MACATAWA BANK CORP
Form 10-Q
April 28, 2011

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2011

OR

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

For the transition period from _______ to _______

Commission file number: 000-25927

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

Michigan	38-3391345
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

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

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 17,679,621 shares of the Company's Common Stock (no par value) were outstanding as of April 28, 2011.

Forward-Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and Macatawa Bank Corporation. Forward-looking statements are identifiable by words or phrases such as "outlook", "plan" or "strategy"; that an event or trend "may", "should", "will", "is likely", or is "probably" to occur or "continue", has "begun" or "is scheduled" or "on track" or that the Company or its management "anticipates", "believes", "estimates", "plans", "forecasts", "intends", "predicts", "projects", or "expects" a particular result, or is "committed", "confident", "optimistic" or has an "opinion" that an event will occur, or other words or phrases such as "ongoing", "future", "signs", "efforts", "tend", "exploring", "appearing", "until", "near term", "going forward", "starting" and variations of such words and similar expressions. Such statements are based upon current beliefs and expectations and involve substantial risks and uncertainties which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These statements include, among others, statements related to trends in credit quality metrics, real estate valuation, future levels of non-performing loans, future levels of loan charge-offs, future levels of provisions for loan losses, the rate of asset dispositions, capital raising activities, dividends, future growth and funding sources, future liquidity levels, future profitability levels, the effects on earnings of changes in interest rates and the future level of other revenue sources. Management's determination of the provision and allowance for loan losses, the appropriate carrying value of intangible assets (including goodwill, mortgage servicing rights and deferred tax assets) and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other-than-temporary and the amount of any impairment) involves judgments that are inherently forward-looking. All statements with references to future time periods are forward-looking. All of the information concerning interest rate sensitivity is forward-looking. Our ability to fully comply with our Consent Order and Written Agreement, raise capital, improve regulatory capital ratios, sell other real estate owned at its carrying value or at all, successfully implement new programs and initiatives, increase efficiencies, address regulatory issues, improve internal controls over financial reporting, maintain our current level of deposits and other sources of funding, maintain liquidity, respond to declines in collateral values and credit quality, increase loan volume, maintain mortgage banking income, realize the benefit of our deferred tax assets, resume payment of dividends and improve profitability is not entirely within our control and is not assured. The future effect of changes in the real estate, financial and credit markets and the national and regional economy on the banking industry, generally, and Macatawa Bank Corporation, specifically, are also inherently uncertain. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("risk factors") that are difficult to predict with regard to timing, extend, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Macatawa Bank Corporation does not undertake to update forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2010. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

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Part I Financial Information
Item 1.

MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
As of March 31, 2011 (unaudited) and December 31, 2010

(dollars in thousands)	March 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 24,265	$ 21,274
Federal funds sold and other short-term investments	238,362	214,853
Cash and cash equivalents	262,627	236,127
Securities available for sale, at fair value	12,660	9,120
Securities held to maturity (fair value 2010 - $83)	---	83
Federal Home Loan Bank stock	11,932	11,932
Loans held for sale, at fair value	942	2,537
Total loans	1,153,992	1,217,196
Allowance for loan losses	(42,343)	(47,426)
Net loans	1,111,649	1,169,770
Premises and equipment - net	56,410	56,988
Accrued interest receivable	3,721	3,845
Bank-owned life insurance	25,229	25,014
Other real estate owned	64,992	57,984
Other assets	7,073	4,861
Total assets	$ 1,557,235	$ 1,578,261
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 282,050	$ 255,897
Interest-bearing	982,615	1,020,723
Total deposits	1,264,665	1,276,620
Other borrowed funds	174,270	185,336
Long-term debt	41,238	41,238
Subordinated debt	1,650	1,650
Accrued expenses and other liabilities	6,259	5,575
Total liabilities	1,488,082	1,510,419
Commitments and contingent liabilities	---	---
Shareholders' equity		
Preferred stock, no par value, 500,000 shares authorized;		
Series A Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 31,290 shares issued and outstanding	30,604	30,604
Series B Noncumulative Convertible Perpetual Preferred Stock, liquidation value of $1,000 per share, 2,600 shares issued and outstanding	2,560	2,560
Common stock, no par value, 200,000,000 shares authorized; 17,679,621 shares issued and outstanding	167,338	167,321
Retained deficit	(131,363)	(132,654)
Accumulated other comprehensive income	14	11
Total shareholders' equity	69,153	67,842
Total liabilities and shareholders' equity	$ 1,557,235	$ 1,578,261

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three Month Periods Ended March 31, 2011 and 2010 (unaudited)

(dollars in thousands, except per share data)	Three Months Ended March 31, 2011		Three Months Ended March 31, 2010	
Interest income				
Loans, including fees	$	15,582	$	19,623
Securities		27		1,191
FHLB Stock		76		62
Federal funds sold and other short-term investments		168		61
Total interest income		15,853		20,937
Interest expense				
Deposits		2,912		5,408
Debt and other borrowed funds		1,343		2,501
Total interest expense		4,255		7,909
Net interest income		**11,598**		**13,028**
Provision for loan losses		(1,450)		19,710
Net interest income (loss) after provision for loan losses		**13,048**		**(6,682)**
Noninterest income				
Service charges and fees		949		1,065
Net gains on mortgage loans		435		181
Trust fees		651		890
ATM and debit card fees		852		785
Other		792		547
Total noninterest income		3,679		3,468
Noninterest expense				
Salaries and benefits		5,347		5,450
Occupancy of premises		1,011		1,052
Furniture and equipment		817		981
Legal and professional		270		769
Marketing and promotion		224		215
Data processing		304		346
FDIC assessment		978		1,257
ATM and debit card processing		271		310
Bond and D&O Insurance		379		548
Losses on repossessed and foreclosed properties		2,493		3,643
Administration of problem assets		1,941		1,892
Other		1,401		1,463
Total noninterest expenses		15,436		17,926
Net income (loss) before income tax		**1,291**		**(21,140)**
Income tax expense (benefit)		0		0
Net income (loss)		**1,291**		**(21,140)**
Dividends declared on preferred shares		0		0
Net income (loss) available to common shares	**$**	**1,291**	**$**	**(21,140)**
Basic earnings (loss) per common share	$	.07	$	(1.19)
Diluted earnings (loss) per common share	$	.07	$	(1.19)
Cash dividends per common share	$	0.00	$	0.00

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Three Month Periods Ended March 31, 2011 and 2010
(unaudited)

(dollars in thousands)	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Net income (loss)	$ 1,291	$ (21,140)
Other comprehensive income (loss), net of tax:		
Net change in unrealized gains on securities available for sale	3	38
Comprehensive income (loss)	**$ 1,294**	**$ (21,102)**

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Three Month Periods Ended March 31, 2011 and 2010
(unaudited)

(dollars in thousands, except per share data)	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2010	**$30,604**	**$2,560**	**$167,183**	**$(114,800)**	**$2,444**	**$87,991**
Net loss for three months ended March 31, 2010				(21,140)		(21,140)
Other comprehensive income (loss), net of tax:						
Net change in unrealized gain (loss) on securities available for sale					38	38
Comprehensive loss						(21,102)
Stock compensation expense			28			28
Balance, March 31, 2010	**$30,604**	**$2,560**	**$167,211**	**$(135,940)**	**$2,482**	**$66,917**
Balance, January 1, 2011	**$30,604**	**$2,560**	**$167,321**	**(132,654)**	**$ 11**	**67,842**
Net income for three months ended March 31, 2011				1,291		1,291
Other comprehensive income (loss), net of tax:						
Net change in unrealized gain (loss) on securities available for sale					3	3
Comprehensive income						1,294
Stock compensation expense			17			17
Balance, March 31, 2011	**$30,604**	**$2,560**	**$167,338**	**$(131,363)**	**$ 14**	**$69,153**

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Three Month Periods Ended March 31, 2011 and 2010 (unaudited)

(dollars in thousands)	Three Months Ended March 31, 2011		Three Months Ended March 31, 2010	
Cash flows from operating activities				
Net income (loss)	$	1,291	$	(21,140)
Adjustments to reconcile net income (loss) to net cash from operating activities:				
Depreciation and amortization		781		896
Stock compensation expense		17		28
Provision for loan losses		(1,450)		19,710
Origination of loans for sale		(16,671)		(9,744)
Proceeds from sales of loans originated for sale		18,701		9,052
Net gains on mortgage loans		(435)		(181)
Write-down of other real estate		2,699		3,516
Net (gain) loss on sales of other real estate		(212)		120
Decrease (increase) in accrued interest receivable and other assets		(2,157)		80
Earnings in bank-owned life insurance		(215)		(200)
Increase (decrease) in accrued expenses and other liabilities		684		(473)
Net cash from operating activities		3,033		1,664
Cash flows from investing activities				
Loan originations and payments, net		45,092		41,204
Purchases of securities available for sale		(10,549)		0
Proceeds from:				
Maturities and calls of securities available for sale		6,988		13,986
Principal paydowns on securities		85		82
Sales of other real estate		4,984		5,711
Additions to premises and equipment		(112)		(201)
Net cash from investing activities		46,488		60,782
Cash flows from financing activities				
Net decrease in in-market deposits		(6,360)		(3,505)
Net decrease in brokered deposits		(5,595)		(42,065)
Proceeds from other borrowed funds		---		20,000
Repayments of other borrowed funds		(11,066)		(66,020)
Net cash from financing activities		(23,021)		(91,590)
Net change in cash and cash equivalents		26,500		(29,144)
Cash and cash equivalents at beginning of period		236,127		78,749
Cash and cash equivalents at end of period	$	262,627	$	49,605
Supplemental cash flow information				
Interest paid	$	3,950	$	7,805
Supplemental noncash disclosures:				
Transfers from loans to other real estate		14,479		17,954

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The Bank operates 26 full service branch offices providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan.

The Company owns all of the common stock of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and are not consolidated with the Company under accounting principles generally accepted in the United States of America.

Basis of Presentation:The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) believed necessary for a fair presentation have been included.

Operating results for the three month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

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

Adoption of New Accounting Standards:

In July 2010, FASB issued ASU No. 2010-20, Receivables (Topic 310): *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The ASU amends FASB Accounting Standards Codification™ Topic 310, Receivables, to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010 and have been added to Note 3. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010 and have been added to Note 3.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosure about Fair Value Measurements*. This standard requires new disclosures on the amount and reason for transfers in and out of Level 1 and Level 2 recurring fair value measurements. The standard also requires disclosure of activities (i.e., on a gross basis), including purchases, sales, issuances, and settlements, in the reconciliation of Level 3 fair value recurring measurements. The standard clarifies existing disclosure requirements on levels of disaggregation and disclosures about inputs and valuation techniques. The new disclosures regarding Level 1 and Level 2 fair value measurements and clarification of existing disclosures are effective for periods beginning after December 15, 2009. The disclosures about the reconciliation of information in Level 3 recurring fair value measurements are required for periods beginning after December 15, 2010. Adoption of this standard did not have a significant impact on our quarterly disclosures.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Newly Issued Not Yet Effective Accounting Standards:

The FASB has issued ASU 2011-02, *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring* (April 2011). This ASU provides guidance for companies when determining whether a loan modification is a troubled debt restructuring. The ASU also provides additional disclosure requirements. It is effective for public companies for interim and annual periods beginning on or after June 15, 2011. The guidance is to be applied retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. This guidance is not expected to have a material effect on our identification of troubled debt restructurings or disclosures.

Regulatory Developments:

Consent Order with Macatawa Bank and its Regulators

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 (our "2010 Form 10-K"), on February 22, 2010, Macatawa Bank entered into a Consent Order (the "Consent Order") with the Federal Deposit Insurance Corporation ("FDIC") and the Michigan Office of Financial and Insurance Regulation ("OFIR"), the primary banking regulators of the Bank. The Bank agreed to the terms of the negotiated Consent Order without admitting or denying any charges of unsafe or unsound banking practices. The Consent Order imposes no fines or penalties on the Bank. The Consent Order will remain in effect and enforceable until it is modified, terminated, suspended, or set aside by the FDIC and the OFIR. The requirements of the Consent Order are summarized in our 2010 Form 10-K.

The Consent Order covers various aspects of the Bank's financial condition and performance; loan administration; and capital planning.

The Consent Order requires the Bank to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11%. At March 31, 2011, the Bank's Tier 1 Leverage Capital Ratio was 7.1% and the Total Risk Based Capital Ratio was 10.4%, which would ordinarily categorize the Bank as "well capitalized" under the regulatory capital standards absent the Consent Order. The Bank needed a capital injection of approximately $14.0 million as of March 31, 2011 to comply with the Tier 1 Leverage Capital Ratio requirement and needed a capital injection of approximately $7.1 million to comply with the Total Risk Based Capital Ratio requirement of the Consent Order. This has declined significantly since March 31, 2010, when the Company needed $43.2 million to comply with the Tier 1 Leverage Capital Ratio requirement.

The Company has developed a capital plan including evaluation of alternatives to reach and maintain the capital levels required by the Consent Order. Achievement of these capital levels could be impacted, positively or negatively, by certain uncertainties, including, but not limited to, earnings levels, changing economic conditions, asset quality, property values and the receptiveness of capital markets to new capital offerings of the Company.

Strategies to increase the Bank's regulatory capital ratios in order to comply with the capital requirements of the Consent Order include reducing operating costs, shrinking assets of the Bank without weakening its liquidity position, preserving capital through suspension of dividends, and raising additional capital. More information regarding these strategies is included in our 2010 Form 10-K.

The Company earlier increased its capital through the sale of $31.3 million of Series A Preferred Stock in the fourth quarter of 2008. During second and third quarters of 2009, the Company increased its capital by $5.9 million through the issuance of Series B Preferred Stock, common stock and subordinated debt.

The Company also remains active at exploring alternatives to raise new capital. In February 2011, the Company filed a registration statement with the Securities and Exchange Commission to offer shares of common stock in a rights offering and a public offering in order to raise e