MACATAWA BANK CORP
Form ARS
March 31, 2010

To Our Shareholders:

2009 was a challenging year for Macatawa Bank. Losses in our real estate loan portfolios accelerated and continued to put pressure on the Bank's operating performance. For the year ended December 31, 2009, we incurred a net loss available to common shares of $66.5 million, or $3.81 per diluted share, compared to a loss of $39.7 million, or $2.33 loss per common share, in 2008.

These results are clearly not acceptable to the Board of Directors, the management team, or our employees, and we apologize for this disappointing performance. We are a community bank, and as a result, know many of our shareholders personally. We take our obligation to you and your investment seriously, and remain determined to take the steps necessary to restore Macatawa Bank to strong financial health.

We still feel strongly that the communities of Western Michigan need locally owned and locally managed community banks that offer superior financial products and excellent customer service. Our customers certainly agree, as evidenced by our rapid growth during the first decade of our existence, and our continued growth during a difficult economic environment. As larger regional and national banks focus their resources on markets other than Michigan, we remain committed to serving the banking needs of Kent, Ottawa and Allegan counties.

Growth, however, must be supported by disciplined business practices and supporting infrastructure. This has been our focus during the past 18 months, and will continue to be our focus as we move into 2010. The recent economic challenges have been unprecedented. Declines in real estate values, rising unemployment and slower consumer spending have clearly impacted our earnings performance. Although we are encouraged by recent signs of improvement in local economies and real estate markets, we are also mindful that economic downturns will occur again, and we must build a conservative and well-disciplined company capable of performing in any economic environment.

We have made significant changes during the past several years to add capabilities, expertise, and resources. We have revised our loan policies and implemented strict lending and compliance rules. Despite these changes, legacy loans, primarily within our land and residential real estate development portfolios, continue to deteriorate as we experience increased borrower defaults and lower real estate valuations. Provisions for loan losses during the year totaled $74.3 million, and costs associated with managing these non-performing loans, including collection costs and payment of real estate taxes, totaled $11.4 million. Significant write-downs in the valuation of these problem assets, along with improved real estate markets, give us the opportunity to accelerate the disposition of these assets, and moving these assets out of the Bank portfolio remains one of our top priorities.

Other events impacting our performance included the one-time $5.5 million settlement of the Trade Partners litigation in June 2009. This settlement puts the Trade Partners litigation behind us. Increased FDIC assessments also impacted all FDIC-insured institutions, and non-cash charges totaling $18.0 million were included in federal income tax expense to establish a valuation allowance on deferred tax assets. On a positive note, net interest margins improved during the year as the Federal Reserve kept interest rates at historic lows in efforts to stimulate economic activity. Operating expense, exclusive of costs associated with collection of delinquent loans and real estate valuation adjustments, continued to decline and reflect the benefits of cost-cutting measures and improved productivity processes implemented during 2008.

Total assets were $1.83 billion as of December 31, 2009, a decrease of $319.2 million from December 31, 2008. Total loans were $1.51 billion and declined by $263.2 million during the year, which represented the majority of the decline in total assets. The commercial real estate portfolio declined by $124.6 million primarily as a result of our efforts to reduce exposure to construction and land development loans, while commercial and industrial loans declined by $82.3 million due to a general decline in business activity.

The reduction in loan balances allowed us to reduce wholesale funding, including out-of-market deposits from brokers, by $138.0 million. The reduction in these deposit balances represents one of the highest costing deposits on our balance sheet, which has also helped provide positive momentum toward our net interest margin.

The Bank's total risk-based capital was 9.06% at December 31, 2009, down from10.71% at December 31, 2008. The Bank's tier one leverage capital ratio fell to 6.57% at year-end 2009, down from 8.26% at year-end 2008. Importantly, the Bank remains adequately capitalized under regulatory guidelines.

We are sharply focused on returning the Bank to profitability, and determined to regain your trust. As a result, the Board of Directors has been very active during the year to increase Board oversight and governance of the Bank.

This includes:

The appointment of Mr. Richard L. Postma as Chairman of the Board of Directors. Mr. Postma is a well-known and highly regarded business leader. He is the co-founder and CEO of U.S. Signal Co., LLC the Midwest's largest fiber optic carrier network. He is active in the West Michigan community, including his service on the Board of Trustees for Hope College.

The appointment of Mr. Doug Padnos, Mr. Tom Wesholski, and Mr. Ronald Haan to the Board of Directors. Mr. Ben Smith and Mr. Phil Koning resigned from the Board during the year.

The implementation of disciplined business and banking practices including strict lending and compliance rules.

The reduction of fees paid to Board members by 50%.

Strengthened risk management initiatives.

The suspension of dividend payments to holders of Trust Preferred Securities, and Series A and B Preferred Securities.

The execution of several expense reduction initiatives, including the suspension of employee retirement plan contributions, the continued prohibition on pay increases and bonus payments. Total cost-cutting measures now exceed $9 million during the previous two years.

The appointment of Ronald L. Haan as Interim CEO of the Corporation and Bank, and the establishment of a special Board Committee to begin the search for a permanent CEO.

Increased direct communication with the FDIC, the Federal Reserve Bank of Chicago, and the State of Michigan Office of Financial Institution Regulation to ensure compliance with regulatory direction.

Purchase activity in bank owned real estate is increasing. The significant reductions in carry values on these assets should provide us with greater opportunities to remove non-performing assets from the Bank's balance sheet. We continue to see growth in new customer households, and have been able to reduce our reliance on out-of-market funding.

Increasing our allowance for loan losses puts us in a much stronger position to address asset quality problems that have not yet been realized. The allowance for loan losses was increased during the year to $54.6 million, an increase of 43% or $16.3 million, from the allowance of $38.3 million at December 31, 2008.

Although improvement in our operating results may be uneven during 2010, we do expect the overall trend to be positive. We will focus on retaining and expanding the relationships we have with current customers, as well as building relationships with new ones. We will continue to make loans to qualified borrowers, but only under the strict lending guidelines that have been implemented during the past year. We intend to accelerate our efforts to dispose of non-performing assets.

The Board of Directors, management team and employees are determined to restore Macatawa Bank to profitability. Our vision of being a strong community bank remains unchanged. We know we have disappointed our shareholders and customers, but are determined to restore the confidence that is so critical to our relationship. Although challenges continue, we are 100% focused on improving our financial performance and building an organization that can provide financial services to the communities of Western Michigan over the long-term.

We sincerely appreciate your continued support and confidence as we work through these challenging times.

Sincerely,

Ronald L. Haan
Interim President & CEO

This letter contains forward-looking statements that are based on management's current beliefs, expectations, plans and intentions. Such statements involve substantial risks and uncertainties which could cause actual results to differ materially from those expressed or implied by the forward-looking statements. Please see the cautionary statement which appears inside of the front cover of the Form 10-K Annual Report which accompanies this letter for a more complete discussion of the risks and uncertainties associated with these forward-looking statements.

# Macatawa Bank Corporation
# 2009 Financial Summary

| (Dollars in thousands, except per share data) | As of and for the year ended December 31 2009 | 2008 |
|---|---|---|
| **SUMMARY OF OPERATIONS** | | |
| Net Interest Income | $ 52,793 | $ 58,131 |
| Provision for loan losses | 74,340 | 37,435 |
| Noninterest income | 16,697 | 18,144 |
| Noninterest expense | 67,391 | 86,067 |
| Net loss (1) | (63,641) | (38,854) |
| Dividends declared on preferred shares | 2,870 | 817 |
| Net loss available to common shares | $ (66,511) | $ (39,671) |
| **FINANCIAL CONDITION** | | |
| Total assets | $ 1,830,172 | $ 2,149,372 |
| Loans | 1,510,816 | 1,774,063 |
| Allowance for loan losses | 54,623 | 38,262 |
| Deposits | 1,416,337 | 1,665,761 |
| Shareholders' equity | $ 87,991 | $ 149,213 |
| **KEY RATIOS** | | |
| Return on average equity | -50.60% | -24.06% |
| Return on average assets | -3.16% | -1.82% |
| Average net interest margin | 2.82% | 2.94% |
| Efficiency ratio | 96.98% | 112.84% |
| Average equity to average assets | 6.24% | 7.58% |
| Total risk-based capital ratio | 9.23% | 11.26% |
| Allowance for loan losses to total loans | 3.62% | 2.16% |
| **SHARE INFORMATION** | | |
| Basic earnings per common share | $ (3.81) | $ (2.33) |
| Diluted earnings per common share | (3.81) | (2.33) |
| Book value per common share | 3.10 | 6.91 |
| Dividends per common share | $ -- | $ .26 |
| Common shares outstanding at end of period | 17,698,108 | 17,161,515 |

(1) - 2009 includes an $11.4 million favorable tax benefit resulting from a tax law change extending the carry-back of net operating losses to five years, an $18.0 million non-cash charge to establish a valuation allowance on deferred tax assets and a one-time charge of $5.5 million associated with the settlement of the Trade Partners litigation.

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2008 includes a $27.6 million ($22.0 million after tax, or $1.60 per share) non-cash impairment charge for goodwill and other intangible assets.

Each of these items is discussed in the Company's December 31, 2009 SEC Form 10-K.

**GRAND RAPIDS AREA**

**1. Allendale**
6299 Lake Michigan Drive
Allendale 49401 616-895-9893
*(Across from Family Fare)*

**2. Breton Village**
2440 Burton Street SE
Grand Rapids 49546 616-301-8099
*(Across from Breton Village Mall)*

**3. Byron Center**
2261 84th Street
Byron Center 49315 616-583-2244
*(In front of Family Fare)*

**4. Cascade**
6330 28th Street SE
Grand Rapids 49546 616-719-4280
*(Next to Culvers and Pizza Hut)*

**5. Clyde Park**
5271 Clyde Park Avenue SW
Wyoming 49509 615-531-0051
*(Just north of 54th Street)*

**6. East Beltline**
3177 Knapp Street NE
Grand Rapids 49525 616-361-2228
*(Corner of Knapp & East Beltline)*

**7. Forest Hills**
4590 Cascade Road
Grand Rapids 49546 616-942-3710
*(Across from Forest Hills Foods)*

**8. Gaines**
1575 68th Street SE
Grand Rapids 49508 616-554-2172
*(Corner of 68th & Kalamazoo)*

**9. Grand Rapids Downtown**
126 Ottawa Avenue NW
Grand Rapids 49503 616-235-7000
*(Next to the Peninsular Club)*

**10. Grandville**
3191 44th Street SW
Grandville 49418 616-531-2551
*(Corner of 44th & Ivanrest)*

**11. Hudsonville**
3526 Chicago Drive
Hudsonville 49426 616-379-1375
*(Across from Family Fare)*

**12. Jenison**
2020 Baldwin Street
Jenison 49428 616-662-5419
*(Corner of 20th & Baldwin)*

**13. Jenison East**
520 Baldwin Street
Jenison 49428 616-667-8860
*(In front of Meijer)*

**14. Rockford**
2820 10 Mile Road
Rockford 49341 616-863-1072
*(Across from Meijer)*

**15. Walker**
2750 Walker Avenue NW
Walker 49544 616-735-6440
*(Corner of Walker & 3 Mile)*

**HOLLAND AREA**

**16. 141 East 8th Street**
Holland 49423 616-820-1320
*(Corner of 8th Street & Columbia)*

**17. 701 Maple Avenue**
Holland 49423 616-820-1330
*(Corner of 29th & Maple)*

**18. 489 Butternut Drive**
Holland 49424 616-786-9555
*(Corner of James & Butternut)*

**19. 699 East 16th Street**
Holland 49423 616-393-8527
*(Corner of 16th & Waverly)*

**20. 20 East Lakewood Boulevard**
Holland 49424 616-594-2100

**ZEELAND AREA**

**24. 815 East Main Avenue**
Zeeland 49464 616-748-9491
*(Corner of Main & Fairview)*

**25. 41 North State Street**
Zeeland 49464 616-748-9847
*(Corner of State & Washington)*

*(In the Railside Strip Mall)*

**21. 12415 Riley Street**
Holland 49424 616-786-4240
*(Next to Meijer on Riley)*

**22. Freedom Village**
145 Columbia Avenue
Holland 49423 616-494-1601
*(Located in Freedom Village)*

**23. GRAND HAVEN BRANCH**
15135 Whittaker Way
Grand Haven 49417 616-847-3740
*(Adjacent to Meijer)*

**NORTHERN ALLEGAN COUNTY**

**26. HAMILTON BRANCH**
4758 136th Avenue
Hamilton 49419 269-751-2505
*(Corner of M-40 & 136th)*

**27. SAUGATUCK/DOUGLAS BRANCH**
132 South Washington Avenue
Douglas 49406 269-857-8398
*(Between Wiley & Center Street)*

## Board of Directors

**Richard L. Postma**, Chairman
CEO, U.S. SIGNAL CO, LLC

**Ronald L. Haan**
INTERIM PRESIDENT AND CEO

**Mark J. Bugge**
CONTROLLER, VA ENTERPRISES, LLC

**Robert E. Den Herder**
PRESIDENT, PREMOVATION AUDIO

**John F. Koetje**
PARTNER, JOHN F. KOETJE AND ASSOCIATES

**Arend D. Lubbers**
PRESIDENT EMERITUS GRAND VALLEY STATE UNIVERSITY

**Douglas B. Padnos**
MANAGER, PADNOS PAPER & PLASTICS

**Thomas J. Wesholski**
FORMER PRESIDENT AND CEO, GRAND BANK

## Management Team

**Ronald L. Haan**
INTERIM PRESIDENT AND CEO

**Renae L.S. Eckland**
SENIOR VICE PRESIDENT, CHIEF INFORMATION OFFICER

**Lee J. Pankratz**
SENIOR VICE PRESIDENT, CHIEF LENDING OFFICER

**Jon W. Swets**
SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

**Jill A. Walcott**
SENIOR VICE PRESIDENT, SENIOR RETAIL BANKING OFFICER

**Christine M. Bart**
VICE PRESIDENT, DIRECTOR OF MARKETING

**John W. Dice**
VICE PRESIDENT, TRUST SERVICES MANAGER

**Lynda K. Logan**
VICE PRESIDENT, DIRECTOR OF RISK MANAGEMENT

**Edward W. Ryan**
VICE PRESIDENT, COMMERCIAL MARKET MANAGER

**Any L. Ziel**
VICE PRESIDENT, DIRECTOR OF HUMAN RESOURCES