. These provisions, however, could discourage potential acquisition proposals and could delay or prevent a change in control. The provisions also could diminish the opportunities for a holder of our common stock to participate in tender offers, including tender offers at a price above the then-current price for our common stock. These provisions could also prevent transactions in which our shareholders might otherwise receive a premium for their shares over then-current market prices, and may limit the ability of our shareholders to approve transactions that they may deem to be in their best interests.

The Michigan Business Corporation Act contains provisions intended to protect shareholders and prohibit or discourage various types of hostile takeover activities. In addition to these provisions and the provisions of our articles of incorporation and by-laws, federal law requires the Federal Reserve Board's approval prior to acquisition of "control" of a bank holding company. All of these provisions may have the effect of delaying or preventing a change in control at the company level without action by our shareholders, and could adversely affect the price of our common stock.

We may not be able to continue to pay dividends on our common stock.

We are a holding company and substantially all of our assets are held by our bank. Our ability to continue to make dividend payments to our shareholders will depend primarily on available cash resources at the holding company level and dividends from our bank. Dividend payments or extensions of credit from our bank are subject to regulatory limitations, generally based on capital levels and current and retained earnings, imposed by regulatory agencies with authority over our bank. The ability of our bank to pay dividends is also subject to its profitability, financial condition, capital expenditures and other cash flow requirements. We cannot assure you that our bank will be able to pay dividends to us in the future.

There is a limited trading market for our common stock.

The price of our shares of common stock subject to this offering may be greater than the market price for our common stock following the offering. Our common stock is reported on the Nasdaq SmallCap Market under the symbol "MCBC." We have filed an application with Nasdaq for listing on the Nasdaq National Market System. The development and maintenance of an active public trading market depends, however, upon the existence of willing buyers and sellers, the presence of which is beyond our control or the control of any market maker.

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While we are a publicly-traded company, the volume of trading activity in our stock is still relatively limited. Even if a more active market develops, there can be no assurance that such a market will continue, or that our shareholders will be able to sell their shares at or above the offering price.

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USE OF PROCEEDS

We estimate that we will receive net proceeds of approximately \$ million from the sale of 1,400,000 shares of our common stock in this offering, at an assumed public offering price of \$ per share and after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us. If the underwriters' over-allotment option is exercised in full, we estimate that our net proceeds will be approximately \$ million.

We will use the net proceeds from this offering to strengthen our capital position in anticipation of future growth, to repay \$4.0 million of indebtedness, and for other general corporate purposes. After repaying \$4.0 million of indebtedness, we will immediately contribute approximately \$3.0 million of the net proceeds to Macatawa Bank to strengthen Macatawa Bank's capital position. The remainder of the net proceeds will be deposited in our account at Macatawa Bank, and will be available for contribution to our bank's capital from time to time as needed and for general corporate purposes.

We have an \$8.0 million credit facility with a correspondent commercial bank that will expire on September 26, 2001. At March 31, 2001, we had \$4.0 million outstanding under this credit facility. The weighted average cost of the outstanding balance drawn on this credit facility was 6.9% at March 31, 2001. We intend to pay off our outstanding balance under this credit facility out of the net proceeds of this offering.

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CAPITALIZATION

The following table sets forth our unaudited total deposits, indebtedness and capitalization at March 31, 2001, and as adjusted to reflect the issuance and sale of 1,400,000 shares at an assumed offering price of \$ per share and the application of the net proceeds. The following table has also been adjusted for the 3% stock dividend distributed May 4, 2001. This information should be read in conjunction with our consolidated financial statements and the related notes.

| | March 31, 2001 | |
|-----------------------------------|------------------------|-------------|
| | Actual | As Adjusted |
| | (Dollars in thousands) | |
| Deposits: | | |
| Noninterest-bearing deposits..... | \$ 45,498 | \$ 45,498 |
| Interest-bearing deposits..... | 373,214 | 373,214 |
| | ----- | ----- |
| Total deposits..... | \$418,712 | \$418,712 |

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| | | |
|--|-----------|-----------|
| | ===== | ===== |
| Indebtedness: | | |
| Long-term and short-term debt..... | \$ 4,000 | \$ -0- |
| Advances from the Federal Home Loan Bank..... | 62,588 | 62,588 |
| | ----- | ----- |
| Total indebtedness..... | \$ 66,588 | \$ 62,588 |
| | ===== | ===== |
| Shareholders' equity: | | |
| Preferred stock, no par value, 500,000 shares authorized, no shares issued and outstanding..... | \$ -0- | \$ -0- |
| Common stock, no par value, 9,500,000 shares authorized, 3,696,789 shares issued and outstanding, 5,096,789 shares as adjusted(1)..... | 38,653 | |
| Retained earnings..... | 211 | 211 |
| Accumulated other comprehensive income, net of income tax..... | 471 | 471 |
| | ----- | ----- |
| Total shareholders' equity..... | \$ 39,335 | \$ |
| | ===== | ===== |
| Total deposits, indebtedness and shareholders' equity..... | \$524,635 | \$ |
| | ===== | ===== |
| Company regulatory capital ratios: | | |
| Total capital to risk-weighted assets..... | 9.9% | % |
| Tier 1 capital to risk-weighted assets..... | 8.7% | % |
| Tier 1 leverage ratio..... | 7.7% | % |
| Bank regulatory capital ratios:(2) | | |
| Total capital to risk-weighted assets..... | 10.7% | 11.4% |
| Tier 1 capital to risk-weighted assets..... | 9.5% | 10.1% |
| Tier 1 leverage ratio..... | 8.3% | 8.9% |

-
- (1) The number of shares outstanding after the offering excludes 167,787 shares issuable upon the exercise of outstanding options and 78,641 shares reserved for future issuance under our stock option and purchase plans. See "Management--Executive Compensation." This number also assumes that the underwriters' over-allotment option is not exercised. If the over-allotment is exercised in full, we will issue and sell an additional 210,000 shares.
- (2) The as adjusted column assumes the contribution of \$3.0 million of the net proceeds of the offering to the bank.

DILUTION

The net tangible book value of our common stock at March 31, 2001 was \$39.3 million, or \$10.64 per share. After giving effect to this offering at an assumed price of \$ per share, the net tangible book value of our common stock at March 31, 2001 would have been \$ million, or \$ per share. This represents an immediate dilution to investors of \$ per share, as illustrated by the following table:

| | |
|---|----|
| Offering price per share..... | \$ |
| Net tangible book value per share of common stock at March 31, 2001.... | \$ |
| Increase per share of common stock attributable to new investors..... | |
| Pro forma net tangible book value per share of common stock after the offering(1)..... | |
| Dilution per share of common stock to new investors(1)..... | \$ |

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(1) The number of shares outstanding after the offering excludes 167,787 shares issuable upon the exercise of outstanding options and 78,641 shares reserved for future issuance under our stock option and purchase plans. See "Management--Executive Compensation." This number also assumes that the underwriters' over-allotment option is not exercised. If the over-allotment is exercised in full, we will issue and sell an additional 210,000 shares.

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MARKET FOR COMMON STOCK

Our common stock has been quoted on the Nasdaq SmallCap Market since December 27, 1999. From the completion of our initial public offering in April 1998 through December 27, 1999, our common stock was quoted on the OTC Bulletin Board. High and low bid prices (as reported on the OTC Bulletin Board) and high and low sales prices (as reported on the Nasdaq SmallCap Market) for each quarter are included in the following table. The following table reflects an adjustment to our historical share data for the 3% stock dividend we distributed on May 4, 2001.

| | High | Low |
|--|---------|---------|
| | ----- | ----- |
| 1998 | | |
| Second quarter..... | \$14.81 | \$14.08 |
| Third quarter..... | 16.02 | 13.59 |
| Fourth quarter..... | 16.99 | 14.56 |
| 1999 | | |
| First quarter..... | \$16.50 | \$14.32 |
| Second quarter..... | 15.05 | 13.11 |
| Third quarter..... | 15.05 | 13.59 |
| Fourth quarter..... | 15.53 | 12.62 |
| 2000 | | |
| First quarter..... | \$15.05 | \$12.75 |
| Second quarter..... | 13.47 | 11.17 |
| Third quarter..... | 12.86 | 10.32 |
| Fourth quarter..... | 13.59 | 10.68 |
| 2001 | | |
| First quarter..... | \$14.56 | \$12.99 |
| Second quarter (through May , 2001)..... | | |

These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions. The quotations do not include intra-day highs or lows. At May , 2001, the closing sales price of our common stock was \$.

At March 31, 2001, we had approximately 2,600 shareholders, consisting of approximately 650 owners of record and approximately 1,950 beneficial owners of our common stock.

DIVIDEND POLICY

We declared our first cash dividend during the fourth quarter of 2000. The dividend amount was \$.07 per share and was paid December 29, 2000. We paid a second cash dividend of \$.07 per share on March 29, 2001. On May 4, 2001, we distributed a 3% stock dividend to our shareholders.

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We intend to continue to declare quarterly cash dividends in the future. We may also consider declaring stock dividends on an annual basis. We are expecting to obtain the funds for the payment of future cash dividends from the dividends we receive from Macatawa Bank out of its earnings. However, there can be no assurance that we will have the financial resources to continue to pay dividends in the future.

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

Overview

We are a Michigan corporation and are the bank holding company for Macatawa Bank. Macatawa Bank commenced operations on November 25, 1997. We provide a full range of commercial and consumer banking services, as well as trust services through a network of 13 full service branches located in communities in Ottawa County, northern Allegan County and southwestern Kent County, Michigan.

While maintaining asset quality and improving profitability, we have experienced rapid and substantial growth since opening in November 1997. Assets have grown from \$189.2 million at year end 1998, to \$528.3 million at March 31, 2001. We first became profitable in 1999 with net income for that year of \$693 thousand. Net income increased to \$3.3 million for 2000 and our net income for the first quarter of 2001 was \$1.1 million as compared with \$527 thousand for the first quarter of 2000. We became fully taxable for federal and state taxes in August 2000. At December 31, 2000, we had 13 branch banking offices and 3 service facilities. We completed an underwritten initial public offering of our common stock in April 1998, resulting in net proceeds of \$14.1 million. Prior to that offering, we raised \$8.2 million in a private offering for the initial capitalization of our bank. In June 1999, we completed an offering of common stock to our shareholders resulting in net proceeds of \$14.6 million.

Financial Condition

Summary. Our total assets increased to \$528.3 million at March 31, 2001 from \$499.8 million at December 31, 2000 and \$344.9 million at December 31, 1999. This was an increase of \$154.9 million or 44.9% for the year 2000 and an increase of \$28.5 million or 5.7% for the first quarter of 2001. We believe the strong asset growth reflects the acceptance of our community banking philosophy in the growing communities we serve. Our asset growth consists primarily of growth in our loan portfolio as we continue to attract new loan customers despite the strong competition from other locally based community banks and larger regional banks. We anticipate continued growth in total assets, due to our ability to capture additional market share, continued economic growth in our market area and, in part, due to the consolidation of our local competitors into large out-of-state regional banks.

Strong deposit growth principally funded our increased total assets. Our total deposits grew to \$418.7 million at March 31, 2001 from \$398.6 million at December 31, 2000 and \$279.4 million at December 31, 1999. This was an increase of \$119.2 million or 42.7% for the year 2000 and an increase of \$20.1 million or 5.0% for the first quarter of 2001. We attribute the strong deposit growth to our quality customer service, the desire of our customers to bank with a local bank, and convenient accessibility through the expansion of our branch network. As we continue to grow, we expect our percentage rate of growth to decline.

Cash and Cash Equivalents. Our cash and cash equivalents, which include

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federal funds sold and short-term investments, were \$23.5 million at March 31, 2001, \$26.3 million at December 31, 2000 and \$20.6 million at December 31, 1999. The increase during 2000, as compared to 1999, was due to higher levels of customer deposit activity at year end. The decrease during the first quarter of 2001 reflected our return to more normal levels of cash and cash equivalents.

Securities. All of the securities we purchase are classified as "available for sale" and may be sold to meet our liquidity needs. The primary objective of our investing activities is to provide for the safety of the principal invested. Our secondary considerations include increased earnings, increased liquidity and

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decreased overall exposure to changes in interest rates. Our securities available for sale increased to \$51.8 million at March 31, 2001 from \$48.7 million at December 31, 2000 and from \$28.3 million at December 31, 1999. This was an increase of \$20.4 million or 72.1% during the year 2000 and an increase of \$3.1 million or 6.4% during the first quarter of 2001. The increase was the result of purchasing additional securities as a means of strengthening our liquidity ratio. We expect continued growth of our securities portfolio generally consistent with the growth of our company in order to maintain appropriate levels of liquidity. Additionally, we expect securities to increase in the upcoming quarters as we invest the proceeds of this offering, pending their deployment in loans and other earning assets.

The following table sets forth the amount of securities available for sale at the end of each period.

| | At March 31, 2001 | At December 31, ----- 2000 1999 ----- | |
|--|----------------------|---|----------|
| | (In thousands) | | |
| U. S. Treasury and U.S. Government Agencies... | \$45,197 | \$45,991 | \$27,337 |
| Michigan municipal bonds..... | 6,621 | 2,678 | 944 |
| | ----- | ----- | ----- |
| | \$51,818 | \$48,669 | \$28,281 |
| | ===== | ===== | ===== |

Excluding our holdings in the investment portfolio of U.S. Treasury and U.S. Government Agency Securities, we had no investments in securities of any one issuer which exceeded 10% of our shareholders' equity.

The following is a schedule of maturities and the weighted average yield of each category of securities we held at March 31, 2001.

| ----- Maturing ----- | | | |
|----------------------------|----------------------|----------------------|-----------------|
| Due Within One Year | One to Five Years | Five to Ten Years | After Ten Years |
| ----- | ----- | ----- | ----- |
| I | | | |
| C | | | |

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| | Estimated Market Value | Avg. Yield | Estimated Market Value | Avg. Yield | Estimated Market Value | Avg. Yield | Estimated Market Value | Avg. Yield | Estimated Market Value | Avg. Yield |
|--|------------------------------|---------------|------------------------------|---------------|------------------------------|---------------|------------------------------|---------------|------------------------------|---------------|
| (Dollars in thousands) | | | | | | | | | | |
| Available for sale: | | | | | | | | | | |
| U.S. Treasury And U.S. Government Agencies... | \$13,109 | 6.51% | \$28,431 | 6.11% | \$3,657 | 5.40% | \$ 0 | 0% | | |
| Tax-Exempt MI municipal bonds..... | 0 | 0% | 0 | 0% | 1,886 | 4.52% | 4,735 | 4.91% | | |
| Total..... | \$13,109 | 6.51% | \$28,431 | 6.11% | \$5,543 | 5.09% | \$4,735 | 4.91% | | |

Loan Portfolio. Our total loan portfolio increased to \$438.5 million at March 31, 2001 as compared to \$410.7 million at December 31, 2000 and \$285.4 million at December 31, 1999. The majority of loans we make are to small and mid-sized businesses in the form of commercial and commercial real estate loans. Our combined commercial loans totaled \$318.1 million at March 31, 2001, up from \$293.5 million at December 31, 2000 and from \$201.4 million at December 31, 1999. That was an increase of \$92.1 million or 45.7% for 2000 and \$24.6 million or 8.4% for the first quarter of 2001. Our total combined commercial loans accounted for 72.6% of our total loans at March 31, 2001 and for 71.4% of our total loan portfolio at year-end for both 2000 and 1999.

Our commercial loan portfolio comprised 53.2% of our total loan portfolio at March 31, 2001. Our commercial loans totaled \$233.4 million at March 31, 2001, \$214.1 million at December 31, 2000, and \$147.2 million at December 31, 1999.

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Our commercial real estate portfolio comprises approximately 19.3% of our total loan portfolio and includes both loans to businesses for real estate and loans to residential home developers as well. Our commercial real estate loans totaled \$84.7 million at March 31, 2001, \$79.4 million at December 31, 2000, and \$54.2 million at December 31, 1999. Most of the commercial real estate loans we make are on owner-occupied real estate.

Our residential real estate loan portfolio, which also includes residential construction loans made to the individual home owner, comprises 14.2% of our total loans. However, our residential loan origination volume is significantly higher, with only a small portion of the residential home loans retained for our own portfolio. We originated \$46.6 million in residential mortgages in the first quarter of 2001, \$91.5 million for 2000, and \$105.0 million for 1999. The higher overall interest rate levels we experienced during most of 2000 resulted in lower levels of residential refinancing and, as a result, lowered our overall loan originations as compared to 1999. Due to lower interest rates in the first quarter of 2001, residential loan origination volume increased significantly, and we are expecting it to remain higher as long as interest rates remain favorable for mortgage originations.

Our consumer loan portfolio includes both loans secured by personal property, as well as home equity fixed term and line of credit loans. Our home equity loans totaled \$34.0 million at March 31, 2001, \$33.5 million at December 31, 2000, and \$22.1 million at December 31, 1999. Approximately 89.0% of our home equity loans are underwritten with a loan to value ratio of less than 90.0%, and are considered by us to be well collateralized.

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The following table reflects the composition of our loan portfolio and the corresponding percentage of our total loans represented by each class of loans as of the dates indicated.

| | At March 31, | | At December 31, | | | |
|----------------------------------|--------------|------|-----------------|------|-----------|------|
| | 2001 | | 2000 | | 1999 | |
| | Amount | % | Amount | % | Amount | % |
| (Dollars in thousands) | | | | | | |
| Commercial..... | \$233,381 | 53% | \$214,098 | 52% | \$147,232 | 52% |
| Commercial real estate.... | 84,723 | 19 | 79,444 | 19 | 54,160 | 19 |
| Residential real estate... | 62,366 | 14 | 60,822 | 15 | 44,734 | 15 |
| Consumer..... | 57,985 | 14 | 56,312 | 14 | 39,248 | 14 |
| | ----- | --- | ----- | --- | ----- | --- |
| Total loans..... | 438,455 | 100% | 410,676 | 100% | 285,374 | 100% |
| | | === | | === | | === |
| Less: | | | | | | |
| Allowance for loan losses..... | (6,243) | | (5,854) | | (3,995) | |
| | ----- | | ----- | | ----- | |
| Total loans receivable, net..... | \$432,212 | | \$404,822 | | \$281,379 | |
| | ===== | | ===== | | ===== | |

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The following table shows our total loans outstanding at March 31, 2001 which, based on remaining scheduled repayments of principal, are due in the periods indicated.

| | Maturing | | | |
|----------------------------------|----------------|---------------|---------------|-----------|
| | Within 1 Year | 1 -5 Years | After 5 years | Total |
| | (In thousands) | | | |
| Commercial..... | \$124,991 | \$102,654 | \$ 5,736 | \$233,381 |
| Commercial real estate..... | 14,320 | 68,322 | 2,081 | 84,723 |
| Residential real estate..... | 7,362 | 12,033 | 42,971 | 62,366 |
| Consumer..... | 7,133 | 33,334 | 17,518 | 57,985 |
| | ----- | ----- | ----- | ----- |
| Totals..... | \$153,806 | \$216,343 | \$68,306 | 438,455 |
| | ===== | ===== | ===== | |
| Allowance for loan losses... | | | | (6,243) |
| | | | | ----- |
| Total loans receivable, net..... | | | | \$432,212 |
| | | | | ===== |

Below is a schedule of our loan amounts maturing or repricing which are classified according to their sensitivity to changes in interest rates at March

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31, 2001.

| Interest Sensitivity | | | |
|---|---------------|---------------|-----------|
| | Fixed Rate | Variable Rate | Total |
| (In thousands) | | | |
| Due within three months..... | \$ 21,243 | \$176,073 | \$197,316 |
| Due after three months within one year..... | 38,536 | 737 | 39,273 |
| Due after one but within five years..... | 154,477 | 21,229 | 175,706 |
| Due after five years..... | 23,897 | 2,263 | 26,160 |
| | ----- | ----- | ----- |
| Total..... | \$238,153 | \$200,302 | 438,455 |
| | ===== | ===== | |
| Allowance for loan losses..... | | | (6,243) |
| | | | ----- |
| Total loans receivable, net..... | | | \$432,212 |
| | | | ===== |

Nonperforming Assets. Our nonperforming loans include loans on nonaccrual, restructured loans, as well as loans delinquent by more than 90 days, but that are still accruing. Our total nonperforming loans at March 31, 2001 totaled \$60 thousand, as compared to \$196 thousand at December 31, 2000 and \$101 thousand at December 31, 1999. Our loan performance is reviewed regularly by an external loan review team, our own loan officers, and our senior management. When reasonable doubt exists concerning collectibility of the interest or principal of one of our loans, that loan will be placed on nonaccrual status. Any interest previously accrued but not collected at that time will be reversed and charged against current earnings. At March 31, 2001, we had no other interest bearing assets which required classification. We are not aware of any recommendations by regulatory agencies, which, if implemented, would have a material impact on our liquidity, capital or operations.

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

| | At March 31, | At December 31, | | |
|--|--------------|-----------------|--------|-------|
| | 2001 | 2000 | 1999 | 1998 |
| (Dollars in thousands) | | | | |
| Nonaccrual loans..... | \$60 | \$ 155 | \$ 101 | \$ -- |
| Loans 90 days or more delinquent and still accruing interest..... | -- | 41 | -- | -- |
| Restructured loans..... | -- | -- | -- | -- |
| | --- | ----- | ----- | ----- |
| Total nonperforming loans..... | 60 | 196 | 101 | -- |
| Other real estate owned..... | 29 | -- | -- | -- |
| | --- | ----- | ----- | ----- |
| Total nonperforming assets..... | \$89 | \$ 196 | \$ 101 | \$ -- |
| | === | ===== | ===== | ===== |

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| | | | | |
|---|------|------|------|------|
| Nonperforming loans to total loans..... | .01% | .04% | .04% | .00% |
| Nonperforming assets to total assets..... | .02% | .04% | .03% | .00% |

The following is a summary of our loan balances at the end of each period and the daily average balances of those loans. It also includes changes in the allowance for possible loan losses arising from loans we may have had to charge off, recoveries on loans we have previously charged off, and additions to the allowance we have expensed.

| | At or for the three months ended March 31, 2001 | At or for the years ended December 31, ----- 2000 1999 1998 ----- | | |
|---|--|---|-----------|-----------|
| | (Dollars in thousands) | | | |
| Loans: | | | | |
| Average daily balance of loans for the period..... | \$425,631 | \$347,351 | \$213,472 | \$ 60,299 |
| Amount of loans outstanding at end of period..... | 438,455 | 410,676 | 285,374 | 137,882 |
| Allowance for loan losses: | | | | |
| Balance at beginning of period..... | \$ 5,854 | \$ 3,995 | \$ 2,030 | \$ 7 |
| Addition to allowance charged to operations..... | 522 | 1,931 | 1,967 | 2,023 |
| Loans charged-off..... | (144) | (87) | (6) | -- |
| Recoveries..... | 11 | 15 | 4 | -- |
| | ----- | ----- | ----- | ----- |
| Balance at end of period..... | \$ 6,243 | \$ 5,854 | \$ 3,995 | \$ 2,030 |
| | ===== | ===== | ===== | ===== |
| Ratios: | | | | |
| Net charge-offs to average loans outstanding..... | 0.03% | .02% | .00% | .00% |
| Allowance for loan losses to loans outstanding at period end..... | 1.42% | 1.43% | 1.40% | 1.47% |

Allowance for Loan Losses. Our allowance for loan losses at March 31, 2001 was \$6.2 million, an increase from \$5.9 million at December 31, 2000 and \$4.0 million at December 31, 1999. In each of these periods, our allowance for loan losses ranged from 1.40% to 1.50% of our total loans outstanding. We have not experienced any material credit losses in our three plus years of operations. First quarter net charge-offs totaled \$133 thousand, which was the largest quarter of losses since our inception. However, this represented only .03% of average loans for the quarter and is still considered by management to be an exceptional level within the banking industry. Although our level of delinquencies has been historically low, due to the short history of our loan portfolio and the significant increases in loans we have originated since we began operations, we cannot assure you that we will not experience an increase in delinquencies and losses as our loans continue to mature. Our allowance for loan losses is maintained at a level our

management considers appropriate based upon their assessment of relevant circumstances. Our management prepares a quarterly evaluation of the allowance

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for loan losses. The analysis is based upon a number of factors, including a continuous review of our loan portfolio, our own loan loss experience, the banking industry's historical loan loss experience, known and inherent risks included in our loan portfolio, the composition of our loans, growth of our portfolio, and current economic conditions.

As part of the analysis, our management assigns a portion of the loan loss allowance to our entire portfolio by loan type and loan grade, and to specific credits that have been identified as problem loans, and also reviews our past loss experience. Our local economy and particular concentrations are considered, as well as a number of other factors. While the commercial loan portfolio has performed very well during our first three plus years of existence, the allowance does reflect a higher percentage allocation against that portfolio due to management's assessment of inherently higher risks in commercial lending. By their very nature, commercial loans generally have a high degree of risk due to:

- . their high dollar amounts;
- . the great discrepancy between the business activities of each customer;
- . the collateral for each loan is extremely varied;
- . the need to have more information and detail and in-depth underwriting; and
- . each customer's ability to repay their obligation may be dramatically affected by overall economic conditions.

The following table shows the allocation of the allowance for loan loss at the dates indicated to the extent specific allocations have been determined relative to particular loans.

| | At December 31, | | | | | | | |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| | At March 31, 2001 | | 2000 | | 1999 | | 1998 | |
| | % of each category | % of each category | % of each category | % of each category | % of each category | % of each category | % of each category | % of each category |
| Allowance to total | Allowance to total | Allowance to total | Allowance to total | Allowance to total | Allowance to total | Allowance to total | Allowance to total | Allowance to total |
| Amount | loans | Amount | loans | Amount | loans | Amount | loans | loans |
| (Dollars in thousands) | | | | | | | | |
| Commercial and commercial real estate..... | \$4,241 | 72.6% | \$3,902 | 71.5% | \$2,784 | 70.6% | \$1,422 | 69 |
| Residential real estate..... | 168 | 14.2 | 176 | 14.8 | 112 | 15.7 | 57 | 16 |
| Consumer..... | 468 | 13.2 | 435 | 13.7 | 297 | 13.7 | 165 | 14 |
| Unallocated..... | 1,366 | 0.0 | 1,341 | 0.0 | 802 | 0.0 | 386 | 0 |
| Total..... | \$6,243 | 100.0% | \$5,854 | 100.0% | \$3,995 | 100.0% | \$2,030 | 100 |
| | ===== | ===== | ===== | ===== | ===== | ===== | ===== | ===== |

The above allocations are not intended to imply limitations on usage of our loan loss allowance. The entire allowance is available for any loan losses without regard to loan type.

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Premises and Equipment. Our premises and equipment totaled \$12.1 million at March 31, 2001 and \$12.3 million at December 31, 2000 as compared to \$10.0 million at December 31, 1999. The increase in 2000 resulted primarily from our purchase of a previously leased branch facility, as well as the construction of a full service branch to replace a temporary storefront branch. Additionally, we invested in a proof processing imaging system that efficiently captures check images as items are processed. This allows electronic retrieval of check images by our staff, and in the future it will enable us to provide images to our customers through on-line inquiries.

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For the first quarter of 2001, our investment in additional premises and equipment was relatively small. However, we expect significant increases in the latter part of 2001 and through 2002. Presently we are completing the build out of a new leased branch in Grandville, have secured a site to relocate our Hudsonville branch in a new full service facility and have preliminary plans to construct a new company headquarters and a new branch in the City of Holland. We have entered into a buy-sell agreement on a parcel of land between Holland and Zeeland where we plan to construct a 25,000 to 30,000 square foot facility that will house our administration, human resources, trust, loan underwriting and processing, and proof and deposit operations. The estimated cost to purchase the land and complete the construction is \$6.2 million. We presently intend to fund the cost of the new headquarters building with long-term debt financing. Our current intention for the next several years is to open at least two additional branches each year, subject to economic conditions, our continued success in penetrating new markets, our ability to find appropriate branch sites and hire qualified employees, our evaluation of costs and other factors.

Deposits. Deposits are gathered from the communities we serve through our network of 13 branches. We offer business and consumer checking accounts, regular and money market savings accounts, and certificates of deposit having many options in their terms.

Our total deposits increased to \$418.7 million at March 31, 2001, an increase from \$398.6 million at December 31, 2000 and from \$279.4 million at December 31, 1999. We believe these increases were substantially a result of deposits from new customers. Noninterest bearing demand accounts comprised 10.9% of our total deposits at March 31, 2001, compared to 12.7% at year end 2000 and 1999. Savings accounts and NOW accounts comprised 45.8% of our total deposits at March 31, 2001, a decrease from 48.3% at the end of 2000 and 54.2% at the end of 1999. Time accounts increased as a percent of our total deposits to 43.3% at March 31, 2001, compared to 38.9% at the end of 2000 and 33.5% at the end of 1999. We attribute the growth in time accounts to our competitive pricing which allows us to maintain current customer accounts while attracting new customers and new funds. We set our deposit pricing to be competitive with other banks in our market area, without being the price leader. This has enabled us to increase deposits from new, as well as existing customers, while maintaining a strong net interest margin. We periodically purchase brokered deposits to supplement our funding sources. These are time accounts originated outside of our local market area. These brokered deposits comprised 5.7% of total deposits at March 31, 2001, as compared to 4.1% at the end of 2000 and 2.3% at the end of 1999. Our present policy is to limit brokered deposits to a maximum of 10% of our total deposits.

The following table sets forth the average deposit balances and the weighted average rates paid thereon.

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| | Average for the three months ended March 31, 2001 | | Average for the years ended December 31, | | | | | |
|------------------------|--|-----------------|--|-----------------|-------------------|-----------------|-------------------|-----------------|
| | | | 2000 | | 1999 | | 1998 | |
| | Average Amount | Average Rate | Average Amount | Average Rate | Average Amount | Average Rate | Average Amount | Average Rate |
| (Dollars in thousands) | | | | | | | | |
| Noninterest bearing | | | | | | | | |
| demand..... | \$ 43,411 | 0% | \$ 39,946 | 0% | \$ 27,186 | 0% | \$ 8,991 | 0% |
| NOW accounts..... | 50,585 | 2.3% | 45,246 | 2.6% | 29,721 | 2.6% | 10,420 | 3.0% |
| MMDA/Savings..... | 137,960 | 4.2% | 131,069 | 4.7% | 97,849 | 4.2% | 35,743 | 4.7% |
| Time..... | 168,042 | 6.4% | 123,756 | 6.4% | 68,629 | 5.5% | 20,899 | 5.7% |
| | ----- | --- | ----- | --- | ----- | --- | ----- | --- |
| Total Deposits..... | \$399,998 | 4.4% | \$340,017 | 4.5% | \$223,385 | 3.9% | \$76,053 | 4.2% |
| | ===== | === | ===== | === | ===== | === | ===== | === |

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The following table summarizes time deposits in amounts of \$100,000 or more by time remaining until maturity at March 31, 2001:

| | At March 31, 2000 |
|-------------------------------------|--------------------------|
| | Amount (In thousands) |
| Three months or less..... | \$36,220 |
| Over 3 months through 6 months..... | 13,808 |
| Over 6 months through 1 year..... | 32,398 |
| Over 1 year..... | 16,644 |
| | ----- |
| | \$99,070 |
| | ===== |

Borrowed Funds. Borrowed funds totaled \$66.6 million at March 31, 2001 as compared to \$61.2 million at December 31, 2000 and \$30.0 million at December 31, 1999. Borrowed funds increased \$31.2 million or 104.0% for 2000 and increased \$5.4 million or 8.8% during the three months ended March 31, 2001. Borrowed funds consist principally of advances from the Federal Home Loan Bank. Borrowed funds also include Federal Funds we purchase, which we use to settle our daily cash letter position with our correspondent banks. Additionally, we secured a \$5.0 million credit facility in September 2000, which was subsequently increased to \$8.0 million in March 2001. At March 31, 2001, \$4.0 million had been advanced on the credit facility and contributed to the capital of Macatawa Bank to enable the bank to maintain its regulatory capital at the well-capitalized level. The total outstanding balance we have on this credit facility will be repaid out of the proceeds of this offering.

Retained Earnings. In May 2001 we distributed a 3% stock dividend resulting in the transfer of \$1.8 million from our retained earnings to our common stock. After adjusting for the stock dividend, we had retained earnings of \$211 thousand at March 31, 2001 as compared to \$1.1 million at year end 2000 and a retained deficit of \$2.0 million at year end 1999. The retained deficit at the

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end of 1999 was primarily the result of our start-up losses for two months of 1997, and full year 1998. Our losses in our initial year included normal operating expenses, loan loss provision on our new and rapidly growing loan portfolio, and costs associated with expanding our branch network. Our management believes that the expenditures made in 1997 and 1998 created the infrastructure and laid the foundation for our future growth and profitability in subsequent years. We had net income of \$3.3 million in 2000, an increase from \$693 thousand in 1999. Our quarterly net income was \$1.1 million for the three months ended March 31, 2001 as compared to \$527 thousand for the three months ended March 31, 2000. We also paid out cash dividends totaling \$251 thousand during the year ended December 31, 2000 and again in the first quarter of 2001. There were no dividends paid out during either 1999 or 1998.

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Results of Operations -- Comparison of our operating results for the three months ended March 31, 2001 and 2000.

Summary of Results. Our net income for the quarter ended March 31, 2001, was \$1.1 million, an increase of \$564 thousand over the same period for 2000. The primary reason for the 107.2% increase in net income was our continued earning asset growth resulting in an increase of net interest income. This increase was partially offset by additional income tax as we became fully taxable in August 2000. The following table summarizes net income and key performance measures for the two periods presented.

| | For the three months ended March 31, | |
|---------------------------------------|--|---------------|
| | ----- 2001 | 2000 ----- |
| | (Dollars in thousands, except per share amounts) | |
| Net Income..... | \$1,091 | \$ 527 |
| Basic earnings per share..... | \$.30 | \$.14 |
| Diluted earnings per share..... | \$.29 | \$.14 |
| Earnings ratios: | | |
| Return on average assets(1)..... | .86% | .58% |
| Return on average equity(1)..... | 10.27% | 6.23% |
| Average equity to average assets..... | 8.36% | 9.35% |
| Dividend payout ratio..... | 24.14% | 0.00% |
| Efficiency ratio..... | 61.85% | 74.28% |
| Net interest margin(1)..... | 4.03% | 4.15% |

(1) The ratio has been annualized and is not necessarily indicative of the results for the entire year.

Our net income for the three months ended March 31, 2001 improved dramatically over net income for the three months ended March 31, 2000 as a result of improved net interest income. Continued strong growth in loans and deposits were primarily responsible for the increases in our net interest income. Net interest income for the quarter ended March 31, 2001 was \$4.8

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million compared to \$3.5 million for the quarter ended March 31, 2000, an increase of 37.1%.

Our noninterest income totaled \$828 thousand for the quarter ended March 31, 2001, as compared to \$406 thousand for the quarter ended March 31, 2000. Noninterest expense totaled \$3.5 million for the quarter ended March 31, 2001, as compared to \$2.9 million for the quarter ended March 31, 2000.

Analysis of Net Interest Income. The following schedule presents, for the periods indicated, information regarding:

- . our total dollar amount of interest income from average earning assets and the resultant average yields;
- . our total dollar amount of interest expense on average interest-bearing liabilities and the resultant average cost;
- . our net interest income;
- . our interest rate spread; and
- . our net yield on average earning assets.

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| For the three months ended March 31, | | | | | | |
|--|-------------------------|-----------------------|-----------------|-------------------------|-----------------------|-------|
| ----- | | | | | | |
| 2001 | | | 2000 | | | |
| ----- | | | | | | |
| Average balance | Interest earned or paid | Average yield or cost | Average balance | Interest earned or paid | Average yield or cost | |
| ----- | | | | | | |
| (Dollars in thousands) | | | | | | |
| ASSETS: | | | | | | |
| Taxable securities..... | \$ 44,005 | \$ 687 | 6.16% | \$ 28,048 | \$ 414 | 5.84% |
| Tax-exempt securities | | | | | | |
| (1)..... | 3,339 | 41 | 7.60% | 1,014 | 13 | 7.99% |
| Loans (2)..... | 425,631 | 9,482 | 8.93% | 301,922 | 6,611 | 8.69% |
| Federal funds sold..... | 689 | 9 | 5.50% | 1,308 | 19 | 5.70% |
| Short-term investments.... | 144 | 2 | 5.45% | 299 | 2 | 2.40% |
| Federal Home Loan Bank stock..... | 3,003 | 59 | 7.87% | 2,312 | 47 | 8.00% |
| | ----- | ----- | | ----- | ----- | |
| Total interest earning assets..... | 476,811 | 10,280 | 8.65% | 334,903 | 7,106 | 8.43% |
| Noninterest earning assets: | | | | | | |
| Cash and due from banks.. | 20,546 | | | 17,513 | | |
| Other..... | 11,237 | | | 8,848 | | |
| | ----- | | | ----- | | |
| Total assets..... | \$508,594 | | | \$361,264 | | |
| | ===== | | | ===== | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | | | | | |
| Deposits: | | | | | | |
| Now and money market accounts..... | \$177,432 | 1,701 | 3.89% | \$146,523 | 1,466 | 4.06% |

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| | | | | | | |
|---|-----------|----------|-------|-----------|---------|-------|
| Savings..... | 10,979 | 50 | 1.85% | 7,859 | 37 | 1.96% |
| IRAs..... | 10,294 | 161 | 6.33% | 6,247 | 89 | 5.67% |
| Time deposits..... | 157,748 | 2,534 | 6.51% | 100,135 | 1,465 | 5.93% |
| Short-term borrowings: | | | | | | |
| Federal funds borrowed... | 3,459 | 51 | 5.86% | 1,702 | 25 | 6.00% |
| Other borrowings..... | 64,060 | 952 | 5.94% | 31,318 | 487 | 6.15% |
| | ----- | ----- | | ----- | ----- | |
| Total interest bearing liabilities..... | 423,972 | 5,449 | 5.20% | 293,784 | 3,569 | 4.87% |
| Noninterest bearing liabilities: | | | | | | |
| Noninterest bearing demand accounts..... | 43,411 | | | 31,920 | | |
| Other noninterest bearing liabilities..... | 2,394 | | | 1,762 | | |
| Shareholders' equity..... | 38,817 | | | 33,798 | | |
| | ----- | | | ----- | | |
| Total liabilities and shareholders' equity... | \$508,594 | | | \$361,264 | | |
| | ===== | | | ===== | | |
| Net interest income..... | | \$ 4,831 | | | \$3,537 | |
| | | ===== | | | ===== | |
| Net interest spread..... | | | 3.45% | | | 3.56% |
| Net interest margin..... | | | 4.03% | | | 4.15% |
| Ratio of average interest-bearing assets to average interest-bearing liabilities..... | | 112.46% | | 114.00% | | |

-
- (1) Yields are adjusted for tax-exempt interest.
 - (2) Loan fees included in interest income are not material. Nonaccrual loans are included in average loans outstanding.

Our net interest margin was 4.03% for the quarter ended March 31, 2001, a decrease from net interest margin of 4.15% for the quarter ended March 31, 2000. Our interest spread, which is the difference between our yield from interest earning assets and our cost of interest bearing liabilities, was 3.45% for the first quarter of 2001, as compared to 3.56% for the same quarter in 2000. The decrease in our net interest spread reflected the cost of our interest-bearing liabilities increasing slightly faster than the yield of our interest earning assets during the first quarter of 2001. Our higher cost reflected the impact of our portfolio shifting to a larger mix of time accounts. Time accounts, with a weighted average cost of 6.51% during the quarter ended March 31, 2001, comprised 37.2% of our interest-bearing liabilities for the quarter ended March 31, 2001, as compared to 34.1% for the same period in 2000. Our average cost of time accounts was 6.51% during the first quarter of 2001, while the cost was 5.93% over the same period in 2000. We expect that our net interest margin will continue to contract modestly as assets reprice faster than liabilities in response to a decrease in interest rates. However, this trend will be at least partially mitigated by the impact of the proceeds of this offering.

Rate/Volume Analysis of Net Interest Income. The following schedule presents the dollar amount of changes in interest income and interest expense for major components of our earning assets and interest-bearing liabilities, distinguishing between changes related to our outstanding balances and changes due to interest rates.

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| | For the three months ended March 31, | | | |
|---|---|-------|--------|---------|
| | 2001 vs 2000 | | | |
| | Increase (Decrease) Due to | | | |
| | Volume | Rate | Days | Total |
| | (In thousands) | | | |
| Interest Income | | | | |
| Taxable securities..... | \$ 233 | \$ 35 | \$ 0 | \$ 268 |
| Tax-exempt securities..... | 30 | (2) | 0 | 28 |
| Loans..... | 2,715 | 217 | (61) | 2,871 |
| Federal funds sold..... | (9) | 0 | 0 | (9) |
| Short term investments..... | (1) | 1 | 0 | 0 |
| Federal Home Loan Bank stock..... | 14 | (1) | (1) | 12 |
| | ----- | ----- | ----- | ----- |
| Total interest income..... | 2,982 | 250 | (62) | 3,170 |
| | ----- | ----- | ----- | ----- |
| Interest Expense | | | | |
| NOWs and money market deposit accounts..... | 290 | (40) | (12) | 238 |
| Savings..... | 15 | (3) | 0 | 12 |
| IRAs..... | 57 | 16 | (1) | 72 |
| Time deposits..... | 836 | 244 | (12) | 1,068 |
| Federal funds borrowed..... | 26 | (1) | 0 | 25 |
| Other borrowings..... | 518 | (47) | (6) | 465 |
| | ----- | ----- | ----- | ----- |
| Total interest expense..... | 1,742 | 169 | (31) | 1,880 |
| | ----- | ----- | ----- | ----- |
| Net interest income..... | \$1,240 | \$ 81 | \$(31) | \$1,290 |
| | ===== | ===== | ===== | ===== |

Provision for Loan Losses. Our provision for loan losses is the amount added to our allowance for loan losses to absorb probable loan losses. The amount of the provision is determined by our management, in their judgment, after reviewing the risk characteristics of our loan portfolio, the industry's and our own historical loan loss experience, known and inherent risks included in our loan portfolio, and current economic conditions. Our provision for loan losses for the quarter ended March 31, 2001 was \$522 thousand, an increase from \$487 thousand at March 31, 2000. This amount was provided as a result of the increase in the total loan portfolio. Our management considers it prudent during the first years of operations to provide for loan losses at similar levels maintained by banks with similar loan portfolios. We will continue to monitor our loan loss performance and increase our loan loss reserve if needed to more closely align it with our own history of loss experience. Along with other financial institutions, management shares a concern for the possible continued softening of the economy in 2001. Should the economic climate continue to deteriorate, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs, and delinquencies could rise and require further increases in the provision.

Noninterest Income. Noninterest income for the quarter ended March 31, 2001 was \$828 thousand, an increase of \$422 thousand, or 103.9%, over the same period last year. Service charges on deposit accounts was the single largest component of noninterest income and increased to \$314 thousand for the quarter ended March 31, 2001, compared to \$201 thousand for the quarter ended March 31,

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2000. The increased service charge income was reflective of increased customer accounts. The largest increase in

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noninterest income was in gain on sale of mortgage loans, which increased by \$227 thousand over first quarter 2000. The increased gains were from higher volumes of residential mortgage financing activity as a result of the lower interest rate market during the first quarter of 2001. Higher mortgage refinancing activity is expected to continue as long as interest rates remain favorable for mortgage originations. The trust department began business on January 3, 1999. Trust revenues for the quarter ended March 31, 2001 were \$180 thousand compared to \$114 thousand for the quarter ended March 31, 2000. Trust revenues continue to improve each quarter, commensurate with the growth of trust assets. We believe trust fee income will continue to increase as the amount of trust assets under our management increases. The following table details the major components of noninterest income for the periods indicated.

| | For the three months ended March 31, | |
|-------------------------------|--|--------|
| | 2001 | 2000 |
| | (In thousands) | |
| Deposit service charges..... | \$ 313 | \$ 201 |
| Net gains on asset sales: | | |
| Loans..... | 266 | 39 |
| Securities..... | 0 | 0 |
| Trust Fees..... | 180 | 114 |
| Other..... | 68 | 52 |
| | ----- | ----- |
| Total noninterest income..... | \$ 828 | \$ 406 |
| | ===== | ===== |

The following schedule shows our net gains on the sale of our residential real estate mortgage loans for the periods indicated.

| | For the three months ended March 31, | |
|---|--|----------|
| | 2001 | 2000 |
| | (Dollars in thousands) | |
| Real estate mortgage loans originated for sale..... | \$ 35,579 | \$ 8,036 |
| Real estate mortgage loan sales..... | 35,845 | 8,075 |
| Net gains on the sale of real estate mortgage loans... | 266 | 39 |
| Net gains as a percent of real estate mortgage loan sales..... | .74% | .48% |

We sell the majority of our fixed-rate residential loan originations. We do

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not retain the servicing rights on mortgages that we sell.

Noninterest Expense. Noninterest expense totaled \$3.5 million, an increase of \$571 thousand compared to the same quarter for 2000. Salary and benefits, and occupancy and equipment expense increased a combined \$362 thousand for the quarter. The growth in expense levels reflected the growth in branch and operational support infrastructure necessary to support increased customer activity. Other increases included advertising and promotion costs, data processing, and other expense, which includes courier, telephone, postage, and outside services. All of these costs are customer activity and branch infrastructure related, and increase as a result of new customer activity being generated.

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The following table details the major components of noninterest expense for the quarters ended March 31, 2001 and 2000.

| | For the three months ended March 31, | |
|--------------------------------------|--|----------|
| | 2001 | 2000 |
| | (In thousands) | |
| Salaries and employee benefits..... | \$ 1,866 | \$ 1,648 |
| Occupancy and equipment..... | 295 | 255 |
| Furniture and equipment expense..... | 367 | 263 |
| Legal and professional fees..... | 66 | 51 |
| Advertising..... | 124 | 70 |
| Supplies..... | 85 | 104 |
| Data processing fees..... | 102 | 74 |
| Other operating expenses..... | 595 | 464 |
| | \$ 3,500 | \$ 2,929 |
| | \$ 3,500 | \$ 2,929 |

Results of Operations -- Comparison of our operating results for the years ended December 31, 2000, 1999 and 1998.

Summary of Results. Our net income for 2000 totaled \$3.3 million compared to 1999 net income of \$693 thousand and a 1998 net loss of \$2.5 million. Our increase in income was due to the continued growth of our customer base and respective loan and deposit portfolios, driving increased net interest income. The following table summarizes net income and key performance measures for the three years presented.

| For the years ended December 31, | | |
|---|------|------|
| 2000 | 1999 | 1998 |
| (Dollars in thousands, except per share data) | | |

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| | | | |
|---------------------------------------|---------|--------|-----------|
| Net income (loss)..... | \$3,349 | \$ 693 | \$(2,489) |
| Basic earnings (loss) per share..... | .91 | .22 | (1.18) |
| Earnings (loss) ratios: | | | |
| Return on average assets..... | .80% | .26% | (2.91%) |
| Return on average equity..... | 9.31% | 2.43% | (15.15%) |
| Average equity to average assets..... | 8.63% | 10.86% | 19.59% |
| Efficiency ratio..... | 67.94% | 78.02% | 110.84% |
| Net interest margin..... | 4.27% | 4.37% | 4.21% |

Our net income for the year 2000 improved dramatically over 1999 net income primarily as a result of improved net interest income. Continued strong growth in our loans made possible by the increase in deposits received is primarily responsible for the increases in our net interest income. Our net interest income increased by \$6.0 million or 56.6% to \$16.6 million in 2000 compared to \$10.6 million in 1999.

Our noninterest income totaled \$2.1 million for 2000, as compared to \$1.5 million for 1999, and \$683 thousand for 1998. Noninterest expense totaled \$12.7 million for 2000, as compared to \$9.4 million for 1999, and \$4.8 million for 1998. We became fully taxable during 2000, after utilizing all tax loss carry forwards from 1998. Our federal income tax expense totaled \$699 thousand for 2000, whereas in both 1999 and 1998 we did not include a provision for tax expense. We expect our effective tax rate for future years will be 34.0%, with a marginal rate of approximately 33.5% due to tax-free investments.

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Analysis of Net Interest Income. The following schedule presents, for the periods indicated, information regarding:

- . our total dollar amount of interest income from average earning assets and the resultant average yields;
- . our total dollar amount of interest expense on average interest-bearing liabilities and the resultant average cost;
- . our net interest income;
- . our interest rate spread; and
- . our net yield on average earning assets.

For the years ended December 31,

| | 2000 | | 1999 | | 1998 | | | |
|-------------------------------|------------------------|-------------------------|-----------------------|-----------------|-------------------------|-----------------------|-----------------|-------------------------|
| | Average Balance | Interest Earned or Paid | Average Yield or Cost | Average Balance | Interest Earned or Paid | Average Yield or Cost | Average Balance | Interest Earned or Paid |
| | (Dollars in Thousands) | | | | | | | |
| ASSETS: | | | | | | | | |
| Taxable securities..... | \$ 35,459 | \$ 2,166 | 6.11% | \$ 21,444 | \$ 1,226 | 5.71% | \$16,471 | \$ 986 |
| Tax-exempt securities(1)..... | 1,639 | 86 | 7.56% | 172 | 9 | 5.23% | 0 | 0 |
| Loans(2)..... | 347,351 | 31,788 | 9.15% | 213,472 | 18,379 | 8.61% | 60,299 | 5,340 |

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| | | | | | | | | |
|---|-----------|----------|-------|-----------|----------|-------|----------|---------|
| Federal funds sold..... | 1,616 | 99 | 6.13% | 4,166 | 204 | 4.90% | 8,421 | 446 |
| Short-term investments.. | 169 | 6 | 3.55% | 1,132 | 56 | 4.95% | 605 | 32 |
| Federal Home Loan Bank stock..... | 2,332 | 193 | 8.28% | 1,593 | 127 | 7.97% | 0 | 0 |
| | ----- | ----- | | ----- | ----- | | ----- | ----- |
| Total interest earning assets..... | 388,566 | 34,338 | 8.85% | 241,979 | 20,001 | 8.27% | 85,796 | 6,804 |
| Noninterest earning assets: | | | | | | | | |
| Cash and due from banks..... | 18,624 | | | 12,828 | | | 4,054 | |
| Other..... | 9,707 | | | 6,694 | | | 2,220 | |
| | ----- | | | ----- | | | ----- | |
| Total assets..... | \$416,897 | | | \$261,501 | | | \$92,070 | |
| | ===== | | | ===== | | | ===== | |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | | | | | | | |
| Deposits: | | | | | | | | |
| NOW and money market accounts..... | \$159,419 | 6,655 | 4.17% | \$116,914 | 4,548 | 3.89% | \$43,336 | 1,915 |
| Savings..... | 9,222 | 177 | 1.92% | 6,123 | 117 | 1.91% | 2,153 | 43 |
| IRAs..... | 7,674 | 465 | 6.06% | 4,533 | 247 | 5.45% | 1,096 | 64 |
| Time deposits..... | 123,756 | 7,916 | 6.40% | 68,629 | 3,787 | 5.52% | 20,304 | 1,164 |
| Short-term borrowings: | | | | | | | | |
| Federal funds borrowed..... | 2,022 | 131 | 6.48% | 695 | 37 | 5.32% | 78 | 4 |
| Other borrowings..... | 38,850 | 2,394 | 6.16% | 12,126 | 692 | 5.71% | 0 | 0 |
| | ----- | ----- | | ----- | ----- | | ----- | ----- |
| Total interest bearing liabilities..... | 340,943 | 17,738 | 5.20% | 209,020 | 9,428 | 4.51% | 66,967 | 3,190 |
| Noninterest bearing liabilities | | | | | | | | |
| Noninterest bearing demand accounts..... | 38,679 | | | 23,690 | | | 8,407 | |
| Other noninterest bearing liabilities... | 1,315 | | | 3,305 | | | 271 | |
| Shareholders' equity.... | 35,960 | | | 25,486 | | | 16,425 | |
| | ----- | | | ----- | | | ----- | |
| Total liabilities and shareholders' equity..... | \$416,897 | | | \$261,501 | | | \$92,070 | |
| | ===== | | | ===== | | | ===== | |
| Net interest income..... | | \$16,600 | | | \$10,573 | | | \$3,614 |
| | | ===== | | | ===== | | | ===== |
| Net interest spread..... | | | 3.65% | | | 3.76% | | |
| Net interest margin..... | | | 4.28% | | | 4.37% | | |
| Ratio of average interest bearing assets to average interest bearing liabilities.... | | 113.97% | | | 115.77% | | | 128.12% |

(1) Yields are adjusted for tax-exempt interest.

(2) Loan fees included in interest income are not material. Nonaccrual loans are included in average loans outstanding.

Our net interest margin was 4.28% for full year 2000, a decrease from 1999 net interest margin of 4.37%. Net interest margin for 1998 was 4.21%. Our interest spread, which is the difference between our yield from interest

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earning assets and our cost of interest bearing liabilities, was 3.65% for 2000, as compared to 3.76% for 1999, and 3.16% for 1998. The decrease in our net interest spread reflected the cost of our interest-bearing liabilities rising slightly faster than the yield of our interest earning assets during 2000. Our increasing cost reflects the impact of our portfolio shifting to a higher mix of time accounts. Time accounts, with a weighted average cost of 6.40% during 2000, comprised 36.3% of our interest-bearing liabilities at December 31, 2000, as compared to 32.8% at the end of 1999, and 31.1% at the end of 1998. Our average cost of time accounts was 5.52% during 1999, while the 1998 cost was 5.73%.

Rate/Volume Analysis of Net Interest Income. The following schedule presents the dollar amount of changes in interest income and interest expense for major components of our earning assets and interest-bearing liabilities, distinguishing between changes related to our outstanding balances and changes due to interest rates.

| For the years ended December 31, | | | | | | |
|-------------------------------------|----------|--------|----------------------------|----------|----------|----------|
| 2000 vs 1999 | | | 1999 vs 1998 | | | |
| Increase (Decrease) Due to | | | Increase (Decrease) Due to | | | |
| Volume | Rate | Total | Volume | Rate | Total | |
| (In thousands) | | | | | | |
| Interest income | | | | | | |
| Taxable securities..... | \$ 851 | \$ 89 | \$ 940 | \$ 286 | \$ (47) | \$ 239 |
| Tax-exempt securities... | 77 | -- | 77 | 9 | -- | 9 |
| Loans..... | 12,186 | 1,223 | 13,409 | 13,192 | (152) | 13,040 |
| Federal funds sold..... | (147) | 42 | (105) | (211) | (31) | (242) |
| Short term investments.. | (38) | (12) | (50) | 26 | (2) | 24 |
| Federal Home Loan Bank stock..... | 61 | 5 | 66 | 127 | -- | 127 |
| Total interest income.. | 12,990 | 1,347 | 14,337 | 13,429 | (232) | 13,197 |
| Interest expenses | | | | | | |
| NOWs and money market accounts..... | | | | | | |
| | \$ 1,754 | \$ 353 | \$ 2,107 | \$ 2,888 | \$ (255) | \$ 2,633 |
| Savings..... | 59 | 1 | 60 | 76 | (2) | 74 |
| IRAs..... | 188 | 30 | 218 | 188 | (5) | 183 |
| Time deposits..... | 3,446 | 683 | 4,129 | 2,668 | (45) | 2,623 |
| Federal funds borrowed.. | 84 | 10 | 94 | 33 | -- | 33 |
| Other borrowings..... | 1,643 | 59 | 1,702 | 692 | -- | 692 |
| Total interest expense..... | 7,174 | 1,136 | 8,310 | 6,545 | (307) | 6,238 |
| Net interest income.... | \$ 5,816 | \$ 211 | \$ 6,027 | \$ 6,884 | \$ 75 | \$ 6,959 |

Provision for Loan Losses. Our provision for loan losses is the amount added to our allowance for loan losses to absorb probable loan losses. The amount of the provision is determined by our management, in their judgment, after reviewing the risk characteristics of our loan portfolio, the industry's and our own historical loan loss experience, known and inherent risks included in originated loans and our loan portfolio, and current economic conditions. Our

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provision for loan losses for 2000 totaled \$1.9 million, approximately the same as the 1999 provision of \$2.0 million. The loan loss provision for 1998 totaled \$2.0 million. While we have not sustained any significant losses in our loan portfolio, our management considers it prudent during the first years of our operations to provide for loan losses at a level which is consistent with levels maintained by banks with similar size loan portfolios to ours. Our management will continue to monitor our loan loss performance and increase our loan loss reserve if needed to more closely align it with our own loss experience history.

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Noninterest Income. Noninterest income totaled \$2.1 million in 2000, an increase of 40% over 1999 noninterest income of \$1.5 million. Noninterest income for 1998 totaled \$683 thousand. Deposit service charges increased by \$483 thousand, or 73.1% during 2000 compared to 1999. The growth in our service charge income reflected the significant growth in our customer base. Trust revenues totaled \$531 thousand for 2000, an increase of \$302 thousand or 131.9% over 1999 trust revenue of \$229 thousand. 1999 was the first year of operations for our trust department. We believe trust fee income will continue to increase as the amount of trust assets under our management increases. Our gain on sale of loans declined \$262 thousand for the year 2000 to \$362 thousand. The higher overall level of interest rates reduced the mortgage loans we originated during 2000 compared to 1999, and resulted in fewer loans sold to secondary markets.

The following table details major components of noninterest income for the years of 2000, 1999, and 1998.

| | For the years ended December 31, | | |
|-------------------------------|-------------------------------------|---------|-------|
| | 2000 | 1999 | 1998 |
| | (In thousands) | | |
| Service fee income..... | \$1,144 | \$ 661 | \$157 |
| Net gains on asset sales: | | | |
| Loans..... | 361 | 624 | 520 |
| Securities..... | 0 | 0 | 0 |
| Trust fees..... | 531 | 228 | 0 |
| Other..... | 16 | 15 | 6 |
| | ----- | ----- | ----- |
| Total noninterest income..... | \$2,052 | \$1,528 | \$683 |
| | ===== | ===== | ===== |

The following table shows our net gains on the sale of residential real estate mortgage loans.

| | For the years ended December 31, | | |
|--|-------------------------------------|----------|----------|
| | 2000 | 1999 | 1998 |
| | (Dollars in thousands) | | |
| Real estate mortgage loans originated for sale.. | \$47,007 | \$54,715 | \$44,146 |

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| | | | |
|--|--------|--------|--------|
| Real estate mortgage loan sales..... | 47,368 | 55,339 | 44,667 |
| | ----- | ----- | ----- |
| Net gains on the sale of real estate mortgage loans..... | \$ 361 | \$ 624 | \$ 521 |
| | ===== | ===== | ===== |
| Net gains as a percent of real estate mortgage loan sales..... | 0.76% | 1.13% | 1.17% |

We sell the majority of our fixed-rate obligations. We do not retain the servicing rights for real estate mortgages that we sell.

Noninterest Expense. Noninterest expense for 2000 was \$12.7 million, compared to \$9.4 million for 1999, and \$4.8 million for 1998. The main components of our noninterest expense were salaries and benefits, and occupancy and equipment expense. These two items comprised approximately 73% of our noninterest expense for 2000, down slightly from approximately 74% for 1999 noninterest expense. Increases in both salary/benefit and occupancy/equipment expenses are primarily due to the full year impact of five new branches we added in the last half of 1999. During 2000 and 1999 we experienced increases in expenses related to our larger branch structure including courier, data processing, advertising, professional service fees, postage, and telephone. We also became fully taxable for the Michigan Single Business Tax during 2000, causing other operating expenses to increase by \$231 thousand compared to 1999 which did not include Single Business Tax expense. Our total noninterest expense for 1999 increased \$4.7 million as compared to 1998, reflecting the full year impact of six branches which we opened throughout 1998.

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The following table details major components of noninterest expense for the years of 2000, 1999, and 1998.

| | For the years ended December 31, | | |
|--------------------------------------|-------------------------------------|---------|---------|
| | 2000 | 1999 | 1998 |
| | ----- | | |
| | (In thousands) | | |
| Salaries and employee benefits..... | \$ 6,865 | \$5,408 | \$2,726 |
| Occupancy and equipment..... | 1,094 | 841 | 305 |
| Furniture and equipment expense..... | 1,244 | 777 | 253 |
| Legal and professional fees..... | 248 | 135 | 199 |
| Advertising..... | 366 | 267 | 199 |
| Supplies..... | 348 | 343 | 233 |
| Data processing fees..... | 561 | 401 | 197 |
| Other operating expenses..... | 1,946 | 1,268 | 651 |
| | ----- | ----- | ----- |
| Total noninterest expense..... | \$12,672 | \$9,440 | \$4,763 |
| | ===== | ===== | ===== |

Liquidity and Capital Resources

Equity Capital. We obtained initial equity capital, in the amount of \$8.2 million, as a result of a private placement on behalf of Macatawa Bank in November 1997. We raised additional equity capital of \$14.1 million in our initial public offering completed in April 1998. Due to our rapid growth,

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additional equity capital was required. In June 1999, we raised \$14.6 million of equity capital net proceeds in an offering made to our shareholders. Substantially all of the proceeds of this offering were subsequently contributed to Macatawa Bank's capital to support required regulatory capital levels. Our continuing asset growth required us to contribute an additional \$8.0 million of capital to Macatawa Bank during 2000. The contributed capital came from our cash reserves, as well as from borrowings arranged to provide capital flexibility. At December 31, 2000, Macatawa Bank's Tier 1 capital was 8.9%. Its Tier 1 capital decreased to 8.3% at March 31, 2001 due to our increased lending activities.

We secured a \$5.0 million credit facility during September 2000, to provide additional capital required to maintain Macatawa Bank at or above required regulatory capital levels. We increased the total limit of our credit under this facility to \$8.0 million in March 2001. The balance outstanding on this line of credit was \$4.0 million at December 31, 2000 and at March 31, 2001. We intend to use a portion of the proceeds of this offering to pay off this line of credit.

The following table shows various capital ratios at March 31, 2001:

| | At March 31, 2001 | | |
|--|--------------------------|-------------------------|--------------------------------------|
| | Tier 1 Leverage Ratio | Tier 1 Capital Ratio | Total Risk-Based Capital Ratio |
| Minimum regulatory requirement for capital adequacy..... | 4.0% | 4.0% | 8.0% |
| Well capitalized regulatory level..... | 5.0% | 6.0% | 10.0% |
| Consolidated..... | 7.7% | 8.7% | 9.9% |
| Bank..... | 8.3% | 9.5% | 10.7% |

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The following table shows the dollar amounts by which our capital (on a consolidated basis) exceeded current regulatory minimum requirements on a dollar amount basis at March 31, 2001:

| | At March 31, 2001 | | |
|---|---|--|---|
| | Tier 1 Leverage to Average Assets | Tier 1 Capital to Risk Weighted Assets | Total Risk-Based Capital to Risk Weighted Assets |
| (In thousands) | | | |
| Capital balances: | | | |
| Required regulatory capital..... | \$20,327 | \$17,938 | \$35,877 |
| Capital in excess of regulatory minimums..... | 18,540 | 20,929 | 8,596 |

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| | | | |
|------------------------------|----------|----------|----------|
| Actual capital balances..... | \$38,867 | \$38,867 | \$44,473 |
| | ===== | ===== | ===== |

The liquidity of a financial institution reflects its ability to provide funds to meet loan requests, to accommodate possible outflows of deposits and to take advantage of interest rate market opportunities. Our sources of liquidity include loan payments by our borrowers, maturity and sales of our securities available for sale, growth of our deposits and deposit equivalents, federal funds sold, our borrowings from the Federal Home Loan Bank, and our issuance of common stock. Liquidity management involves the ability to meet the cash flow requirements of our customers. Our customers may be either borrowers with credit needs or depositors wanting to withdraw funds.

Market Risk Analysis

Our primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of Macatawa Bank's transactions are denominated in U.S. dollars with no specific foreign exchange exposure. Macatawa Bank has only limited agricultural-related loan assets, and therefore has no significant exposure to changes in commodity prices. Therefore, our market risk exposure is mainly comprised of our sensitivity to interest rate risk. Our balance sheet has sensitivity, in various categories of assets and liabilities to changes in prevailing rates in the U.S. for prime rate, mortgage rates, U.S. Treasury rates and various money market indexes. Our asset/liability management process aids us in providing liquidity while maintaining a balance between interest earning assets and interest bearing liabilities.

We use two interest rate risk measurement techniques in our interest rate risk management. The first is static gap analysis. This measures the difference between the dollar amounts of interest sensitive assets and liabilities that may 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 summarizes our interest rate repricing gaps for selected maturity periods as of March 31, 2001.

Estimated Maturity or Repricing At March 31, 2001
