MERCANTILE BANK CORP
Form 10-Q
May 10, 2010

Table of Contents

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

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

**For the quarterly period ended March 31, 2010**

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

**For the transition period from _____ to _____.**

**Commission File No. 000-26719**

**MERCANTILE BANK CORPORATION**

(Exact name of registrant as specified in its charter)

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

**310 Leonard Street, NW, Grand Rapids, MI 49504**

(Address of principal executive offices) (Zip Code)

**(616) 406-3000**

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Yes o No o

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

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

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

Yes o No þ

At May 10, 2010, there were 8,593,270 shares of Common Stock outstanding.

MERCANTILE BANK CORPORATION
INDEX


| | Page No. |
|---|---|
| PART I. Financial Information | |
| Item 1. Financial Statements | |
| Consolidated Balance Sheets - March 31, 2010 (Unaudited) and December 31, 2009 | 1 |
| Consolidated Statements of Operations - Three Months Ended March 31, 2010 (Unaudited) and March 31, 2009 (Unaudited) | 2 |
| Consolidated Statements of Changes in Shareholders Equity - Three Months Ended March 31, 2010 (Unaudited) and March 31, 2009 (Unaudited) | 4 |
| Consolidated Statements of Cash Flows - Three Months Ended March 31, 2010 (Unaudited) and March 31, 2009 (Unaudited) | 6 |
| Notes to Consolidated Financial Statements (Unaudited) | 8 |
| Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations | 27 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 45 |
| Item 4. Controls and Procedures | 48 |
| PART II. Other Information | |
| Item 1. Legal Proceedings | 49 |
| Item 1A. Risk Factors | 49 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 49 |
| Item 3. Defaults Upon Senior Securities | 49 |
| Item 4. Reserved | 49 |
| Item 5. Other Information | 49 |
| Item 6. Exhibits | 50 |
| Signatures | 51 |

EX-31
EX-32.1
EX-32.2

Table of Contents

MERCANTILE BANK CORPORATION
PART I FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

| | March 31, 2010 (Unaudited) | December 31, 2009 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 12,606,000 | $ 18,896,000 |
| Short-term investments | 9,475,000 | 1,471,000 |
| Federal funds sold | 74,352,000 | 1,368,000 |
| Total cash and cash equivalents | 96,433,000 | 21,735,000 |
| Securities available for sale | 212,949,000 | 182,492,000 |
| Securities held to maturity (fair value of $60,271,000 at December 31, 2009) | 0 | 59,211,000 |
| Federal Home Loan Bank stock | 15,681,000 | 15,681,000 |
| Loans and leases | 1,497,624,000 | 1,539,818,000 |
| Allowance for loan and lease losses | (50,126,000) | (47,878,000) |
| Loans and leases, net | 1,447,498,000 | 1,491,940,000 |
| Premises and equipment, net | 29,141,000 | 29,684,000 |
| Bank owned life insurance | 45,436,000 | 45,024,000 |
| Accrued interest receivable | 7,057,000 | 7,088,000 |
| Other real estate owned and repossessed assets | 23,096,000 | 26,608,000 |
| Other assets | 25,632,000 | 26,745,000 |
| Total assets | $ 1,902,923,000 | $ 1,906,208,000 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Deposits | | |
| Noninterest-bearing | $ 118,391,000 | $ 121,157,000 |
| Interest-bearing | 1,301,818,000 | 1,280,470,000 |
| Total deposits | 1,420,209,000 | 1,401,627,000 |
| Securities sold under agreements to repurchase | 98,619,000 | 99,755,000 |
| Federal funds purchased | 0 | 2,600,000 |
| Federal Home Loan Bank advances | 190,000,000 | 205,000,000 |
| Subordinated debentures | 32,990,000 | 32,990,000 |
| Other borrowed money | 16,829,000 | 16,890,000 |
| Accrued expenses and other liabilities | 6,056,000 | 7,242,000 |

| | | |
|---|---|---|
| Total liabilities | 1,764,703,000 | 1,766,104,000 |
| | | |
| Shareholders equity | | |
| Preferred stock, no par value; 1,000,000 shares authorized; 21,000 shares outstanding at March 31, 2010 and December 31, 2009 | 19,896,000 | 19,839,000 |
| Common stock, no par value; 20,000,000 shares authorized; 8,593,270 shares outstanding at March 31, 2010 and 8,592,514 shares outstanding at December 31, 2009 | 172,493,000 | 172,438,000 |
| Common stock warrant | 1,138,000 | 1,138,000 |
| Retained earnings (deficit) | (57,134,000) | (54,170,000) |
| Accumulated other comprehensive income | 1,827,000 | 859,000 |
| | | |
| Total shareholders equity | 138,220,000 | 140,104,000 |
| | | |
| Total liabilities and shareholders equity | $ 1,902,923,000 | $ 1,906,208,000 |

See accompanying notes to consolidated financial statements.

1.

Table of Contents

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| Interest income | | |
| Loans and leases, including fees | $ 20,406,000 | $ 25,185,000 |
| Securities, taxable | 1,983,000 | 1,936,000 |
| Securities, tax-exempt | 760,000 | 840,000 |
| Federal funds sold | 31,000 | 47,000 |
| Short-term investments | 9,000 | 13,000 |
| Total interest income | 23,189,000 | 28,021,000 |
| Interest expense | | |
| Deposits | 6,497,000 | 12,841,000 |
| Short-term borrowings | 344,000 | 440,000 |
| Federal Home Loan Bank advances | 1,696,000 | 2,452,000 |
| Other borrowings | 346,000 | 483,000 |
| Total interest expense | 8,883,000 | 16,216,000 |
| **Net interest income** | 14,306,000 | 11,805,000 |
| Provision for loan and lease losses | 8,400,000 | 10,400,000 |
| **Net interest income after provision for loan and lease losses** | 5,906,000 | 1,405,000 |
| Noninterest income | | |
| Service charges on accounts | 466,000 | 512,000 |
| Earnings on bank owned life insurance | 411,000 | 345,000 |
| Rental income from other real estate owned | 401,000 | 133,000 |
| Mortgage banking activities | 100,000 | 369,000 |
| Net gain on sales of securities | 476,000 | 0 |
| Gain on sales of commercial loans | 220,000 | 0 |
| Other income | 581,000 | 673,000 |
| Total noninterest income | 2,655,000 | 2,032,000 |
| Noninterest expense | | |
| Salaries and benefits | 4,665,000 | 5,552,000 |
| Occupancy | 750,000 | 921,000 |
| Furniture and equipment depreciation, rent and maintenance | 409,000 | 467,000 |
| Nonperforming asset costs | 2,504,000 | 983,000 |

| | | |
|---|---|---|
| FDIC insurance costs | 1,186,000 | 634,000 |
| Other expense | 2,120,000 | 2,215,000 |
| Total noninterest expenses | 11,634,000 | 10,772,000 |
| **Income (loss) before federal income tax expense (benefit)** | (3,073,000) | (7,335,000) |
| Federal income tax expense (benefit) | (430,000) | (2,846,000) |
| Net income (loss) | (2,643,000) | (4,489,000) |
| Preferred stock dividends and accretion | 320,000 | 0 |
| **Net income (loss) attributable to common shares** | $ (2,963,000) | $ (4,489,000) |

See accompanying notes to consolidated financial statements.

Table of Contents

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

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| Basic earnings (loss) per share | $ (0.35) | $ (0.53) |
| Diluted earnings (loss) per share | $ (0.35) | $ (0.53) |
| Cash dividends per share | $ 0.01 | $ 0.04 |
| Average basic shares outstanding | 8,501,671 | 8,481,265 |
| Average diluted shares outstanding | 8,501,671 | 8,481,265 |

See accompanying notes to consolidated financial statements.

Table of Contents

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

| ($ in thousands) | Preferred Stock | Common Stock | Common Stock Warrant | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income (Loss) | Total Shareholders Equity |
|---|---|---|---|---|---|---|
| **Balances, January 1, 2010** | $ 19,839 | $ 172,438 | $ 1,138 | $ (54,170) | $ 859 | $ 140,104 |
| Accretion of preferred stock | 57 | | | (57) | | 0 |
| Employee stock purchase plan (3,003 shares) | | 12 | | | | 12 |
| Dividend reinvestment plan (687 shares) | | 2 | | | | 2 |
| Stock-based compensation expense | | 126 | | | | 126 |
| Cash dividends ($0.01 per common share) | | (85) | | | | (85) |
| Preferred stock dividends | | | | (264) | | (264) |
| Comprehensive income (loss): | | | | | | |
| Net loss for the period from January 1, 2010 through March 31, 2010 | | | | (2,643) | | (2,643) |
| Change in net unrealized gain on securities available for sale, net of reclassifications and tax effect | | | | | 758 | 758 |
| Net unrealized gain on securities transferred from held to maturity to available for sale, net of tax effect | | | | | 274 | 274 |
| Reclassification of unrealized gain on interest rate swaps, net of tax effect | | | | | (64) | (64) |
| Total comprehensive loss | | | | | | (1,675) |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Balances, March 31, 2010** | $ 19,896 | $ 172,493 | $ 1,138 | $ (57,134) | $ 1,827 | $ 138,220 |

See accompanying notes to consolidated financial statements.

Table of Contents

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

| ($ in thousands) | Preferred Stock | Common Stock | Common Stock Warrant | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income (Loss) | Total Shareholders Equity |
|---|---|---|---|---|---|---|
| **Balances, January 1, 2009** | $ 0 | $ 172,353 | $ 0 | $ (1,281) | $ 3,300 | $ 174,372 |
| Employee stock purchase plan (3,395 shares) | | 18 | | | | 18 |
| Dividend reinvestment plan (1,755 shares) | | 7 | | | | 7 |
| Stock-based compensation expense | | 155 | | | | 155 |
| Cash dividends ($0.04 per common share) | | (339) | | | | (339) |
| Comprehensive income (loss): | | | | | | |
| Net loss for the period from January 1, 2009 through March 31, 2009 | | | | (4,489) | | (4,489) |
| Change in net unrealized gain on securities available for sale, net of reclassifications and tax effect | | | | | 121 | 121 |
| Reclassification of unrealized gain on interest rate swaps, net of tax effect | | | | | (500) | (500) |
| Total comprehensive loss | | | | | | (4,868) |
| **Balances, March 31, 2009** | $ 0 | $ 172,194 | $ 0 | $ (5,770) | $ 2,921 | $ 169,345 |

See accompanying notes to consolidated financial statements.

Table of Contents

MERCANTILE BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income (loss) | $ (2,643,000) | $ (4,489,000) |
| Adjustments to reconcile net income (loss) to net cash from operating activities | | |
| Depreciation and amortization | 615,000 | 714,000 |
| Provision for loan and lease losses | 8,400,000 | 10,400,000 |
| Stock-based compensation expense | 126,000 | 155,000 |
| Proceeds from sales of mortgage loans held for sale | 7,297,000 | 26,833,000 |
| Origination of mortgage loans held for sale | (5,326,000) | (26,802,000) |
| Net gain from sales of mortgage loans held for sale | (58,000) | (294,000) |
| Gain from sale of commercial loans | (220,000) | 0 |
| Net gain from sale of held to maturity securities | (476,000) | 0 |
| Net loss from sale and valuation write-down of foreclosed assets | 817,000 | 197,000 |
| Recognition of unrealized gain on interest rate swaps | (99,000) | (769,000) |
| Earnings on bank owned life insurance | (411,000) | (345,000) |
| Net change in: | | |
| Accrued interest receivable | 31,000 | (84,000) |
| Other assets | 466,000 | (2,705,000) |
| Accrued expenses and other liabilities | (1,186,000) | 207,000 |
| Net cash from operating activities | 7,333,000 | 3,018,000 |
| **Cash flows from investing activities** | | |
| Loan and lease originations and payments, net | 26,602,000 | 71,299,000 |
| Purchases of: | | |
| Securities available for sale | (7,525,000) | (12,639,000) |
| Securities held to maturity | 0 | (1,024,000) |
| Proceeds from: | | |
| Maturities, calls and repayments of available for sale securities | 17,958,000 | 14,093,000 |
| Sales of held to maturity securities | 20,452,000 | 0 |
| Proceeds from sales of commercial loans | 5,519,000 | 0 |
| Proceeds from sales of foreclosed assets | 4,923,000 | 487,000 |
| Purchases of premises and equipment, net | (14,000) | (12,000) |
| Net cash from investing activities | 67,915,000 | 72,204,000 |
| **Cash flows from financing activities** | | |
| Net increase (decrease) in time deposits | (64,396,000) | 47,435,000 |
| Net increase in all other deposits | 82,978,000 | 4,273,000 |
| Net decrease in securities sold under agreements to repurchase | (1,136,000) | (2,431,000) |
| Net decrease in federal funds purchased | (2,600,000) | 0 |

| | | |
|---|---|---|
| Proceeds from Federal Home Loan Bank advances | 0 | 5,000,000 |
| Maturities of Federal Home Loan Bank advances | (15,000,000) | (15,000,000) |
| Net decrease in other borrowed money | (61,000) | (2,703,000) |
| Employee stock purchase plan | 12,000 | 18,000 |
| Dividend reinvestment plan | 2,000 | 7,000 |
| Payment of cash dividends on preferred stock | (264,000) | 0 |
| Payment of cash dividends on common shares | (85,000) | (339,000) |
| Net cash from (for) financing activities | (550,000) | 36,260,000 |

See accompanying notes to consolidated financial statements.

Table of Contents

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

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| Net change in cash and cash equivalents | 74,698,000 | 111,482,000 |
| Cash and cash equivalents at beginning of period | 21,735,000 | 25,804,000 |
| Cash and cash equivalents at end of period | $ 96,433,000 | $ 137,286,000 |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the period for: | | |
| Interest | $ 10,536,000 | $ 16,827,000 |
| Federal income tax | 0 | 0 |
| Noncash financing and investing activities: | | |
| Transfers from loans and leases to foreclosed assets | 2,228,000 | 2,198,000 |
| Preferred stock cash dividend accrued | 131,000 | 0 |

See accompanying notes to consolidated financial statements.

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**1. SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

Due to our net loss, approximately 88,000 and 112,000 unvested restricted shares were not included in determining both basic and diluted earnings per share for the three month periods ended March 31, 2010 and 2009, respectively. In addition, stock options and a stock warrant for approximately 292,000 and 616,000 shares of common stock, respectively, were antidilutive and not included in determining diluted earnings per share for the three months ended March 31, 2010. Stock options for approximately 325,000 shares of common stock were antidilutive and not included in determining diluted earnings per share for the three months ended March 31, 2009. Weighted average diluted common shares outstanding equals the weighted average common shares outstanding during the three month periods ended March 31, 2010 and 2009 due to the net losses recorded during those time periods.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

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

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

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

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

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

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

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

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosure about Fair Value Measurements*. This 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. Upon adoption of the applicable portions of this standard on January 1, 2010, we provided the required disclosures as presented in Note 12. For those additional disclosures required for fiscal years beginning after December 15, 2010, we anticipate first including those disclosures in our Form 10-Q for the period ending March 31, 2011.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**2. SECURITIES**

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

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| March 31, 2010 | | | | |
| U.S. Government agency debt obligations | $ 89,973,000 | $ 684,000 | $ (532,000) | $ 90,125,000 |
| Mortgage-backed securities | 58,238,000 | 2,951,000 | 0 | 61,189,000 |
| Michigan Strategic Fund bonds | 20,550,000 | 0 | 0 | 20,550,000 |
| Municipal general obligation bonds | 32,464,000 | 459,000 | (98,000) | 32,825,000 |
| Municipal revenue bonds | 6,763,000 | 73,000 | (13,000) | 6,823,000 |
| Mutual funds | 1,436,000 | 1,000 | 0 | 1,437,000 |
| | $ 209,424,000 | $ 4,168,000 | $ (643,000) | $ 212,949,000 |
| December 31, 2009 | | | | |
| U.S. Government agency debt obligations | $ 96,438,000 | $ 490,000 | $ (1,384,000) | $ 95,544,000 |
| Mortgage-backed securities | 62,171,000 | 2,811,000 | 0 | 64,982,000 |
| Michigan Strategic Fund bonds | 20,550,000 | 0 | 0 | 20,550,000 |
| Mutual funds | 1,425,000 | 0 | (9,000) | 1,416,000 |
| | $ 180,584,000 | $ 3,301,000 | $ (1,393,000) | $ 182,492,000 |

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

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

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**2. SECURITIES** (Continued)

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

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| Description of Securities | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| March 31, 2010 | | | | | | |
| U.S. Government agency debt obligations | $ 39,330,000 | $ (502,000) | $ 5,697,000 | $ (30,000) | $ 45,027,000 | $ (532,000) |
| Mortgage-backed securities | 0 | 0 | 0 | 0 | 0 | 0 |
| Michigan Strategic Fund bonds | 0 | 0 | 0 | 0 | 0 | 0 |
| Mutual funds | 0 | 0 | 0 | 0 | 0 | 0 |
| Municipal general obligation bonds | 0 | 0 | 6,757,000 | (98,000) | 6,757,000 | (98,000) |
| Municipal revenue bonds | 0 | 0 | 784,000 | (13,000) | 784,000 | (13,000) |
| | $ 39,330,000 | $ (502,000) | $ 13,238,000 | $ (141,000) | $ 52,568,000 | $ (643,000) |
| December 31, 2009 | | | | | | |
| U.S. Government agency debt obligations | $ 50,190,000 | $ (1,322,000) | $ 7,927,000 | $ (62,000) | $ 58,117,000 | $ (1,384,000) |
| Mortgage-backed securities | 0 | 0 | 0 | 0 | 0 | 0 |
| Michigan Strategic Fund bonds | 0 | 0 | 0 | 0 | 0 | 0 |
| Mutual funds | 0 | 0 | 1,211,000 | (9,000) | 1,211,000 | (9,000) |
| Municipal general obligation bonds | 738,000 | (5,000) | 8,638,000 | (106,000) | 9,376,000 | (111,000) |
| Municipal revenue bonds | 228,000 | (12,000) | 1,073,000 | (7,000) | 1,301,000 | (19,000) |
| | $ 51,156,000 | $ (1,339,000) | $ 18,849,000 | $ (184,000) | $ 70,005,000 | $ (1,523,000) |

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**2. SECURITIES** (Continued)

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

There were 4 U.S. Government agency debt obligations, 23 municipal general obligation bonds, and 3 municipal revenue bonds in a continuous loss position for 12 months or more at March 31, 2010. At March 31, 2010, 56 debt securities with a fair value totaling $52.6 million have unrealized losses with aggregate depreciation of $0.6 million, or 0.3% from the amortized cost basis of total securities. At March 31, 2010, 224 debt securities and a mutual fund with a fair value totaling $137.6 million have unrealized gains with aggregate appreciation of $4.2 million, or 2.0% from the amortized cost basis of total securities. After we considered whether the securities were issued by the federal government or its agencies and whether downgrades by bond rating agencies had occurred, we determined that unrealized losses were due to changing interest rate environments. As we do not intend to sell our debt securities before recovery of their cost basis and we believe it is more likely than not that we will not have to sell our debt securities before recovery of the cost basis, no declines are deemed to be other-than-temporary.

The amortized cost and fair values of debt securities at March 31, 2010, by contractual maturity, are shown below. The contractual maturity is utilized below for U.S. Government agency debt obligations and municipal bonds. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**2. SECURITIES** (Continued)

The maturities of securities and their weighted average yields at March 31, 2010 are also shown in the following table. The yields for municipal securities are shown at their tax equivalent yield.

| | Weighted Average Yield | Amortized Cost | Fair Value |
|---|---|---|---|
| Due in 2010 | 6.43% | $ 6,155,000 | $ 6,221,000 |
| Due in 2011 through 2015 | 5.98 | 6,058,000 | 6,430,000 |
| Due in 2016 through 2020 | 6.80 | 15,364,000 | 15,414,000 |
| Due in 2021 and beyond | 5.30 | 101,623,000 | 101,708,000 |
| Mortgage-backed securities | 5.15 | 58,238,000 | 61,189,000 |
| Michigan Strategic Fund bonds | 3.05 | 20,550,000 | 20,550,000 |
| Mutual funds | 2.99 | 1,436,000 | 1,437,000 |
| | 5.18% | $ 209,424,000 | $ 212,949,000 |

At March 31, 2010, and December 31, 2009, the amortized cost of securities issued by the State of Michigan and all its political subdivisions totaled $39.2 million and $59.2 million, with an estimated market value of $39.6 million and $60.3 million, respectively. Total securities of any other specific issuer, other than the U.S. Government and its agencies, did not exceed 10% of shareholders equity.

The carrying value of U.S. Government agency debt obligations and mortgage-backed securities that are pledged to secure repurchase agreements, other deposits, and letters of credit issued on behalf of our customers was $147.1 million and $158.1 million at March 31, 2010 and December 31, 2009, respectively. In addition, substantially all of our municipal bonds have been pledged to the Discount Window of the Federal Reserve Bank of Chicago. Investments in Federal Home Loan Bank stock are restricted and may only be resold or redeemed by the issuer.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**3. LOANS**

Our total loans at March 31, 2010 were $1.50 billion compared to $1.54 billion at December 31, 2009, a decrease of $42.2 million, or 2.7%. The components of our outstanding balances at March 31, 2010 and December 31, 2009, and the percentage change in loans from the end of 2009 to the end of the first quarter 2010, are as follows:

| | March 31, 2010 Balance | % | December 31, 2009 Balance | % | Percent Increase (Decrease) |
|---|---|---|---|---|---|
| Real Estate: | | | | | |
| Construction and land development | $ 159,938,000 | 10.7% | $ 176,078,000 | 11.4% | (9.2)% |
| Secured by 1-4 family properties | 120,411,000 | 8.0 | 124,805,000 | 8.1 | (3.5) |
| Secured by multi-family properties | 48,768,000 | 3.3 | 47,679,000 | 3.1 | 2.2 |
| Secured by nonresidential properties | 810,665,000 | 54.1 | 814,058,000 | 52.9 | (0.4) |
| Commercial | 351,180,000 | 23.4 | 370,146,000 | 24.0 | (5.1) |
| Leases | 816,000 | 0.1 | 1,055,000 | 0.1 | (22.7) |
| Consumer | 5,846,000 | 0.4 | 5,997,000 | 0.4 | (2.5) |
| Total loans and leases | $ 1,497,624,000 | 100.0% | $ 1,539,818,000 | 100.0% | (2.7)% |

**4. ALLOWANCE FOR LOAN AND LEASE LOSSES**

The following is a summary of the change in our allowance for loan and lease losses for the three months ended March 31:

| | 2010 | 2009 |
|---|---|---|
| Balance at January 1 | $ 47,878,000 | $ 27,108,000 |
| Charge-offs | (6,846,000) | (5,740,000) |
| Recoveries | 694,000 | 116,000 |
| Provision for loan and lease losses | 8,400,000 | 10,400,000 |
| Balance at March 31 | $ 50,126,000 | $ 31,884,000 |

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**5. PREMISES AND EQUIPMENT, NET**

Premises and equipment are comprised of the following:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| Land and improvements | $ 8,531,000 | $ 8,531,000 |
| Buildings and leasehold improvements | 24,515,000 | 24,515,000 |
| Furniture and equipment | 12,546,000 | 12,532,000 |
| | 45,592,000 | 45,578,000 |
| Less: accumulated depreciation | 16,451,000 | 15,894,000 |
| Premises and equipment, net | $ 29,141,000 | $ 29,684,000 |

Depreciation expense totaled $0.6 million during the first quarter of 2010, compared to $0.7 million in the first quarter of 2009.

**6. DEPOSITS**

Our total deposits at March 31, 2010 were $1.42 billion compared to $1.40 billion at December 31, 2009, an increase of $18.6 million, or 1.3%. The components of our outstanding balances at March 31, 2010 and December 31, 2009, and percentage change in deposits from the end of 2009 to the end of the first quarter 2010, are as follows:

| | March 31, 2010 | | December 31, 2009 | | Percent Increase |
|---|---|---|---|---|---|
| | Balance | % | Balance | % | (Decrease) |
| Noninterest-bearing demand | $ 118,391,000 | 8.3% | $ 121,157,000 | 8.6% | (2.3)% |
| Interest-bearing checking | 114,056,000 | 8.0 | 86,320,000 | 6.2 | 32.1 |
| Money market | 63,696,000 | 4.5 | 32,008,000 | 2.3 | 99.0 |
| Savings | 37,688,000 | 2.7 | 38,625,000 | 2.8 | (2.4) |
| Time, under $100,000 | 80,862,000 | 5.7 | 105,195,000 | 7.5 | (23.1) |
| Time, $100,000 and over | 270,612,000 | 19.1 | 293,455,000 | 20.9 | (7.8) |
| | 685,305,000 | 48.3 | 676,760,000 | 48.3 | 1.3 |
| Out-of-area interest- bearing checking | 27,257,000 | 1.9 | 0 | NA | NA |
| Out-of-area time, under $100,000 | 53,414,000 | 3.8 | 62,760,000 | 4.5 | (14.9) |
| Out-of-area time, $100,000 and over | 654,233,000 | 46.0 | 662,107,000 | 47.2 | (1.2) |
| | 734,904,000 | 51.7 | 724,867,000 | 51.7 | 1.4 |
| Total deposits | $ 1,420,209,000 | 100.0% | $ 1,401,627,000 | 100.0% | 1.3% |

(Continued)

16.

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**7. SHORT-TERM BORROWINGS**

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

| | Three Months Ended March 31, 2010 | Twelve Months Ended December 31, 2009 |
|---|---|---|
| Outstanding balance at end of period | $ 98,619,000 | $ 99,755,000 |
| Average interest rate at end of period | 1.40% | 1.41% |
| Average balance during the period | $ 99,042,000 | $ 98,409,000 |
| Average interest rate during the period | 1.41% | 1.87% |
| Maximum month end balance during the period | $ 98,619,000 | $ 111,692,000 |

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

**8. FEDERAL HOME LOAN BANK ADVANCES**

Our outstanding balances at March 31, 2010 totaled $190.0 million and mature at varying dates from April 2010 through January 2014, with fixed rates of interest from 2.97% to 4.18% and averaging 3.52%. At December 31, 2009, outstanding balances totaled $205.0 million with maturities ranging from January 2010 through January 2014 and fixed rates of interest from 2.95% to 4.18% and averaging 3.50%.

Each advance is payable at its maturity date, and is subject to a prepayment fee if paid prior to the maturity date. The advances are collateralized by residential mortgage loans, first mortgage liens on multi-family residential property loans, first mortgage liens on commercial real estate property loans, and substantially all other assets of our bank, under a blanket lien arrangement. Our borrowing line of credit as of March 31, 2010 totaled about $249.0 million, with availability approximating $50.0 million.

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

| | |
|---|---|
| 2010 | $ 50,000,000 |
| 2011 | 85,000,000 |
| 2012 | 40,000,000 |
| 2013 | 10,000,000 |
| 2014 | 5,000,000 |

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**9. COMMITMENTS AND OFF-BALANCE SHEET RISK**

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

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

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

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| Commercial unused lines of credit | $ 184,736,000 | $ 205,018,000 |
| Unused lines of credit secured by 1 4 family residential properties | 25,115,000 | 24,916,000 |
| Credit card unused lines of credit | 8,321,000 | 8,565,000 |
| Other consumer unused lines of credit | 4,286,000 | 4,526,000 |
| Commitments to extend credit | 13,938,000 | 7,701,000 |
| Standby letters of credit | 34,425,000 | 36,512,000 |
| | $ 270,821,000 | $ 287,238,000 |

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Certain of our commercial loan customers have entered into interest rate swap agreements directly with our correspondent banks. To assist our commercial loan customers in these transactions, and to encourage our correspondent banks to enter into the interest rate swap transactions with minimal credit underwriting analyses on their part, we have entered into risk participation agreements with the correspondent banks whereby we agree to make payments to the correspondent banks owed by our commercial loan customers under the interest rate swap agreement in the event that our commercial loan customers do not make the payments. We are not a party to the interest rate swap agreements under these arrangements. As of March 31, 2010, the total notional amount of the underlying interest rate swap agreements was $57.4 million, with a net fair value from our commercial loan customers perspective of negative $4.2 million. Payments made in regards to the risk participation agreements total $385,000; however, we believe the affected customer will reimburse us for such payments and therefore we have accrued no valuation allowance for our receivable from this customer and have accrued no liability for potential future payments. These risk participation agreements are considered financial guarantees in accordance with applicable accounting guidance and are therefore recorded as liabilities at fair value, generally equal to the fees collected at the time of their execution. These liabilities are accreted into income during the term of the interest rate swap agreements, generally ranging from four to fifteen years.

**10. HEDGING ACTIVITIES**

Our interest rate risk policy includes guidelines for measuring and monitoring interest rate risk. Within these guidelines, parameters have been established for maximum fluctuations in net interest income. Possible fluctuations are measured and monitored using net interest income simulation. Our policy provides for the use of certain derivative instruments and hedging activities to aid in managing interest rate risk to within the policy parameters. A majority of our assets are comprised of commercial loans on which the interest rates are variable, while a majority of our liabilities are comprised of fixed rate certificates of deposit and FHLB advances. Due to this repricing mismatch, we may periodically enter into derivative financial instruments to mitigate the exposure in cash flows resulting from changes in interest rates.

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**10. HEDGING ACTIVITIES** (Continued)

On October 30, 2008, we terminated all of our interest rate swaps. The termination coincided with our decision to not lower our prime rate in association with the Federal Open Market Committee s reduction of the targeted federal funds rate by 50 basis points on October 29, 2008. Virtually all of our prime rate-based commercial floating rate loans are tied to the Mercantile Bank Prime Rate, while our interest rate swaps utilized the Wall Street Journal Prime Rate. The resulting difference negatively impacted the effectiveness of our interest rate swaps, so we believed it was prudent to terminate them. The aggregate fair value of the interest rate swaps on October 30, 2008 was $2.4 million, which has been accreted into interest income on loans and leases based on the original term of the interest rate swaps. As of March 31, 2010, we had fully accreted the $2.4 million into interest income, including $0.1 million during the first quarter of 2010.

**11. FAIR VALUES OF FINANCIAL INSTRUMENTS**

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

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Values | Fair Values | Carrying Values | Fair Values |
| Financial assets | | | | |
| Cash and cash equivalents | $ 96,433,000 | $ 96,433,000 | $ 21,735,000 | $ 21,735,000 |
| Securities available for sale | 212,949,000 | 212,949,000 | 182,492,000 | 182,492,000 |
| Securities held to maturity | 0 | 0 | 59,211,000 | 60,271,000 |
| Federal Home Loan Bank stock | 15,681,000 | 15,681,000 | 15,681,000 | 15,681,000 |
| Loans, net | 1,447,498,000 | 1,466,054,000 | 1,491,940,000 | 1,501,860,000 |
| Bank owned life insurance | 45,436,000 | 45,436,000 | 45,024,000 | 45,024,000 |
| Accrued interest receivable | 7,057,000 | 7,057,000 | 7,088,000 | 7,088,000 |
| Financial liabilities | | | | |
| Deposits | 1,420,209,000 | 1,430,280,000 | 1,401,627,000 | 1,407,310,000 |
| Securities sold under agreements to repurchase | 98,619,000 | 98,619,000 | 99,755,000 | 99,755,000 |
| Federal funds purchased | 0 | 0 | 2,600,000 | 2,600,000 |
| Federal Home Loan Bank advances | 190,000,000 | 193,414,000 | 205,000,000 | 208,435,000 |
| Subordinated debentures | 32,990,000 | 33,016,000 | 32,990,000 | 32,971,000 |
| Accrued interest payable | 4,506,000 | 4,506,000 | 6,158,000 | 6,158,000 |

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**11. FAIR VALUES OF FINANCIAL INSTRUMENTS** (Continued)

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

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

**12. FAIR VALUES**

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**12. FAIR VALUES** (Continued)

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

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

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

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

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

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

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**12. FAIR VALUES** (Continued)

*Mortgage loans held for sale*. Mortgage loans held for sale are carried at the lower of cost or fair value and are measured on a nonrecurring basis. Fair value is based on independent quoted market prices, where applicable, or the prices for other mortgage whole loans with similar characteristics. As of March 31, 2010 and December 31, 2009, we determined that the fair value of our mortgage loans held for sale was similar to the cost; therefore, we carried the $0.6 million and $0.9 million, respectively, of such loans at cost so they are not included in the nonrecurring table below.

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

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

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

*Assets and Liabilities Measured at Fair Value on a Recurring Basis*

The balances of assets and liabilities measured at fair value on a recurring basis as of March 31, 2010 are as follows:

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| U.S. Government agency debt obligations | $ 90,125,000 | $ 0 | $ 90,125,000 | $ 0 |
| Mortgage-backed securities | 61,189,000 | 0 | 61,189,000 | 0 |
| Michigan Strategic Fund bonds | 20,550,000 | 0 | 20,550,000 | 0 |
| Municipal general obligation bonds | 32,825,000 | 0 | 32,825,000 | 0 |
| Municipal revenue bonds | 6,823,000 | 0 | 6,823,000 | 0 |
| Mutual funds | 1,437,000 | 0 | 1,437,000 | 0 |
| Total | $ 212,949,000 | $ 0 | $ 212,949,000 | $ 0 |

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**12. FAIR VALUES** (Continued)

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

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

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

The balances of assets and liabilities measured at fair value on a nonrecurring basis as of March 31, 2010 are as follows:

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Impaired loans [1] | $ 50,214,000 | $ 0 | $ 0 | $ 50,214,000 |
| Foreclosed assets [1] | 23,096,000 | 0 | 0 | 23,096,000 |
| Total | $ 73,310,000 | $ 0 | $ 0 | $ 73,310,000 |

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

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Impaired loans [1] | $ 41,456,000 | $ 0 | $ 0 | $ 41,456,000 |
| Foreclosed assets [1] | 26,608,000 | 0 | 0 | 26,608,000 |

| | | | | |
|---|---|---|---|---|
| Total | $ 68,064,000 | $ 0 | $ 0 | $ 68,064,000 |

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

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

## 13. REGULATORY MATTERS

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

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

Our actual capital levels (dollars in thousands) and minimum required levels were:

| | Actual | | Minimum Required for Capital Adequacy Purposes | | Minimum Required to be Well Capitalized Under Prompt Corrective Action Regulations | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| March 31, 2010 | | | | | | |
| Total capital (to risk weighted assets) | | | | | | |
| Consolidated | $ 189,758 | 11.3% | $ 134,436 | 8.0% | $ NA | NA |
| Bank | 188,140 | 11.2 | 134,319 | 8.0 | 167,898 | 10.0% |
| Tier 1 capital (to risk weighted assets) | | | | | | |
| Consolidated | 168,393 | 10.0 | 67,218 | 4.0 | NA | NA |
| Bank | 166,793 | 9.9 | 67,160 | 4.0 | 100,739 | 6.0 |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | 168,393 | 8.8 | 76,831 | 4.0 | NA | NA |
| Bank | 166,793 | 8.7 | 76,775 | 4.0 | 95,968 | 5.0 |

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**13. REGULATORY MATTERS** (Continued)

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

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

Our and our bank s ability to pay cash and stock dividends is subject to limitations under various laws and regulations and to prudent and sound banking practices. On January 14, 2010, we declared a $0.01 per share cash dividend on our common stock, which was paid on March 10, 2010 to record holders as of February 10, 2010. Because we had a retained deficit at the time of the declaration, the cash dividend was recorded as a reduction of our common stock account. In April 2010, we suspended future payments of cash dividends on our common stock until economic conditions and our financial performance improve.

(Continued)

Table of Contents

MERCANTILE BANK CORPORATION

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

**Forward Looking Statements**

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

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

**Introduction**

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

**Critical Accounting Policies**

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

Table of Contents

MERCANTILE BANK CORPORATION

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

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

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

Table of Contents

MERCANTILE BANK CORPORATION

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

**Financial Overview**

Our earnings performance has been negatively impacted by substantial provisions to the allowance. Ongoing state, regional and national economic struggles have negatively impacted some of our borrowers cash flows and underlying collateral values, leading to increased nonperforming assets, higher loan and lease charge-offs and increased overall credit risk within our loan portfolio. We continue to work with our borrowers to develop constructive dialogue to strengthen our relationships and enhance our ability to resolve complex issues; however, with the environment for the banking industry likely to remain stressed until economic conditions improve, credit quality will continue to be our major concern. We will remain vigilant in the identification and administration of problem assets, but provisions to the allowance will likely remain above historical levels for some period of time, dampening future earnings performance. Our earnings performance also reflects positive steps we have taken to not only partially mitigate the impact of asset quality-related costs in the near term, but to benefit us on a longer-term basis as well. First, our net interest margin has been expanding as we have replaced maturing high-rate deposits with lower-cost funds, while at the same time our commercial loan pricing initiatives offset the negative impact of an increase in nonaccrual loans. Despite a substantial reduction in total loans and leases, our net interest income is on an increasing trend due to the improving net interest margin, and we expect our net interest margin to improve further over the next several quarters. Next, our regulatory risk-based capital ratios are also increasing, as the sale of preferred stock under the Department of Treasury s Capital Purchase Program and the reduction of loans and leases outstanding have more than offset the impact of our net losses. In addition, we are increasing our local deposit balances, reflecting the successful implementation of various initiatives, campaigns and product enhancements. The local deposit growth, combined with the reduction of loans and leases outstanding, are providing for a substantial reduction of, and reliance on, wholesale funds. Lastly, we are starting to see the positive effect of our branch consolidation and other overhead cost reduction initiatives, as we continue to make strides to reduce controllable noninterest expense.

**Financial Condition**

During the first three months of 2010, our total assets decreased $3.3 million, and totaled $1.90 billion as of March 31, 2010. The decline in total assets was comprised primarily of a $42.2 million reduction in total loans and leases and a $28.8 million decrease in securities, more than offsetting a $74.7 million increase in cash and cash equivalents. Total deposits increased $18.6 million, while Federal Home Loan Bank ( FHLB ) advances decreased $15.0 million.

Table of Contents

MERCANTILE BANK CORPORATION

Commercial loans and leases declined by $37.6 million during the first three months of 2010, and at March 31, 2010 totaled $1.37 billion, or 91.6% of the total loan and lease portfolio. The decline in outstanding balances primarily reflects the slowdown in business activity in our markets and the impact of a concerted effort on our part to reduce exposure to certain non-owner occupied commercial real estate ( CRE ) and automotive-related businesses. The largest decline occurred in the commercial and industrial ( C&I ) loan portfolio, where total outstanding balances were reduced by about $19.0 million, in large part reflecting the slowdown in business activity and a corresponding reduction in accounts receivable and inventory financings. We would expect to see an increase in commercial line of credit usage when economic conditions improve. During the first three months of 2010, commercial loans collateralized by non-owner occupied real estate declined by about $16.0 million. Our systematic approach to reducing our exposure to certain CRE lending will be pro-longed, given the nature of CRE lending and the current depressed economic conditions; however, we believe that such a reduction is in our best interest when taking into account the increased inherent credit risk, relatively low loan rates and nominal deposit balances associated with targeted borrowing relationships.

The commercial loan and lease portfolio represents loans to businesses generally located within our market areas. Approximately 74% of the commercial loan and lease portfolio is primarily secured by real estate properties, with the remaining generally secured by other business assets such as accounts receivable, inventory and equipment. The continued significant concentration of the loan and lease portfolio in commercial loans and leases is consistent with our strategy of focusing a substantial amount of our efforts on commercial banking. Corporate and business lending is an area of expertise for our senior management team, and our commercial lenders have extensive commercial lending experience, with most having at least ten years experience. Of each of the loan categories that we originate, commercial loans and leases are most efficiently originated and managed, thus limiting overhead costs by necessitating the attention of fewer employees. Our commercial lending business generates the largest portion of local deposits and is our primary source of demand deposits.

Table of Contents

MERCANTILE BANK CORPORATION

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

LOANS SECURED BY REAL ESTATE

| | 3/31/10 | 12/31/09 | 9/30/09 | 6/30/09 | 3/31/09 |
|---|---|---|---|---|---|
| Residential-Related: | | | | | |
| Vacant Land | $ 20,871,000 | $ 19,465,000 | $ 20,630,000 | $ 21,400,000 | $ 22,244,000 |
| Land Development | 32,199,000 | 34,027,000 | 33,862,000 | 42,053,000 | 50,402,000 |
| Construction | 7,872,000 | 7,199,000 | 9,446,000 | 11,157,000 | 14,646,000 |
| | 60,942,000 | 60,691,000 | 63,938,000 | 74,610,000 | 87,292,000 |
| Comm I Non-Owner Occupied: | | | | | |
| Vacant Land | 22,304,000 | 25,549,000 | 25,564,000 | 29,005,000 | 28,775,000 |
| Land Development | 19,058,000 | 19,402,000 | 22,412,000 | 23,469,000 | 24,636,000 |
| Construction | 52,107,000 | 65,697,000 | 79,339,000 | 94,225,000 | 93,322,000 |
| Commercial Buildings | 539,284,000 | 537,891,000 | 528,727,000 | 545,501,000 | 556,280,000 |
| | 632,753,000 | 648,539,000 | 656,042,000 | 692,200,000 | 703,013,000 |
| Comm I Owner Occupied: | | | | | |
| Construction | 1,651,000 | 1,404,000 | 5,456,000 | 7,407,000 | 9,290,000 |
| Commercial Buildings | 316,302,000 | 324,451,000 | 349,335,000 | 359,610,000 | 365,250,000 |
| | 317,953,000 | 325,855,000 | 354,791,000 | 367,017,000 | 374,540,000 |
| Total | $ 1,011,648,000 | $ 1,035,085,000 | $ 1,074,771,000 | $ 1,133,827,000 | $ 1,164,845,000 |

Residential mortgage loans and consumer loans declined in aggregate $4.5 million during the first three months of 2010, and at March 31, 2010, totaled $126.3 million, or 8.4% of the total loan and lease portfolio. Although residential mortgage loan and consumer loan portfolios may increase in future periods, we expect the commercial sector of the lending efforts and resultant assets to remain the dominant loan portfolio category.

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

distressed market conditions.

31.

Table of Contents

MERCANTILE BANK CORPORATION

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

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

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

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

Table of Contents

MERCANTILE BANK CORPORATION

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

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

As of March 31, 2010, nonperforming assets totaled $117.6 million, or 6.18% of total assets. Nonperforming loans and leases totaled $94.5 million and foreclosed properties/repossessed assets equaled $23.1 million. As of March 31, 2010, nonperforming loans secured by CRE, combined with all foreclosed properties, totaled $68.1 million. Nonperforming loans and foreclosed properties associated with the development of residential-related real estate totaled $34.2 million, with another $5.9 million in nonperforming loans secured by, and foreclosed properties consisting of, residential properties. Nonperforming C&I loans and repossessed assets totaled $9.3 million. Net loan and lease charge-offs during the first quarter of 2010 totaled $6.2 million, or an annualized 1.64% of average total loans and leases. Although lower than the level (as a percent of average total loans and leases) charged-off throughout 2009, net loan and lease charge-offs during 2010 are expected to remain elevated compared to historical averages due to a higher volume of nonperforming loans and leases and significant declines in property values.

Table of Contents

MERCANTILE BANK CORPORATION

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

NONPERFORMING ASSETS

| | 3/31/10 | 12/31/09 | 9/30/09 | 6/30/09 | 3/31/09 |
|---|---|---|---|---|---|
| Residential Real Estate: | | | | | |
| Land Development | $ 22,781,000 | $ 19,722,000 | $ 13,645,000 | $ 10,422,000 | $ 12,646,000 |
| Construction | 11,425,000 | 12,103,000 | 13,021,000 | 12,882,000 | 13,538,000 |
| Owner Occupied / Rental | 5,908,000 | 7,493,000 | 6,830,000 | 4,910,000 | 4,877,000 |
| | 40,114,000 | 39,318,000 | 33,496,000 | 28,214,000 | 31,061,000 |
| Commercial Real Estate: | | | | | |
| Land Development | 3,031,000 | 2,971,000 | 4,621,000 | 2,292,000 | 2,383,000 |
| Construction | 1,238,000 | 1,268,000 | 228,000 | 0 | 0 |
| Owner Occupied | 17,311,000 | 19,918,000 | 21,429,000 | 17,378,000 | 8,753,000 |
| Non-Owner Occupied | 46,552,000 | 38,417,000 | 36,473,000 | 28,110,000 | 28,364,000 |
| | 68,132,000 | 62,574,000 | 62,751,000 | 47,780,000 | 39,500,000 |
| Non-Real Estate: | | | | | |
| Commercial Assets | 9,303,000 | 9,758,000 | 14,510,000 | 10,629,000 | 13,155,000 |
| Consumer Assets | 8,000 | 8,000 | 8,000 | 8,000 | 31,000 |
| | 9,311,000 | 9,766,000 | 14,518,000 | 10,637,000 | 13,186,000 |
| Total | $ 117,557,000 | $ 111,658,000 | $ 110,765,000 | $ 86,631,000 | $ 83,747,000 |

Table of Contents

MERCANTILE BANK CORPORATION

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

NET LOAN AND LEASE CHARGE-OFFS

| | 1st Qtr 2010 | 4th Qtr 2009 | 3rd Qtr 2009 | 2nd Qtr 2009 | 1st Qtr 2009 |
|---|---|---|---|---|---|
| Residential Real Estate: | | | | | |
| Land Development | $ 565,000 | $ 2,204,000 | $ 467,000 | $ 1,060,000 | $ 624,000 |
| Construction | 587,000 | 733,000 | 3,208,000 | 1,023,000 | 86,000 |
| Owner Occupied / Rental | 326,000 | 946,000 | 530,000 | 729,000 | 1,442,000 |
| | 1,478,000 | 3,883,000 | 4,205,000 | 2,812,000 | 2,152,000 |
| Commercial Real Estate: | | | | | |
| Land Development | 617,000 | 45,000 | 0 | 74,000 | 0 |
| Construction | 0 | 0 | 0 | 0 | 0 |
| Owner Occupied | 1,091,000 | 1,140,000 | 1,254,000 | 593,000 | 75,000 |
| Non-Owner Occupied | 1,945,000 | 3,009,000 | 3,265,000 | 2,347,000 | 786,000 |
| | 3,653,000 | 4,194,000 | 4,519,000 | 3,014,000 | 861,000 |
| Non-Real Estate: | | | | | |
| Commercial Assets | 1,012,000 | 2,788,000 | 2,232,000 | 4,918,000 | 2,475,000 |
| Consumer Assets | 9,000 | (1,000) | 7,000 | 35,000 | 136,000 |
| | 1,021,000 | 2,787,000 | 2,239,000 | 4,953,000 | 2,611,000 |
| Total | $ 6,152,000 | $ 10,864,000 | $ 10,963,000 | $ 10,779,000 | $ 5,624,000 |

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

NONPERFORMING LOANS AND LEASES

| | 3/31/10 | 12/31/09 | 9/30/09 | 6/30/09 | 3/31/09 |
|---|---|---|---|---|---|
| Past due 90 days or more and accruing interest | $ 0 | $ 243,000 | $ 3,040,000 | $ 48,000 | $ 2,426,000 |
| Nonaccrual | 88,450,000 | 81,818,000 | 87,190,000 | 73,623,000 | 71,943,000 |
| Troubled debt restructurings | 6,011,000 | 2,989,000 | 1,012,000 | 0 | 0 |
| Total | $ 94,461,000 | $ 85,050,000 | $ 91,242,000 | $ 73,671,000 | $ 74,369,000 |

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

Table of Contents

MERCANTILE BANK CORPORATION

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

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

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

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

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

Table of Contents

MERCANTILE BANK CORPORATION

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

Securities decreased by $28.8 million during the first three months of 2010, totaling $228.6 million as of March 31, 2010. The decline in the securities portfolio primarily reflects the sale of certain tax-exempt municipal bonds with an aggregate book value of $20.0 million, which were sold in late March after analyzing our current and forecasted federal income tax position. A vast majority of the sales proceeds were used to purchase U.S. Government agency bonds during April and early May. Proceeds from matured and called U.S. Government agency bonds during the first three months of 2010 totaled $14.0 million, with another $4.0 million received from principal paydowns on mortgage-backed securities. Purchases during the first three months of 2010, consisting almost exclusively of U.S. Government agency bonds, totaled $7.5 million. At March 31, 2010, the portfolio was comprised of U.S. Government agency bonds (39%), U.S. Government agency issued or guaranteed mortgage-backed securities (27%), tax-exempt municipal general obligation and revenue bonds (17%), Michigan Strategic Fund bonds (9%), Federal Home Loan Bank stock (7%) and mutual funds (1%). All of our securities are currently designated as available for sale. Historically, we had designated our tax-exempt municipal bonds as held to maturity; however, we changed the designation to available for sale immediately after the sale of certain of our tax-exempt municipal bonds in late March. We maintain the securities portfolio at levels to provide adequate pledging and secondary liquidity for our daily operations.

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

Federal funds sold, consisting of excess funds sold overnight to a correspondent bank, along with investments in interest-bearing deposits at correspondent banks, are used to manage daily liquidity needs and interest rate sensitivity. During the first three months of 2010, the average balance of these funds equaled $58.4 million, or 3.2% of average earning assets. This level is similar to that during all of 2009, but considerably higher than the historical average of less than 1.0%. Given the stressed market and economic conditions, in early 2009 we made the decision to operate with a higher than traditional balance of federal funds sold and interest-bearing deposits. We expect to maintain the higher balance of federal funds sold and other interest-bearing deposits, likely 2.0% to 3.0% of average earning assets, until market and economic conditions return to more normalized levels.

Premises and equipment at March 31, 2010 equaled $29.1 million, a decrease of $0.6 million over the past three months. Purchases of premises and equipment during the first three months of 2010 were nominal, while depreciation expense totaled $0.6 million. On December 30, 2009, all FDIC-insured financial institutions were required to pre-pay estimated FDIC deposit insurance assessments for the fourth quarter of 2009 and the years 2010, 2011 and 2012. The amount we paid equaled $16.3 million, which will be expensed over the future quarterly assessment periods. As of March 31, 2010, the balance of this prepaid asset was $15.1 million.

Table of Contents

MERCANTILE BANK CORPORATION

Foreclosed and repossessed assets totaled $23.1 million at March 31, 2010, compared to $26.6 million on December 31, 2009. The $3.5 million net decline consisted of $5.1 million in sales proceeds, $0.9 million in valuation write-downs, and $2.5 million in transfers from the loan and lease portfolio. We expect foreclosed and repossessed assets to remain at elevated levels as we move through the difficult economic environment and in certain situations elect to foreclose or repossess collateral. The State of Michigan has a relatively protracted foreclosure process that generally takes six to twelve months before deed is obtained. While we expect further transfers from loans and leases to foreclosed and repossessed assets in future periods reflecting our collection efforts on impaired lending relationships, we are hopeful that the increased sales activity we witnessed during the first quarter of 2010 and the latter part of 2009 will continue and limit the overall increase in this nonperforming asset category.

Deposits increased $18.6 million during the first three months of 2010, totaling $1.42 billion at March 31, 2010. Local deposits increased $8.6 million, while out-of-area deposits increased $10.0 million. As a percent of total deposits, local deposits equaled 48.3% on March 31, 2010, unchanged from the level at December 31, 2009. In comparing balances as of March 31, 2010 to those at December 31, 2008, total deposits have declined by $179.4 million, consisting of a $215.0 million increase in local deposits and a $394.4 million decrease in out-of-area deposits. The decline in out-of-area deposits primarily results from the decline in total loans and leases and the increase in local deposits. The increase in local deposits reflects various programs and initiatives we have implemented over the past five quarters, including: certificate of deposit campaign; implementation of several deposit-gathering initiatives in our commercial lending function; introduction of new deposit-related products and services; and the continuation of providing our customers with the latest in technological advances that give improved information, convenience and timeliness.

Noninterest-bearing checking deposit accounts remain relatively stable, averaging between $110.0 million and $120.0 million over the past several years, and $114.5 million during the first three months of 2010. Local interest-bearing checking accounts, in large part reflecting the strong success of our executive banking product, increased $27.7 million during the first three months of 2010, and are up $63.8 million since year-end 2008. Money market deposit accounts increased $31.7 million during the first three months of 2010, and are up $38.8 million since year-end 2008. Certificates of deposit purchased by customers located within our market areas declined $47.2 million during the first three months of 2010, after increasing $164.1 million during 2009. During the first quarter of 2009, we ran a high-rate one-year certificate of deposit campaign that raised about $65.0 million, with most of the dollars representing new deposits to our bank. As these certificates of deposit matured during the first quarter of 2010, we were able to retain about 70% of the maturing funds. A majority of the funds that remained in our bank were deposited into either our executive banking product or a money market deposit account.

Deposits obtained from customers located outside of our market areas increased $10.0 million during the first three months of 2010, but have declined $394.4 million since year-end 2008. As of March 31, 2010, out-of-area deposits totaled $734.9 million. Out-of-area deposits consist of certificates of deposit and interest-bearing checking accounts obtained from depositors located outside our market areas and placed by deposit brokers for a fee, but also include certificates of deposit obtained from the deposit owners directly. The owners of out-of-area deposits include individuals, businesses and municipal governmental units located throughout the United States. The significant decline in out-of-area deposits since year-end 2008 primarily reflects the influx of cash resulting from the reduction in total loans and leases and from the increase in local deposits.

Table of Contents

MERCANTILE BANK CORPORATION

Repurchase agreements decreased $1.1 million during the first three months of 2010, totaling $98.6 million as of March 31, 2010. As part of our sweep account program, collected funds from certain business noninterest-bearing checking accounts are invested into over-night interest-bearing repurchase agreements. Such repurchase agreements are not deposit accounts and are not afforded federal deposit insurance.

FHLB advances declined $15.0 million during the first three months of 2010, and are down $80.0 million since year-end 2008. As of March 31, 2010, FHLB advances totaled $190.0 million. The decline in FHLB advances since year-end 2008 primarily reflects the influx of cash resulting from the reduction in total loans and leases and from the increase in local deposits. The FHLB advances are collateralized by residential mortgage loans, first mortgage liens on multi-family residential property loans, first mortgage liens on commercial real estate property loans, and substantially all other assets of our bank, under a blanket lien arrangement. Our borrowing line of credit as of March 31, 2010 totaled about $249.0 million, with availability approximating $50.0 million.

**Liquidity**

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

Our liquidity strategy is to fund loan growth with deposits, repurchase agreements and FHLB advances, and to maintain an adequate level of short- and medium-term investments to meet typical daily loan and deposit activity. To assist in providing needed funds, we have regularly obtained monies from wholesale funding sources. Wholesale funds, comprised primarily of deposits from customers outside of our market areas and advances from the FHLB, totaled $939.9 million, or 54.5% of combined deposits and borrowed funds as of March 31, 2010, compared to $947.5 million, or 55.0% of combined deposits and borrowed funds as of December 31, 2009, and $1.41 billion, or 71.5% of combined deposits and borrowed funds as of December 31, 2008.

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

Table of Contents

MERCANTILE BANK CORPORATION

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

As a member of the Federal Home Loan Bank of Indianapolis, we have access to the FHLB advance borrowing programs. Advances totaled $190.0 million at March 31, 2010, compared to $205.0 million and $270.0 million outstanding at December 31, 2009 and December 31, 2008, respectively. Based on available collateral at March 31, 2010, we could borrow an additional $50.0 million. We also have the ability to borrow up to $30.0 million on a daily basis through a correspondent bank using an established unsecured federal funds purchased line of credit. During the first quarter of 2010, our federal funds purchased position averaged less than $0.1 million, compared to an average federal funds sold position of $50.5 million and another $7.9 million invested in interest-bearing deposits at correspondent banks. During 2009, our federal funds purchased position averaged only $0.1 million, compared to an average federal funds sold position of $53.8 million and another $6.7 million invested in interest-bearing deposits at correspondent banks. Given the volatile market and stressed economic conditions, we have been operating with a higher than normal balance of federal funds sold and other short-term investments. It is expected that we will maintain a higher than historical level of liquid funds, likely to average 2% to 3% of average earning assets, until market and economic conditions return to more normalized levels. As a result, we expect the use of our federal funds purchased line of credit, in at least the near future, will be rare, if at all.

We have a line of credit through the Discount Window of the Federal Reserve Bank of Chicago. Using a substantial majority of our tax-exempt municipal securities as collateral, at March 31, 2010 we could have borrowed up to about $34.0 million for terms of 1 to 28 days. We did not utilize this line of credit during the first three months of 2010 or at any time during 2009, and do not plan to access this line of credit in future periods.

In addition to normal loan funding and deposit flow, we must maintain liquidity to meet the demands of certain unfunded loan commitments and standby letters of credit. As of March 31, 2010, we had a total of $236.4 million in unfunded loan commitments and $34.4 million in unfunded standby letters of credit. Of the total unfunded loan commitments, $222.5 million were commitments available as lines of credit to be drawn at any time as customers cash needs vary, and $13.9 million were for loan commitments expected to close and become funded within the next twelve months. The level of commitments to make loans has declined significantly when compared to historical levels, primarily reflecting poor economic conditions. We monitor fluctuations in loan balances and commitment levels, and include such data in our overall liquidity management.

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

Table of Contents

MERCANTILE BANK CORPORATION

**Capital Resources**

Shareholders equity is a noninterest-bearing source of funds that generally provides support for asset growth and the absorption of operating losses. Shareholders equity was $138.2 million at March 31, 2010, compared to $140.1 million at December 31, 2009. The $1.9 million decline during the first three months of 2010 is primarily due to the loss attributable to common shares of $3.0 million. Positively impacting shareholders equity during the first three months of 2010 was a $1.0 million tax-adjusted increase in the market value of our available for sale securities portfolio.

Despite the reduction in shareholders equity during the first three months of 2010, our and our bank s regulatory capital ratios increased, and our bank remains well capitalized . As of March 31, 2010, our bank s total risk-based capital ratio was 11.2%, compared to 11.1% at December 31, 2009. Our bank s total regulatory capital, consisting of shareholders equity plus a portion of the allowance, declined by $3.0 million during the first three months of 2010, reflecting a net loss of $1.9 million, a reduction of $0.6 million in eligible allowance due to a decline in total risk-weighted assets, and cash dividends totaling $0.5 million. Despite the reduction in total regulatory capital, our bank s total risk-based capital ratio increased due to a decline of $46.6 million in total risk-weighted assets, primarily resulting from a reduction in commercial loans. As of March 31, 2010, our bank s total regulatory capital equaled $188.1 million, or $20.2 million in excess of the 10.0% minimum which is among the requirements to be categorized as well capitalized . Our and our bank s capital ratios as of March 31, 2010 and December 31, 2009 are disclosed in Note 12 of the Notes to Consolidated Financial Statements.

We and our bank are subject to regulatory capital requirements administered by state and federal banking agencies. Failure to meet the various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements. Our bank s ability to pay cash and stock dividends is subject to limitations under various laws and regulations, to prudent and sound banking practices, and to contractual provisions relating to our subordinated debentures and participation in the Capital Purchase Program. On January 14, 2010, we declared a $0.01 per share cash dividend on our common stock that was paid on March 10, 2010 to shareholders of record on February 10, 2010. In April 2010, we suspended future payments of cash dividends on our common stock until economic conditions and our financial condition improve.

**Results of Operations**

We recorded a net loss attributable to common shares of $3.0 million for the first quarter of 2010 ($0.35 per basic and diluted share), compared with a net loss of $4.5 million ($0.53 per basic and diluted share) recorded during the first quarter of 2009. The establishment of a valuation allowance against our net deferred tax asset in the fourth quarter of 2009 has significantly limited our ability to recognize federal income tax benefits during periods in which net losses are recorded, thereby distorting bottom line earnings performance comparisons with previous quarters. On a pre-tax basis, our net loss was $3.1 million in the first quarter of 2010 compared to $7.3 million in the first quarter of 2009. The 58.1% improvement in earnings performance on a pre-tax basis in the first quarter of 2010 compared to the year-ago quarter primarily resulted from increased net interest income and decreased provision expense. The net loss recorded during the first quarter of 2010 is primarily the result of a substantial provision for loan and lease losses, reflecting continuing deterioration in the loan portfolio, most notably in the CRE and C&D segments. The declining state, regional and national economies have significantly hampered certain commercial borrowers cash flows and negatively impacted real estate values, resulting in an increasing level of nonperforming assets and elevated level of net loan and lease charge-offs.

Table of Contents

MERCANTILE BANK CORPORATION

Interest income during the first quarter of 2010 was $23.2 million, a decrease of $4.8 million, or 17.2%, from the $28.0 million earned during the first quarter of 2009. The reduction in interest income is primarily attributable to a significant decrease in earning assets, and to a much lesser extent, a declining yield on earning assets. During the first three months of 2010, earning assets averaged $1.82 billion, a decline of $331.4 million, or 15.4%, from the $2.16 billion in average earning assets during the first quarter of 2009. Average loans and leases were down $304.5 million, average federal funds sold decreased $24.3 million, average securities increased $6.9 million, and average short-term investments decreased $9.5 million. During the first three months of 2010 and 2009, earning assets had a weighted average rate (tax equivalent-adjusted basis) of 5.22% and 5.33%, respectively. The decline in earning asset yield in the first quarter of 2010 compared to the prior-year first quarter primarily resulted from a higher level of nonperforming assets. At March 31, 2010, nonperforming assets totaled $117.6 million, or 6.18% of total assets, up from $83.7 million, or 3.74% of total assets, at March 31, 2009.

Interest expense during the first quarter of 2010 was $8.9 million, a decrease of $7.3 million, or 45.2%, from the $16.2 million expensed during the first quarter of 2009. The reduction in interest expense is primarily attributable to a decline in the weighted average cost of interest-bearing liabilities and a decrease in the volume of interest-bearing liabilities. During the first three months of 2010 and 2009, interest-bearing liabilities had a weighted average rate of 2.17% and 3.36%, respectively. The lower weighted average cost of interest-bearing liabilities is primarily due to the decline in market interest rates that began late in the third quarter of 2007 and continued through December of 2008. Maturing fixed-rate liabilities were replaced with lower-costing funds throughout 2009 and during the first quarter of 2010. During the first three months of 2010, interest-bearing liabilities averaged $1.66 billion, or $297.3 million lower than average interest-bearing liabilities of $1.96 billion during the same time period in 2009. Average interest-bearing deposits were down $233.3 million, while average FHLB advances decreased $70.5 million, average short-term borrowings increased $8.3 million, and average other borrowings decreased $1.8 million.

Net interest income during the first quarter of 2010 was $14.3 million, an increase of $2.5 million, or 21.2%, over the $11.8 million earned during the first quarter of 2009. The increase in net interest income was due to an increase in the net interest margin, which more than offset a decrease in earning assets. The net interest margin increased from 2.28% during the first three months of 2009 to 3.25% during the first three months of 2010, primarily reflecting a reduction in our cost of funds, which more than offset the decreased yield on earning assets. Although our yield on earning assets declined in the first quarter of 2010 compared to the prior-year first quarter mainly due to a higher level of nonperforming assets, our cost of funds declined at a far greater rate, resulting in the improved net interest margin. The cost of funds primarily decreased as a result of higher-costing matured wholesale funds, consisting of certificates of deposit and FHLB advances, being replaced by lower-costing funds.

Given the multitude of factors that impact the net interest margin, it is difficult to predict future net interest margins. However, in light of the current interest rate environment, our net interest margin during the remainder of 2010 should benefit from a continued reduction in our cost of funds and the loan pricing initiatives instituted in 2008 and 2009. With respect to our cost of funds, we have about $430 million in wholesale funds at an average rate of 1.80% scheduled to mature during the remainder of 2010. Current rates on wholesale instruments generally range from 0.30% to 3.00%, depending on the type of product and term. During the first quarter of 2010, our average rate on new wholesale funds was about 1.10%; the planned implementation of a matched-funding program involving new and existing fixed-rate loans will likely place upward pressure on the average rate of wholesale funds acquired in future periods as the duration of the wholesale funding portfolio is increased. While a continued reduction in our cost of funds will positively impact our net interest margin, the impact of asset quality on the net interest margin is difficult to predict.

Table of Contents

MERCANTILE BANK CORPORATION

The following table sets forth certain information relating to our consolidated average interest-earning assets and interest-bearing liabilities and reflects the average yield on assets and average cost of liabilities for the first quarter of 2010 and 2009. Such yields and costs are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the period presented. Tax-exempt securities interest income and yield have been computed on a tax equivalent basis using a marginal tax rate of 35%. Securities interest income was increased by $296,000 and $326,000 in the first quarter of 2010 and 2009, respectively, for this adjustment.

| | Quarters ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | | 2009 | | |
| | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| | (dollars in thousands) | | | | | |
| **ASSETS** | | | | | | |
| Loans and leases | $ 1,516,898 | $ 20,406 | 5.46% | $ 1,821,428 | $ 25,185 | 5.61% |
| Investment securities | 248,483 | 3,039 | 4.89 | 241,608 | 3,102 | 5.13 |
| Federal funds sold | 50,511 | 31 | 0.25 | 74,784 | 47 | 0.25 |
| Short-term investments | 7,937 | 9 | 0.44 | 17,458 | 13 | 0.29 |
| Total interest earning assets | 1,823,829 | 23,485 | 5.22 | 2,155,278 | 28,347 | 5.33 |
| Allowance for loan and lease losses | (51,224) | | | (29,105) | | |
| Other assets | 148,146 | | | 128,134 | | |
| Total assets | $ 1,920,751 | | | $ 2,254,307 | | |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | | | | | |
| Interest-bearing deposits | $ 1,318,607 | $ 6,497 | 2.00% | $ 1,551,957 | $ 12,841 | 3.36% |
| Short-term borrowings | 99,128 | 344 | 1.41 | 90,794 | 440 | 1.97 |
| Federal Home Loan Bank advances | 193,222 | 1,696 | 3.51 | 263,722 | 2,452 | 3.72 |
| Other borrowings | 49,853 | 346 | 2.78 | 51,615 | 483 | 3.74 |
| Total interest-bearing liabilities | 1,660,810 | 8,883 | 2.17 | 1,958,088 | 16,216 | 3.36 |
| Noninterest-bearing deposits | 114,484 | | | 106,367 | | |
| Other liabilities | 5,972 | | | 16,438 | | |
| Shareholders equity | 139,485 | | | 173,414 | | |
| | $ 1,920,751 | | | $ 2,254,307 | | |

| | | | | |
|---|---|---|---|---|
| Total liabilities and shareholders equity | | | | |
| Net interest income | $ 14,602 | | $ 12,131 | |
| Net interest rate spread | | 3.05% | | 1.97% |
| Net interest rate margin on average assets | | 3.08% | | 2.18% |
| Net interest margin on earning assets | | 3.25% | | 2.28% |

Table of Contents

MERCANTILE BANK CORPORATION

The provision for loan and lease losses during the first quarter of 2010 was $8.4 million, compared to $10.4 million during the first quarter of 2009. The significant provision expense incurred in both periods is in response to the deterioration of the quality of our loan portfolio; continued state, regional, and national economic struggles have negatively impacted some of our borrowers cash flows and underlying collateral values, leading to increased nonperforming assets, elevated net loan and lease charge-offs, and increased overall credit risk within our loan and lease portfolio.

Net loan and lease charge-offs of $6.2 million were recorded during the first three months of 2010, compared to net loan and lease charge-offs of $10.9 million during the fourth quarter of 2009 and $5.6 million during the first quarter of 2009. Of the $6.8 million in gross loans and leases charged-off during the first three months of 2010, $4.4 million, or about 64%, represents the elimination of specific reserves that were established in earlier periods. The remaining $2.4 million, while in part covered through general reserve allocations via our loan grading system, is included in the $8.4 million provision that was expensed during the first quarter of 2010. Provision expense during the first three months of 2010 allocated to CRE loans totaled $5.0 million, with another $3.7 million allocated to C&D loans and $0.7 million allocated to C&I loans. Recoveries and a reduction in total loans and leases outstanding during the first quarter of 2010 mitigated the necessary provision expense by $1.0 million. The allowance, as a percentage of total loans and leases outstanding, was 3.35% as of March 31, 2010, compared to 3.11% as of December 31, 2009 and 1.79% as of March 31, 2009.

Noninterest income during the first quarter of 2010 was $2.66 million, an increase of 30.7% over the $2.03 million earned during the first quarter of 2009. Since we will not be in a taxable position near-term, we elected to sell $20 million of our $60 million tax-exempt municipal bond portfolio late in the first quarter of 2010, realizing a gain on sale of $0.5 million. Also during the first quarter of 2010, we sold $5.5 million in guaranteed portions of certain Small Business Administration-guaranteed commercial loans, recognizing a gain on sale of $0.2 million. Excluding these gains, noninterest income declined 3.6% in the first quarter of 2010 compared to the year-ago quarter. Declines in mortgage banking income and overdraft service charges, which were partially offset by increases in rental income from foreclosed properties and earnings on bank-owned life insurance, resulted in the lower level of recurring noninterest income during the first three months of 2010 compared to the same time period in 2009.

Noninterest expense during the first quarter of 2010 was $11.6 million, an increase of 8.0% over the $10.8 million expensed during the first quarter of 2009, primarily due to higher costs associated with the administration and resolution of nonperforming assets, including legal expenses, property tax payments, appraisal fees, and write-downs on foreclosed properties, and increased FDIC insurance premiums. Nonperforming asset administration and resolution costs totaled $2.5 million during the first three months of 2010, an increase of $1.5 million from the $1.0 million in costs incurred during the first three months of 2009. FDIC insurance premiums were $1.2 million in the first quarter of 2010 compared to $0.6 million in the prior-year first quarter. While it is difficult to predict future FDIC deposit insurance assessments given the enormous stress on the Deposit Insurance Fund from the significant losses incurred from bank failures, it is very likely that the expense will remain at elevated levels until economic conditions improve and the rate of bank failures declines substantially. Controllable operating expenses, including salaries and benefits, occupancy, furniture and equipment costs, and various other expenses, declined $1.2 million, or 13.2%, in the first quarter of 2010 compared to the same 2009 time period. Salary and benefit costs were down $0.9 million during the first three months of 2010 compared to the respective 2009 timeframe, primarily resulting from a reduction in full-time equivalent employees from 298 at first quarter-end 2009 to 251 at first quarter-end 2010. Occupancy, furniture and equipment costs declined by $0.2 million in the first quarter of 2010 compared to the year-ago quarter, primarily resulting from an aggregate reduction in rent and depreciation expenses. Beginning in the fourth quarter of 2009, overhead cost savings of approximately $200,000 per month were achieved as a result of the consolidation of the mid- and eastern regions of our Michigan banking activities that was completed in August of 2009.

Table of Contents

MERCANTILE BANK CORPORATION

During the first quarter of 2010, we recorded a loss before federal income tax of $3.1 million and a federal income tax benefit of $0.4 million, compared to a loss before federal income tax of $7.3 million and a federal income tax benefit of $2.8 million during the first quarter of 2009. Our ability to recognize federal income tax benefits during periods in which net losses are recorded is significantly limited due to the establishment of a valuation allowance against the entire balance of our net deferred tax asset in the fourth quarter of 2009. Generally, the calculation for the federal income tax provision (benefit) does not consider the tax effects of changes in other comprehensive income ( OCI ), which is a component of shareholders equity on the balance sheet. However, an exception is provided in certain circumstances, such as when there is a pre-tax loss from continuing operations. In such cases, pre-tax income from other categories (such as changes in OCI) is included in the calculation of the federal income tax provision (benefit) for the current year. This resulted in the recognition of a $0.4 million federal income tax benefit in the first quarter of 2010.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

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

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

Table of Contents

MERCANTILE BANK CORPORATION

The following table depicts our GAP position as of March 31, 2010:

| | Within Three Months | Three to Twelve Months | One to Five Years | After Five Years | Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Commercial loans (1) | $ 509,593,000 | $ 239,808,000 | $ 580,370,000 | $ 40,780,000 | $ 1,370,551,000 |
| Leases | 6,000 | 124,000 | 686,000 | 0 | 816,000 |
| Residential real estate loans | 47,150,000 | 12,509,000 | 48,770,000 | 11,982,000 | 120,411,000 |
| Consumer loans | 2,013,000 | 979,000 | 2,678,000 | 176,000 | 5,846,000 |
| Securities (2) | 40,758,000 | 3,131,000 | 52,099,000 | 132,642,000 | 228,630,000 |
| Federal funds sold | 74,352,000 | 0 | 0 | 0 | 74,352,000 |
| Short-term investments | 9,475,000 | 0 | 0 | 0 | 9,475,000 |
| Allowance for loan and lease losses | 0 | 0 | 0 | 0 | (50,126,000) |
| Other assets | 0 | 0 | 0 | 0 | 142,968,000 |
| Total assets | 683,347,000 | 256,551,000 | 684,603,000 | 185,580,000 | $ 1,902,923,000 |
| Liabilities: | | | | | |
| Interest-bearing checking | 141,313,000 | 0 | 0 | 0 | 141,313,000 |
| Savings deposits | 37,688,000 | 0 | 0 | 0 | 37,688,000 |
| Money market accounts | 63,696,000 | 0 | 0 | 0 | 63,696,000 |
| Time deposits under $100,000 | 30,315,000 | 74,314,000 | 29,647,000 | 0 | 134,276,000 |
| Time deposits $100,000 & over | 243,152,000 | 398,442,000 | 283,251,000 | 0 | 924,845,000 |
| Short-term borrowings | 98,619,000 | 0 | 0 | 0 | 98,619,000 |
| Federal Home Loan Bank advances | 30,000,000 | 65,000,000 | 95,000,000 | 0 | 190,000,000 |
| Other borrowed money | 34,819,000 | 5,000,000 | 10,000,000 | 0 | 49,819,000 |
| Noninterest-bearing checking | 0 | 0 | 0 | 0 | 118,391,000 |
| Other liabilities | 0 | 0 | 0 | 0 | 6,056,000 |
| Total liabilities | 679,602,000 | 542,756,000 | 417,898,000 | 0 | 1,764,703,000 |
| Shareholders equity | 0 | 0 | 0 | 0 | 138,220,000 |
| Total liabilities & shareholders equity | 679,602,000 | 542,756,000 | 417,898,000 | 0 | $ 1,902,923,000 |
| Net asset (liability) GAP | $ 3,745,000 | $ (286,205,000) | $ 266,705,000 | $ 185,580,000 | |

| | | | | |
|---|---|---|---|---|
| Cumulative GAP | $ 3,745,000 | $ (282,460,000) | $ (15,755,000) | $ 169,825,000 |
| Percent of cumulative GAP to total assets | 0.2% | (14.8)% | (0.8)% | 8.9% |

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

(2) Mortgage-backed securities are categorized by average life calculations based upon prepayment trends as of March 31, 2010.

Table of Contents

MERCANTILE BANK CORPORATION

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

We conducted multiple simulations as of March 31, 2010, in which it was assumed that changes in market interest rates occurred ranging from up 300 basis points to down 300 basis points in equal quarterly instalments over the next twelve months. The following table reflects the suggested impact on net interest income over the next twelve months in comparison to estimated net interest income based on our balance sheet structure, including the balances and interest rates associated with our specific loans, securities, deposits and borrowed funds, as of March 31, 2010. The resulting estimates are well within our policy parameters established to manage and monitor interest rate risk.

| Interest Rate Scenario | Dollar Change In Net Interest Income | Percent Change In Net Interest Income |
|---|---|---|
| Interest rates down 300 basis points | $ (685,000) | (1.1)% |
| Interest rates down 200 basis points | (5,000) | 0.0 |
| Interest rates down 100 basis points | 630,000 | 1.0 |
| No change in interest rates | 1,415,000 | 2.2 |
| Interest rates up 100 basis points | (130,000) | (0.2) |
| Interest rates up 200 basis points | 250,000 | 0.4 |
| Interest rates up 300 basis points | 2,170,000 | 3.4 |

The resulting estimates have been significantly impacted by the current interest rate and economic environments, as adjustments have been made to critical model inputs with regards to traditional interest rate relationships. This is especially important as it relates to floating rate commercial loans and brokered certificates of deposit, which comprise a substantial portion of our balance sheet. As of March 31, 2010, the Mercantile Bank Prime Rate is 4.50% as compared to the Wall Street Journal Prime Rate of 3.25%. Historically, the two indices have been equal; however, we elected not to reduce the Mercantile Bank Prime Rate in late October and mid-December of 2008 when the Wall Street Journal Prime Rate declined by 50 and 75 basis points, respectively. In conducting our simulations at March 31, 2010, we have made the assumption that the Mercantile Bank Prime Rate will remain unchanged until the Wall Street Journal Prime Rate exceeds the Mercantile Bank Prime Rate, at which time the two indices will remain equal in the increasing interest rate scenarios. Also, brokered certificate of deposit rates have substantially decreased since December of 2008, with part of the decline attributable to a significant imbalance whereby the supply of available funds far outweighs the demand from banks looking to raise funds. As a result, we have substantially limited further reductions in brokered certificate of deposit rates in the declining interest rate scenarios.

Table of Contents

MERCANTILE BANK CORPORATION

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

**Item 4. Controls and Procedures**

As of March 31, 2010, an evaluation was performed under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of March 31, 2010. There have been no significant changes in our controls over financial reporting during the quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents

MERCANTILE BANK CORPORATION

## PART II OTHER INFORMATION

**Item 1. Legal Proceedings.**

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

**Item 1A. Risk Factors.**

There have been no material changes in our risk factors from those previously disclosed in our annual report on Form 10-K for the year ended December 31, 2009.

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

We made no unregistered sale of equity securities, nor did we purchase our equity securities, during the quarter ended March 31, 2010.

In April 2010, our Board of Directors suspended future payments of cash dividends on our common stock until economic conditions and our financial performance improve. Holders of our common stock are entitled to receive cash dividends to the extent that they are declared from time to time by our Board of Directors. We may only pay cash dividends out of funds that are legally available for that purpose. We are a holding company and substantially all of our assets are held by our subsidiaries. Our ability to pay cash dividends to our shareholders depends primarily on our bank s ability to pay cash dividends to us. Cash dividend payments and extensions of credit to us from our bank are subject to legal and regulatory limitations, generally based on capital levels and current and retained earnings, imposed by law and regulatory agencies with authority over our bank. The ability of our bank to pay cash dividends is also subject to its profitability, financial condition, capital expenditures and other cash flow requirements. In addition, under the terms of the subordinated debentures that we issued to the trust, we would be precluded from paying cash dividends on our common stock if an event of default has occurred and is continuing under the subordinated debentures, or if we exercised our right to defer payments of interest on the subordinated debentures, until the deferral ended. Also, in connection with our participation in the United States Treasury Department s Capital Purchase Program, we agreed that we would not, without the Treasury Department s consent, increase the cash dividend rate on our common stock, or with certain exceptions, repurchase any shares of our common stock. These restrictions relating to the Capital Purchase Program remain in effect until the earlier of (i) May 15, 2012, or (ii) when all of the preferred stock that we sold to the Treasury Department has been redeemed by us or transferred by the Treasury Department to third parties.

**Item 3. Defaults Upon Senior Securities.**

Not applicable.

**Item 4. Reserved**

Not applicable.

**Item 5. Other Information.**

Not applicable.

Table of Contents

MERCANTILE BANK CORPORATION

**Item 6. Exhibits**

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

Table of Contents

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on May 10, 2010.

MERCANTILE BANK CORPORATION

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

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

Table of Contents

**EXHIBIT INDEX**

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