

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

IMMTECH INTERNATIONAL INC  
Form 10-Q  
February 14, 2003

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended December 31, 2002.

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 000-25669

IMMTECH INTERNATIONAL, INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware

39-1523370

-----  
(State or other jurisdiction of incorporation or organization)

(I. R. S. Employer Identification No.)

150 Fairway Drive, Suite 150, Vernon Hills, Illinois 60061

-----  
(Address of principal executive offices)

(Zip Code)

Registrant's telephone number: (847) 573-0033

Indicate by checkmark 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  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of January 31, 2003, 7,661,310 shares of the Registrant's common stock, par value \$0.01 ("Common Stock"), were outstanding.

INDEX

Page No.

PART I. FINANCIAL INFORMATION.....	1
Item 1. Condensed Financial Statements.....	1
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	15

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

Item 3. Quantitative and Qualitative Disclosures about Market Risk.....20  
Item 4. Controls and Procedures.....20  
  
PART II. OTHER INFORMATION.....21  
  
Item 1. Legal Proceedings.....21  
Item 2. Changes in Securities and Use of Proceeds.....21  
Item 3. Defaults Upon Senior Securities.....23  
Item 4. Submission of Matters to a Vote of Security Holders.....23  
Item 5. Other Information.....24  
Item 6. Exhibits, and Reports on Form 8-K.....24  
  
Exhibit Index.....25  
  
SIGNATURES.....26

-i-

PART I. FINANCIAL INFORMATION

Item 1. Condensed Financial Statements.

IMMTECH INTERNATIONAL, INC.  
(A Development Stage Enterprise)

CONDENSED BALANCE SHEETS (UNAUDITED)

ASSETS

CURRENT ASSETS:

Cash and cash equivalents  
Restricted funds on deposit  
Other current assets

Total current assets

PROPERTY AND EQUIPMENT - Net

OTHER ASSETS

TOTAL

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable  
Accrued expenses  
Deferred revenue

Total current liabilities

# Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

## DEFERRED RENTAL OBLIGATION

Total liabilities

### STOCKHOLDERS' EQUITY:

Preferred stock, par value \$0.01 per share, 4,440,000 shares authorized and unissued  
 Series A convertible preferred stock, par value \$0.01 per share, stated value \$25 per share, 320,000 shares authorized, 142,800 and 160,100 shares outstanding as of December 31, 2002 and March 31, 2002, respectively; aggregate liquidation preference of 3,633,287 as of December 31, 2002  
 Series B convertible preferred stock, par value \$0.01 per share, stated value \$25 per share, 240,000 shares authorized, 76,725 shares outstanding as of December 31, 2002; aggregate liquidation preference of \$1,950,075 as of December 31, 2002  
 Common stock, par value \$0.01 per share, 30,000,000 shares authorized, 6,395,647 and 6,066,459 shares issued and outstanding as of December 31, 2002 and March 31, 2002, respectively  
 Additional paid-in capital  
 Deficit accumulated during the developmental stage

Total stockholders' equity

TOTAL

See notes to condensed financial statements.

2

IMMTECH INTERNATIONAL, INC.  
 (A DEVELOPMENT STAGE ENTERPRISE)

### CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

	THREE MONTHS ENDED DECEMBER 31,		NINE MO DEC
	2002	2001	2002
REVENUES	\$ 233,830	\$ 954,660	\$ 1,024,082
EXPENSES:			
Research and development	401,667	1,205,808	1,864,193
General and administrative	723,978	689,328	3,059,166
Equity in loss of joint venture			
Total expenses	1,125,645	1,895,136	4,923,359

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

LOSS FROM OPERATIONS	(891,815)	(940,476)	(3,899,277)
	-----	-----	-----
OTHER INCOME (EXPENSE):			
Interest income	3,130	2,409	13,031
Interest expense			
Loss on sales of investment securities - net			
Cancelled offering costs			
	-----	-----	-----
Other income (expense) - net	3,130	2,409	13,031
	-----	-----	-----
LOSS BEFORE EXTRAORDINARY ITEM	(888,685)	(938,067)	(3,886,246)
EXTRAORDINARY GAIN ON EXTINGUISHMENT OF DEBT			
	-----	-----	-----
NET LOSS	(888,685)	(938,067)	(3,886,246)
CONVERTIBLE PREFERRED STOCK DIVIDENDS	(96,249)		(362,996)
REDEEMABLE PREFERRED STOCK CONVERSION, PREMIUM AMORTIZATION AND DIVIDENDS			
	-----	-----	-----
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (984,934)	\$ (938,067)	\$ (4,249,242)
	=====	=====	=====
BASIC AND DILUTED NET LOSS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS:			
Net loss	\$ (0.14)	\$ (0.16)	\$ (0.62)
Convertible preferred stock dividends	(0.02)		(0.06)
	-----	-----	-----
BASIC AND DILUTED NET LOSS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (0.16)	\$ (0.16)	\$ (0.68)
	=====	=====	=====
WEIGHTED AVERAGE SHARES USED IN COMPUTING BASIC AND DILUTED LOSS PER SHARE	6,350,855	6,055,371	6,246,023
	=====	=====	=====

See notes to condensed financial statements.

3

IMMTECH INTERNATIONAL, INC.  
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

THREE MONTHS ENDED  
DECEMBER 31,

-----  
2002

-----  
2001

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

OPERATING ACTIVITIES:

Net loss	\$ (888,685)	\$ (938,067)	\$ (3,886)
Adjustments to reconcile net loss to net cash used in operating activities:			
Compensation recorded related to issuance of common stock, common stock options and warrants	55,963	85,087	1,132
Depreciation and amortization of property and equipment	23,654	25,480	71
Deferred rental obligation	(1,591)	(1,592)	(4)
Equity in loss of joint venture			
Loss on sales of investment securities - net			
Amortization of debt discounts and issuance costs			
Extraordinary gain on extinguishment of debt			
Changes in assets and liabilities:			
Restricted funds on deposit	(1,843,265)	751,339	(2,534)
Other current assets	(35,000)	50,000	4
Other assets			
Accounts payable	(5,047)	419,092	(201)
Accrued expenses	(6)		(3)
Deferred revenue	1,817,170	(858,215)	2,575

Net cash used in operating activities	(876,807)	(466,876)	(2,846)
---------------------------------------	-----------	-----------	---------

INVESTING ACTIVITIES:

Purchases of investment securities			
Proceeds from sales and maturities of investment securities			
Purchases of property and equipment	(5,397)		(1)
Investment in and advances to joint venture			

Net cash used in investing activities	(5,397)		(16)
---------------------------------------	---------	--	------

FINANCING ACTIVITIES:

Advances from stockholders and affiliates			
Proceeds from issuance of notes payable			
Principal payments on notes payable			
Payments for debt issuance costs			
Payments for extinguishment of debt			
Proceeds from issuance of redeemable preferred stock			
Net proceeds from issuance of common stock			
Net proceeds from issuance of convertible preferred stock and warrants	25,000		1,859
Payments for convertible preferred stock dividends and for fractional shares of common stock resulting from the conversions of convertible preferred stock	(86)		
Additional capital contributed by stockholders			

Net cash provided by financing activities	24,914		1,859
---	--------	--	-------

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(857,290)	(466,876)	(1,003)
--	-----------	-----------	---------

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,892,029	530,770	2,037
--	-----------	---------	-------

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 1,034,739	\$ 63,894	\$ 1,034
--	--------------	-----------	----------

See notes to condensed financial statements.

IMMTECH INTERNATIONAL, INC.  
(A DEVELOPMENT STAGE ENTERPRISE)

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

---

1. BASIS OF PRESENTATION

The accompanying condensed financial statements have been prepared by Immtech International, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of the Company, include all adjustments necessary for a fair statement of results for each period shown (unless otherwise noted herein, all adjustments are of a normal recurring nature). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such SEC rules and regulations. The Company believes that the disclosures made are adequate to prevent the financial information given from being misleading. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's latest Annual Report on Form 10-K and subsequent quarterly reports on Form 10-Q.

2. COMPANY BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business - Immtech International, Inc. is a pharmaceutical company focused on the discovery, development and commercialization of drugs to treat infectious diseases that include fungal infections, malaria, tuberculosis, hepatitis C, Pneumocystis carinii pneumonia and tropical medicine diseases including African sleeping sickness (Trypanosomiasis) and Leishmaniasis. The Company is a development stage enterprise and since its inception on October 15, 1984, the Company has engaged in research and development programs, expanding its network of scientists and scientific advisors, technology licensing agreements, and advancing its technology platform toward commercialization. The Company uses the expertise and resources of strategic partners and contracted parties in a number of areas, including: (i) laboratory research, (ii) pre-clinical and human clinical trials and (iii) the manufacture of pharmaceutical products. The Company holds worldwide patents, licenses and rights to license worldwide patents, patent applications and technologies from third parties that are integral to the Company's business. The Company has licensing and commercialization rights to a dicationic anti-infective pharmaceutical platform and is developing drugs intended for commercial use based on that platform.

The Company does not have any products currently available for sale, and no products are expected to be commercially available for sale prior to the 4th calendar quarter of 2003 if at all.

Going Concern Presentation and Related Risks and Uncertainties - The accompanying condensed financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

Since inception, the Company has incurred accumulated losses of approximately \$42,355,000. Management expects the Company to continue to

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

incur significant losses during the next several years as the Company continues its research, development and commercialization activities and clinical trial efforts. There can be no assurance that the Company's continued research will lead to the development of commercially viable products. The Company's operations to date have consumed substantial amounts of cash. Negative cash flow from operations is expected to continue in the foreseeable future. The Company will require substantial funds to conduct research and

5

development, laboratory and clinical testing and to manufacture (or have manufactured) and market (or have marketed) its product candidates.

The Company's working capital is not sufficient to fund the Company's operations through the commercialization of one or more products yielding sufficient revenues to support the Company's operations; therefore, the Company will need to raise additional funds. The Company believes its existing unrestricted cash and cash equivalents and the grants the Company has received or has been awarded and is awaiting disbursement of, will be sufficient to meet the Company's planned expenditures through May 2003, although there can be no assurance the Company will not require additional funds. These factors, among others, indicate that the Company may be unable to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of these uncertainties.

The Company's ability to continue as a going concern is dependent upon its ability to generate sufficient funds to meet its obligations as they become due and, ultimately, to obtain profitable operations. Management's plans for the forthcoming year, in addition to normal operations, include continuing their efforts to obtain additional equity and/or debt financing, obtain additional research grants and enter into various research and development agreements with other entities.

Cash and Cash Equivalents - The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of an amount on deposit at a bank and an investment in a money market mutual fund, stated at cost, which approximates fair value.

Restricted Funds on Deposit - Restricted funds on deposit consist of cash on deposit at a bank which is restricted for use in accordance with a clinical research subcontract agreement with The University of North Carolina at Chapel Hill.

Investment - The Company accounts for its investment in NextEra Therapeutics, Inc. ("NextEra") on the equity method. As of December 31, 2002 and March 31, 2002, the Company owned approximately 28% of the issued and outstanding shares of NextEra common stock. The Company has recognized an equity loss in NextEra to the extent of the basis of its investment, and the investment balance is zero as of December 31, 2002 and March 31, 2002. Recognition of any investment income on the equity method by the Company for its investment in NextEra will occur only after NextEra has earnings in excess of previously unrecognized equity losses.

Income Taxes - The Company accounts for income taxes using an asset and liability approach. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. In addition, the valuation allowance is recognized if it is more likely than not that some or all of the deferred income tax assets will not be realized. A valuation allowance is used to offset the related net deferred income tax assets due to uncertainties of realizing the benefits of certain net operating loss and tax credit carryforwards and other deferred income tax assets.

Net Income (Loss) Per Share - Net income (loss) per share is calculated in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share." Basic net income (loss) per share and diluted net loss per share are computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. Diluted net income per share, when applicable, is computed by dividing net income attributable to common stockholders by

6

the weighted average number of common shares outstanding increased by the number of potential dilutive common shares based on the treasury stock method. Diluted net loss per share was the same as the basic net loss per share for the three and nine months ended December 31, 2002 and 2001, as the Company's outstanding common stock options, warrants and conversion features of Series A and B Convertible Preferred Stock were antidilutive.

Comprehensive Loss - There were no differences between comprehensive loss and net loss for the three and nine month periods ended December 31, 2002 and 2001, respectively.

New Accounting Standards - In December 2002, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition to SFAS No.123's fair value method for accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure provisions of SFAS No. 123 and Accounting Principles Board ("APB") Opinion No. 28, "Interim Financial Reporting," to require disclosure in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. The Company is in the process of assessing the impact of SFAS No. 148 and will adopt this standard for periods beginning after December 15, 2002.

### 3. STOCKHOLDERS' EQUITY

Series A Convertible Preferred Stock - On February 14, 2002, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware designating 320,000 shares of the Company's 5,000,000 authorized shares of preferred stock as Series A Convertible Preferred Stock, \$0.01 par value, with a stated value of \$25.00 per share. Dividends accrue at a rate of 6.0% per annum on the \$25.00 stated value per share and are payable semi-annually on April 15 and October 15 of each year while the shares are outstanding. The Company has the option to pay the dividend either in cash or in equivalent shares of common stock, as defined. Accrued preferred stock dividends are included in the carrying value of the Series A Convertible Preferred Stock in the accompanying condensed balance sheets. Each share of Series A Convertible Preferred Stock shall be convertible by the holder at any time into shares of the Company's common stock at a



## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

conversion rate determined by dividing the \$25.00 stated value, plus any accrued and unpaid dividends (the "Liquidation Price"), by a \$4.42 conversion price (the "Conversion Price"), subject to certain antidilution adjustments as defined in the Certificate of Designation. On April 15, 2002 and October 15, 2002 the Company issued 8,249 and 28,959 shares of common stock and paid \$165.92 and \$64.23 to holders of fractional shares as dividends on the Series A preferred shares, respectively. During the three month period ended December 31, 2002, certain Series A preferred stockholder converted 8,000 shares of Series A Convertible Preferred Stock and the related dividend for 45,978 shares of common stock. A total of \$56,127 was accrued for the preferred stock dividend payable April 15, 2003 and was reported in the net loss attributable to common stockholder in the accompanying statement of operations for the three months ended December 31, 2002. During the nine month period ended December 31, 2002, certain Series A preferred stockholders converted 17,300 shares of Series A Convertible Preferred Stock including accrued dividends for 99,105 shares of common stock.

The Company may at any time after February 14, 2003, require that any or all outstanding shares of Series A Convertible Preferred Stock be converted into shares of the Company's common stock, provided that the shares of common stock into which the Series A Convertible Preferred Stock are convertible are registered pursuant to an effective registration statement, as defined. The number of

7

shares of common stock to be received by the holders of the Series A Convertible Preferred Stock upon conversion at the request of the Company shall be determined by (i) dividing the Liquidation Price by the Conversion Price provided that the closing bid price for the Company's common stock exceeds \$9.00 for 20 consecutive trading days within 180 days prior to notice of conversions, as defined, (ii) or if the requirements of (i) are not met, the number of shares of common stock is determined by dividing 110% of the Liquidation Price by the Conversion Price. The Conversion Price is subject to certain antidilution adjustments, as defined in the Certificate of Designation.

The Company may at any time, upon 30 day notice, redeem any or all outstanding shares of the Series A Convertible Preferred Stock by payment of the Liquidation Price to the holder of such shares, provided that the holder does not convert the Series A Convertible Preferred Stock into shares of Common Stock during the 30 day period. The Series A Convertible Preferred Stock has a preference in liquidation equal to \$25.00 per share, plus any accrued and unpaid dividends. Each issued and outstanding share of Series A Convertible Preferred Stock is entitled to 5.6561 votes (subject to adjustment for dilution) with respect to any and all matters presented to the stockholders of the Company for their action or consideration. Except as provided by law or by the provisions establishing any other series of preferred stock, Series A Convertible Preferred stockholders and holders of any other outstanding preferred stock shall vote together with the holders of common stock as a single class.

Series B Convertible Preferred Stock - On September 25, 2002, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware designating 240,000 shares of the Company's 5,000,000 authorized shares of preferred stock as Series B Convertible Preferred Stock, \$0.01 par value, with a stated value of \$25.00 per share. Dividends accrue at a rate of 8.0% per annum on the \$25.00 stated value per share and

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

are payable semi-annually on April 15 and October 15 of each year while the shares are outstanding. The Company has the option to pay the dividend either in cash or in equivalent shares of common stock, as defined. Accrued preferred stock dividends are included in the carrying value of the Series B Convertible Preferred Stock in the accompanying condensed balance sheets. Each share of Series B Convertible Preferred Stock shall be convertible by the holder at any time into shares of the Company's common stock at a conversion rate determined by dividing the \$25.00 stated value, plus any accrued and unpaid dividends (the "Liquidation Price"), by a \$4.00 conversion price (the "Conversion Price"), subject to certain antidilution adjustments, as defined in the Certificate of Designation. During September 2002 the Company issued 75,725 shares of preferred stock, Series B Convertible Preferred for net proceeds of \$1,834,333 (net of offering costs of \$58,900 of which \$18,700 was paid during the quarter-ended June 30, 2002). During the quarter ended December 31, 2002 the Company issued 1000 shares of preferred stock, Series B Convertible Preferred for net proceeds of \$25,000. On October 15, 2002, the Company issued 2,658 shares of common stock and paid \$16.59 to holders of fractional shares as dividends on the Series B preferred shares. A total of \$38,173 was accrued for the preferred stock dividend payable April 15, 2003 and was reported in the net loss attributable to common stockholder in the accompanying statement of operations for the three months ended December 31, 2002.

The Company may at any time after September 24, 2003, require that any or all outstanding shares of Series B Convertible Preferred Stock be converted into shares of the Company's common stock, provided that the shares of common stock into which the Series B Convertible Preferred Stock are convertible are registered pursuant to an effective registration statement, as defined. The number of shares of common stock to be received by the holders of the Series B Convertible Preferred Stock upon conversion at the request of the Company shall be determined by (i) dividing the Liquidation Price by the Conversion Price provided that the closing bid price for the Company's common stock exceeds \$9.00 for 20 consecutive trading days within 180 days prior to notice of conversions, as defined, (ii) or if the requirements of (i) are not met, the number of shares of common stock is

8

determined by dividing 110% of the Liquidation Price by the Conversion Price. The Conversion Price is subject to certain antidilution adjustments, as defined in the Certificate of Designation.

The Company may at any time, upon 30 day notice, redeem any or all outstanding shares of the Series B Convertible Preferred Stock by payment of the Liquidation Price to the holder of such shares, provided that the holder does not convert the Series B Convertible Preferred Stock into shares of Common Stock during the 30 day period. The Series B Convertible Preferred Stock has a preference in liquidation equal to \$25.00 per share, plus any accrued and unpaid dividends. Each issued and outstanding share of Series B Convertible Preferred Stock shall be entitled to 6.25 votes (subject to adjustment for dilution) with respect to any and all matters presented to the stockholders of the Company for their action or consideration. Except as provided by law or by the provisions establishing any other series of preferred stock, Series B Convertible Preferred stockholders and holders of any other outstanding preferred stock shall vote together with the holders of common stock as a single class.

In September 2002 and October 2002, the Company, in connection with the Series B Convertible Preferred Stock private placement offerings, issued warrants to purchase 189,312 and 2,500 shares of the Company's common stock

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

at an exercise price of \$6.125 per share of common stock, respectively. The warrants expire at various dates in September and October 2007. At any time after the first anniversary of the date of grant and if the Company's common stock closes above 200% of the exercise price for 20 consecutive trading days, the Company may, upon 20 days notice, redeem any unexercised portion of any warrants for a redemption fee of \$.10 per share of common stock underlying the warrants. During the 20 day notice period, if the warrants are then exercisable as a result of the conversion or redemption of the Series B Convertible Preferred Stock, such warrant holder may then exercise all or a portion of the warrant by tendering the appropriate exercise price.

The warrants issued in September 2002 to the holders of the Series B Preferred Convertible Stock were valued using the Black-Scholes option valuation model and the amount recorded of \$147,483 was determined by applying the relative fair value method in relation to the estimated fair value of Series B Convertible Preferred Stock resulting in a \$147,483 preferred stock dividend calculated in accordance with the Emerging Issues Task Force ("EITF") Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments." The dividend on the Series B Convertible Preferred Stock was charged to deficit accumulated during the development stage immediately upon issuance, as the preferred stock is immediately convertible. The preferred stock dividend of approximately \$149,000 and the accrued preferred stock dividends of approximately \$40,700 were reported as dividends in determining the net loss attributable to common stockholders in the accompanying statement of operations for the nine months ended December 31, 2002.

Common Stock - On June 28, 2002, the Company entered into a Finder's Agreement with an individual to develop and qualify potential strategic partners for the purpose of testing and/or the commercialization of Company products in China. As consideration for entering into the agreement, the individual received 150,000 shares of the Company's common stock and the Company recognized approximately \$757,500 as a general and administrative expense during the three month period ended September 30, 2002, based on the estimated fair value of the shares issued.

On July 31, 2002, the Company entered into a one year agreement with The Gabriele Group, L.L.C. ("Gabriele") for assistance to be provided by Gabriele to the Company with respect to management consulting, strategic planning, public relations and promotions. As compensation for these services, the company granted Gabriele 40,000 shares of the Company's common stock and the Company recognized approximately \$187,600 as a general and administrative expense during the three month

9

period ended September 30, 2002, based on the estimated fair value of the shares issued. The Company also granted Gabriele warrants to purchase 30,000 shares of the Company's common stock at \$6.00 per share. These warrants vest when the price of the Company's common stock reaches certain milestones, beginning at \$10.00 per share for a period of 20 consecutive days. This agreement may be renewed for additional one year terms at the sole discretion of the Company.

Common Stock Options - On October 12, 2000, the Company's board approved the issuance of options to purchase shares of common stock to certain employees and other nonemployees who have been engaged to assist the Company in various research and administrative capacities as part of the 2000 Stock Incentive Plan. The 2000 Stock Incentive Plan provides for the

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

issuance of up to 350,000 shares of common stock, in the form of incentive options and non-qualified stock options. At the stockholders meeting held November 15, 2002, the stockholders approved an amendment to the 2000 Stock Incentive Plan to increase the number of shares of common stock reserved for issuance from 350,000 shares to 1,100,000 shares. Options granted under the 2000 Stock Incentive Plan that expire without exercise are available to be reissued. The incentive stock options must be granted at a price at least equal to fair market value on the date of grant.

The Company has granted common stock options to individuals who have contributed to the Company in various capacities. The options contain various provisions regarding vesting periods and expiration dates. The options generally vest over periods ranging from 0 to 4 years and generally expire after five or ten years. During the three and nine month periods ended December 31, 2002, the Company issued 203,000 options to purchase shares, of common stock to its employees and directors. During the three and nine month periods ended December 31, 2002, 0 and 20,000 options expired, respectively, which were previously granted under the 2000 Stock Incentive Plan which are available to be reissued. As of December 31, 2002, there were 620,750 shares available for grant (including 12,000 shares which are reserved for issuance under certain consulting agreements with nonemployees).

During the three and nine months ended December 31, 2002, the Company issued options to purchase 0 and 22,000 shares, respectively, of common stock to nonemployees and recognized expense of approximately \$56,000 and \$187,000, respectively, related to these options and certain options issued prior to July 1, 2002 which vest over a four year service period. During the three months ended December 31, 2001, the Company did not issue any options to nonemployees and recognized expense of approximately \$85,000 related to certain options issued prior to July 1, 2001 which vest over four year service periods. During the nine months ended December 31, 2001, the Company issued options to purchase 12,000 shares of common stock to nonemployees and recognized expense of approximately \$247,000 related to these options and certain options issued prior to July 1, 2001 which vest over four year service periods. The expenses were determined based on the estimated fair value of the options issued.

The Company's stockholders exercised options for 0 and 217 shares of common stock during the three and nine months ended December 31, 2002.

#### 4. COLLABORATIVE RESEARCH AND DEVELOPMENT ACTIVITIES

The Company has various collaborative research agreements with commercial enterprises. Under the terms of these arrangements, the Company has agreed to perform best efforts research and development and, in exchange, the Company may receive advanced cash funding and may also earn additional fees for the attainment of certain milestones. The Company may receive royalties on the sales of such products. The other parties generally receive exclusive marketing and distribution rights for certain products for set time periods in specific geographic areas.

The Company initially acquired its rights to the platform technology and indications developed by a consortium of universities consisting of The University of North Carolina at Chapel Hill ("UNC"), Duke University, Auburn University and Georgia State University (the "Consortium") pursuant to an agreement, dated January 15, 1997 (as amended, the "Consortium Agreement") among the Company, Pharm-Eco Laboratories, Inc. ("Pharm-Eco"),

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

and UNC (to which each of the other members of the Consortium agreed shortly thereafter to become a party). The Consortium Agreement commits the parties to collectively research, develop, finance the research and development of, manufacture and market both the technology and compounds owned by the Consortium and previously licensed or optioned to Pharm-Eco (the "Current Compounds") and to license to the Company in accordance with the Consortium Agreement, all technology and compounds developed by the Consortium after January 15, 1997, through use of Company-sponsored research funding or National Cooperative Drug Development grant funding made available to the Consortium (the "Future Compounds" and, collectively with the Current Compounds, the "Compounds").

The Consortium Agreement contemplated that upon the completion of the Company's initial public offering ("IPO") of shares of its common stock with gross proceeds of at least \$10,000,000 by April 30, 1999, the Company and Pharm-Eco, with respect to the Current Compounds, and the Company and UNC, (on behalf of the Consortium), with respect to Future Compounds, would enter into license agreements for, or assignments of, the intellectual property rights relating to the Compounds held by Pharm-Eco and the Consortium; pursuant to which the Company would pay royalties and other payments based on revenues received for the sale of products based on the Compounds.

The Company completed its IPO on April 26, 1999, with gross proceeds in excess of \$10,000,000. Pursuant to the Consortium Agreement, both Pharm-Eco and the Consortium then became obligated to grant or assign to the Company an exclusive worldwide license to use, manufacture, have manufactured, promote, sell, distribute, or otherwise dispose of any products based directly or indirectly on all of the Current Compounds and Future Compounds.

As a result of the closing of the IPO, the Company issued an aggregate of 611,250 shares of common stock, of which 162,500 shares were issued to the Consortium and 448,750 shares were issued to Pharm-Eco or persons designated by Pharm-Eco.

Pursuant to the Consortium Agreement, the Company may, subject to the satisfaction of certain conditions, be required to issue 100,000 shares of common stock to the Consortium upon the filing by the Company of the first new drug application or an abbreviated new drug application with the Food and Drug Administration with respect to a product incorporating certain Compounds. In addition, the Company will pay the Consortium an aggregate royalty of up to 5.0% of net sales derived from the Compounds, except that the royalty rate payable on any Compound developed at Duke University will be determined by negotiation at the time such Compound is developed. In the event that the Company sublicenses its rights with respect to the Compounds to a third party, the Company will pay the Consortium a royalty based on a percentage of any royalties the Company receives, and a percentage of all signing, milestone and other payments made to the Company pursuant to the sublicense agreement.

As contemplated by the Consortium Agreement, on January 28, 2002, the Company entered into a License Agreement with the Consortium whereby the Company received the exclusive license to commercialize dication technology and compounds developed or invented by one or more of the Consortium scientists after January 15, 1997, and which also incorporated into such License Agreement the Company's existing license with the Consortium with regard to the Current Compounds.

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

In June 1999, the Company entered into a research and manufacturing agreement with Pharm-Eco for Pharm-Eco to produce good manufacturing practices quality, as defined, dicationic drugs and products for clinical testing and for early commercialization. Pharm-Eco was unable to manufacture certain required compounds and the Company subsequently engaged alternate suppliers who successfully manufactured the compounds.

In August 2000, Pharm-Eco and two of its senior executives filed suit in Delaware against the Company in connection with a dispute under the Consortium Agreement. The Company responded by denying the allegations and filing a counter-claim against Pharm-Eco for breach of contract.

The Company filed a Motion for Summary Judgment, which was granted on February 21, 2001. In his Memorandum Opinion, the Vice Chancellor hearing the proceeding dismissed all of the plaintiffs' claims against the Company and held that Pharm-Eco had breached the Consortium Agreement by failing to grant or assign to the Company a license for the Current Compounds. On March 12, 2001, the Vice Chancellor signed a Final Order and Judgment directing Pharm-Eco to execute and deliver to the Company an agreement granting or assigning to the Company the license. On March 27, 2001, Pharm-Eco and the Company entered into an agreement assigning the license. No further claims against the Company remain in this proceeding, and on May 1, 2001, a Stipulation of Dismissal was filed with the Court.

On April 20, 2001, the Company entered into a settlement agreement with Pharm-Eco and certain other parties resolving all remaining matters between them. Pursuant to this agreement, the Company received a cash payment of \$1,000,000; an assignment from Pharm-Eco of various contract rights; and a termination of all of the Company's obligations to Pharm-Eco, including, without limitation, (a) the obligation to issue an aggregate of 850,000 warrants for shares of the Company's stock, (b) the obligation to issue shares of common stock upon the occurrence of a certain future event, (c) the obligation to pay a percentage of all non-royalty payments that the Company might receive under any sublicense that the Company might enter into with respect to certain compounds, and (d) certain accounts payable which Pharm-Eco claimed to be owed of approximately \$159,000; and a release of any and all claims that Pharm-Eco may have had against the Company. The cash payment received and the accounts payable obligations which were forgiven, aggregating approximately \$1,159,000, was recorded as a credit to (reduction of) research and development expense during the three months ended June 30, 2001; as the Company had previously expensed the estimated fair value of the shares of common stock issued to Pharm-Eco at the time of the IPO and the accounts payable obligations, as research and development expense.

The Company was required, under an agreement which has subsequently expired, to make quarterly research grants in the amount of \$100,000 to UNC through April 30, 2002. During the three month period ended December 31, 2001, the Company expensed grant payments to UNC of \$100,000. During the nine month periods ended December 31, 2002 and 2001, the Company expensed grant payments to UNC of \$100,000 and \$300,000, respectively. Such payments were recorded as research and development costs.

In August 2000, the Company was awarded two Small Business Innovation Research ("SBIR") grants aggregating approximately \$831,000 from the National Institutes of Health ("NIH") to research various infections. During the three and nine months ended December 31, 2001, the Company recognized revenues of approximately \$65,000 and \$503,000, respectively, from these grants. During the three and nine months ended December 31, 2001, the Company expensed payments of approximately \$86,000 and \$189,000, respectively, to UNC and certain other Consortium universities for contracted research related to these grants. There is no additional funding

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

available to the Company under these grants.

12

In August 2001, the Company was awarded an additional SBIR grant from the NIH of approximately \$144,000 as the third year grant to continue research on "Novel Procedures for Treatment of Opportunistic Infections." During the three and nine months ended December 31, 2002, the Company recognized revenues of approximately \$0 and \$70,000, respectively, from this grant and expensed payments of approximately \$0 and \$70,000, respectively, to UNC and certain other Consortium universities for contracted research related to this grant. There is no additional funding available to the Company under this grant.

During the three month periods ended December 31, 2002 and 2001, the Company expensed approximately \$99,000 and \$58,000, respectively, of other payments to UNC and certain other Consortium universities for patent related costs and other contracted research. Total payments expensed to UNC and certain other Consortium universities were approximately \$99,000 and \$222,000 during the three months ended December 31, 2002 and 2001, respectively. During the nine months ended December 31, 2002 and 2001 the Company expensed approximately \$231,000 and \$231,000, respectively, of other payments to UNC and certain other Consortium universities for reimbursement of patent related costs and other contracted research. Total payments expensed to UNC and certain other Consortium universities were approximately \$401,000 and \$727,000 during the nine months ended December 31, 2002 and 2001, respectively. Included in accounts payable as of December 31, 2002 and March 31, 2002, were approximately \$66,000 and \$267,000, respectively, due to UNC and certain other Consortium universities.

In November 2000, The Bill & Melinda Gates Foundation ("Gates Foundation") awarded a \$15,114,000 grant to UNC to develop new drugs to treat Human Trypanosomiasis (African sleeping sickness) and Leishmaniasis. On March 29, 2001, UNC entered into a clinical research subcontract agreement with the Company, whereby the Company is to receive up to \$9,800,000, subject to certain terms and conditions, over a five year period to conduct certain clinical and research studies. The proceeds from this agreement are restricted and must be segregated from the Company's other funds and used for specific purposes. On March 29, 2001, the Company received a first installment of \$4,300,000, on September 24, 2002 approximately \$1,364,000 and on December 31, 2002 approximately \$2,016,000 of which approximately \$199,000 and \$804,000 was utilized for clinical and research purposes conducted and expensed during the three months and nine months ended December 31, 2002. The Company has recognized aggregate revenues since inception of approximately \$4,541,000 through December 31, 2002 for services performed under the agreement, including approximately \$199,000 and \$804,000 during the three and nine months ended December 31, 2002. The remaining amount (approximately \$3,139,000 as of December 31, 2002) has been deferred and will be recognized as revenue over the term of the agreement as the services are performed.

On April 22, 2002, the Company entered into a Confidentiality, Testing and Option Agreement with Neurochem, Inc., ("Neurochem"), a Canadian corporation, to supply Neurochem with selected dicationic compounds for the testing, evaluation and potential future licensing of such compounds for (i) the treatment and diagnosis of amyloidosis and the related underlying conditions of Alzheimer's Disease, cerebral amyloid angiopathy, primary amyloidosis, diabetes, rheumatic diseases and (ii) the treatments of conditions related to secondary amyloidosis. Neurochem has the right to

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

license tested compounds upon the conclusion of the Confidentiality, Testing and Option Agreement, as defined in the agreement. The Company has recognized revenues for the three and nine month period ended December 31, 2002 of \$35,000 and \$150,000, respectively.

13

### 5. SUBSEQUENT EVENTS

On January 13, 2003, the Company issued 1,200,000 shares of its common stock pursuant to a joint venture entered into with an investor ("seller") who owned 100% of the outstanding equity of Lenton Fibre Optics Development Limited ("Lenton"), a Hong Kong company. The primary purpose of the joint venture is to construct and operate a pharmaceutical manufacturing facility capable of producing commercial quantities of the Company's pharmaceutical products at competitive costs. The land is located in a "free-trade zone" called the Futian Free Trade Zone, Shenzhen, in the Peoples Republic of China. The Company intends, once the facility is built and government approvals are obtained, to engage the joint venture company to manufacture for commercial distribution, Immtech's pharmaceutical products intended for sale in Asia, Africa and other selected regions. Under the terms of the agreement, the joint venture will be operated under the name Immtech Hong Kong Limited.

The Company purchased an 80% interest in Lenton from the seller pursuant to a Share Purchase Agreement relating to Shares in Lenton Fibre Optics Development Limited for the aggregate consideration of 1,200,000 unregistered shares of Immtech common stock. The unaudited pro forma condensed balance sheet below reflects the historical financial position of the Company, with pro forma adjustments as if the joint venture had closed on December 31, 2002. The accounting for the joint venture reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values.

	DECEMBER 31, 2002
<b>ASSETS</b>	
Total current assets	\$ 4,119,608
Property and equipment - net	120,054
Other assets:	
Investment	2,856,000
Deposits	19,848
	-----
Total assets	\$7,115,510 =====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
Total current liabilities	\$3,533,157
Deferred rental obligation	22,371
	-----
Total liabilities	3,555,528



## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

Total stockholders' equity	3,559,982 -----
Total liabilities and stockholders' equity	\$7,115,510 =====

As consideration for investment advisory services performed for the Company in connection with the acquisition of Lenton, two entities (Pacific Dragons Group Limited and Champion Traders Investment Limited) each received 30,000 shares of the Company's common stock.

14

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

#### Forward-looking Statements

Certain statements contained in this report and in the documents incorporated by reference herein, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements frequently, but not always, use the words "intends," "plans," "believes," "anticipates" or "expects" or similar words and may include statements concerning the Company's strategies, goals and plans. Forward-looking statements involve a number of significant risks and uncertainties that could cause our actual results or achievements or other events to differ materially from those reflected in such forward-looking statements. Such factors include, among others described in this report and in our annual report, the following (i) we are in an early stage of product development, (ii) our technology is in the research and development stage and therefore its potential benefits for human therapy are unproven, (iii) the possibility that favorable relationships with collaborators cannot be established or, if established, will be abandoned by the collaborators before completion of product development, (iv) the possibility that we or our collaborators will not successfully develop any marketable products, (v) the possibility that advances by competitors will cause our product candidates not to be viable, (vi) uncertainties as to the requirement that a drug product be found to be safe and effective after extensive clinical trials and the possibility that the results of such trials, if commenced and completed, will not establish the safety or efficacy of our drug product candidates, (vii) risks relating to requirements for approvals by governmental agencies, such as the FDA, before products can be marketed and the possibility that such approvals will not be obtained in a timely manner or at all or will be conditioned in a manner that would impair our ability to market our product candidates successfully, (viii) the risk that our patents could be invalidated or narrowed in scope by judicial actions or that our technology could infringe upon the patent or other intellectual property rights of third parties, (ix) the possibility that we will not be able to raise adequate capital to fund our operations through the process of developing and testing a successful product or that future financing will be completed on unfavorable terms, (x) the possibility that any products successfully developed by us will not achieve market acceptance and (xi) other risks and uncertainties which may not be described herein.

#### Overview

We are a pharmaceutical company focused on the development and commercialization of oral drugs to treat infectious diseases that include fungal

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

infections, malaria, tuberculosis, hepatitis C, Pneumocystis carinii pneumonia and tropical medicine diseases including African sleeping sickness (Trypanosomiasis) and Leishmaniasis. We hold worldwide patents, licenses and rights to license worldwide patents, patent applications, technologies from a scientific consortium and exclusive rights to commercialize products from those patents and licenses that are integral to our business.

15

Since our formation in October 1984, we have engaged in research and development programs, expanding our network of scientists and scientific advisors, licensing technology agreements, and advancing the commercialization of the dication technology platform. We use the expertise and resources of strategic partners and contracted parties in a number of areas, including: (i) laboratory research, (ii) pre-clinical and human clinical trials and (iii) manufacture of pharmaceutical products. We have licensing and exclusive commercialization rights to a dicationic anti-infective pharmaceutical platform and are developing drugs intended for commercial use based on that platform. These dication pharmaceuticals work by blocking life-sustaining enzymes from binding to the key sites in the "minor groove" of an organism's deoxyribonucleic acid ("DNA"), thereby killing the infectious organisms that cause fungal, parasitic, bacterial and viral diseases. The minor groove or key site on an organism's DNA is an area where enzymes interact with the DNA as part of their normal life cycle. Structurally, dications are chemical molecules that have two positively charged ends held together by a chemical linker. The composition of the dications, with positive charges on both ends (shaped like molecular barbells) allows dications to bind (similar to a bandaid) to the negatively charged active sites (sites where enzymes interact with DNA) of an infectious microorganism's DNA. The bound dications block the enzymes necessary to the life of the microorganism from attaching to certain of its DNA's active sites thereby killing the infectious microorganism.

Dication technology is the result of a research program developed by scientists at The University of North Carolina at Chapel Hill ("UNC"), Duke University ("Duke University"), Auburn University ("Auburn University") and Georgia State University ("Georgia State") (collectively, the "Consortium"). We entered into an agreement with the Consortium, dated January 15, 1997, as amended, and a License Agreement, dated as of January 28, 2002 (collectively, the "Consortium Agreements"), to commercialize product candidates resulting from the Consortium's research, including the dication technology.

We have entered Phase IIb human trials with our lead compound DB289 for treatment of African sleeping sickness (Trypanosomiasis) and expect, assuming results consistent with our prior trials, to book orders for sales of DB289 for limited distribution in certain African countries by the end of calendar year 2003 or first quarter 2004. In connection with the above limited distribution product orders, we anticipate using our existing, and engaging new, pharmaceutical manufacturers to produce the quantities of DB289 needed, and seeking foreign regulatory approvals to import the product into the selected countries, all of which may take several months or more to complete. We have also entered into a joint venture arrangement with a Hong Kong entity whereby we acquired real property located in a "free trade zone" in the Peoples Republic of China on which we intend, through the joint venture entity Immtech Hong Kong Limited, to construct a pharmaceutical manufacturing facility to produce our future products.

### Results of Operations

Immtech has not generated any revenue from operations and does not anticipate generating any revenue from operations prior to the 4th calendar

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

quarter of 2003. The Company has funded, and plans to continue to fund, its operations through research funding agreements and grants, and the sale of debt and equity securities. For the period from inception, October 15,

16

1984, to December 31, 2002, the Company incurred cumulative net losses of approximately \$42,355,000. The Company has incurred additional losses since such date and expects to incur additional operating losses for the foreseeable future.

Three Months Ended December 31, 2002 Compared with the Three Months Ended December 31, 2001.

Revenues under collaborative research and development agreements were approximately \$234,000 and \$955,000 for the three months ended December 31, 2002 and December 31, 2001, respectively. For the three months ended December 31, 2002 there were revenues recognized of approximately \$199,000 relating to a clinical research subcontract agreement between the Company and UNC and revenues of \$35,000 relating to the Confidentiality, Testing and Option Agreement between the Company and Neurochem, Inc. ("Neurochem"), while for the three months ended December 31, 2001, there were revenues recognized of approximately \$858,000 relating to the clinical research subcontract agreement between the Company and UNC and grant revenues of approximately \$97,000 from SBIR grants from the NIH. The clinical research subcontract agreement relates to a grant from the Bill & Melinda Gates Foundation ("Gates Foundation") to UNC to develop new drugs to treat Trypanosomiasis (African sleeping sickness) and Leishmaniasis. This program was initiated in March 2001. Grant and research and development agreement revenue is recognized as research is completed under the terms of the respective agreements, according to Company estimates. Grant and research and development funds received prior to completion under the terms of the respective agreements are recorded as deferred revenues.

Interest income for the three months ended December 31, 2002 was approximately \$3,000. Interest income for the three months ended December 31, 2001 was approximately \$2,000. The increase is due to an increase in available funds invested. The Company had no interest expense for the three months ended December 31, 2002 and December 31, 2001.

Research and development expenses decreased to approximately \$402,000 in the three months ended December 31, 2002 from approximately \$1,206,000 in the three months ended December 31, 2001. The Company had significant expenses relating to pre-clinical studies required for regulatory filings and purchase of product in the three months ended December 31, 2001 that were not incurred in 2002.

General and administrative expenses increased for the three months ended December 31, 2002 to approximately \$724,000 from approximately \$689,000 for the three months ended December 31, 2001.

We incurred a net loss of approximately \$889,000 for the three months ended December 31, 2002 as compared with a net loss of approximately \$938,000 for the three months ended December 31, 2001.

Nine Months Ended December 31, 2002 Compared with the Nine Months ended December 31, 2001.

17

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

Revenues under collaborative research and development agreements were approximately \$1,024,000 and \$2,914,000 for the nine months ended December 31, 2002 and 2001, respectively. For the nine months ended December 31, 2002 there were revenues recognized of approximately \$804,000 relating to the clinical research subcontract agreement between the Company and UNC, grant revenues of approximately \$70,000 from SBIR grants from the NIH and revenues of \$150,000 relating to the Confidentiality, Testing and Option Agreement between the Company and Neurochem, while for the nine months ended December 31, 2001, there were revenues recognized of approximately \$2,379,000 relating to the clinical research subcontract agreement between the Company and UNC and grant revenues of approximately \$535,000 from SBIR grants from the NIH.

Interest income for the nine months ended December 31, 2002 was approximately \$13,000. Interest income for the nine months ended December 31, 2001 was approximately \$39,000. The decrease is due to a reduction in funds invested and a reduction in interest rates paid on the invested funds. The Company had no interest expense for the nine months ended December 31, 2002 and December 31, 2001.

Research and development expenses decreased to approximately \$1,864,000 in the nine months ended December 31, 2002 from approximately \$2,987,000 in the nine months ended December 31, 2001. The decrease for the period is primarily attributable to a reduction in expenses relating to pre-clinical studies required for regulatory filings and funding of clinical trials in the nine months ended December 31, 2001 that were not incurred in 2002.

General and administrative expenses increased for the nine months ended December 31, 2002 to approximately \$3,059,000 from approximately \$2,370,000 for the nine months ended December 31, 2001. The increase was primarily due to non-cash compensation charges of approximately \$946,000 recorded in the nine months ended December 31, 2002 related to the issuance of 150,000 shares of the Company's Common Stock to Mr. Cheung Ming Tak (for services with respect to introduction to strategic partners in China) and 40,000 shares of Common Stock to the Gabriele Group (for providing management consulting, strategic planning, public relations and promotions assistance). Additionally, the Company incurred increases of approximately \$86,000 in patent related expenses and approximately \$107,000 in travel expenses related to fund raising, offset by a decrease of approximately \$444,000 in legal fees.

We incurred a net loss of approximately \$3,886,000 for the nine months ended December 31, 2002 as compared with a net loss of approximately \$2,404,000 for the nine months ended December 31, 2001.

### Liquidity and Capital Resources

As of December 31, 2002, the Company had approximately \$1,035,000 of cash and cash equivalents, substantially all of which were invested in a money market mutual fund.

There were equipment expenditures of approximately \$5,000 for the three month period ended December 31, 2001 as compared to no equipment expenditures for the same period last year. During the nine month periods ended December 31, 2002 and December 31, 2001,

equipment purchases were approximately \$16,000 and \$62,000, respectively. No significant purchases of equipment are anticipated by the Company.

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

The Company periodically receives cash from the exercise of common stock options. During the three months ended December 31, 2002 there were no options exercised and during the nine months ended December 31, 2002 there were 217 options exercised.

On September 25, 2002 and October 28, 2002 we closed private placements of 76,725 shares of our Series B Convertible Preferred Stock, \$0.01 par value ("Series B Stock"), pursuant to Regulation D and Regulation S of the Securities Act of 1933, as amended ("Securities Act") at a stated value of \$25.00 per share and warrants to purchase 191,813 shares of our Common Stock at an exercise price of \$6.125 per share of Common Stock for \$1,918,125 in the aggregate, before issue cost. Each share of Series B Stock, among other things, (i) earns an 8% dividend payable, at the Company's discretion, in cash or Common Stock, (ii) has a \$25.00 (plus accrued but unpaid dividends) liquidation preference pari passu with our Series A Convertible Preferred Stock, (iii) is convertible into 6.25 shares of Common Stock and (iv) may be redeemable by the Company after one year from issuance. The warrants expire five years from the date of grant and contain certain anti-dilution protections. A complete description of the designations, preferences, voting powers, qualifications, special or relative rights and privileges of the Series B Stock is contained in the Company's Series B Convertible Preferred Stock Certificate of Designation filed on a Current Report on Form 8-K on September 25, 2002. We believe our existing unrestricted cash and cash equivalents and the grants we have received or have been awarded and are awaiting disbursement of, will be sufficient to meet our planned expenditures through May 2003, although there can be no assurance we will not require additional funds.

To date, we have financed our operations with:

- o proceeds from the above mentioned Series B Stock private placements which in the aggregate raised net proceeds of approximately \$1,859,000;
- o proceeds from various other private placements of debt and equity securities, an initial public offering, exercises of stock options and warrants and other cash contributed from stockholders, which in the aggregate raised approximately \$26,896,000;
- o funding from research agreements, foundation grants, SBIR grants and Small Business Technology Transfer Program grants and testing agreements of approximately \$8,258,000; and
- o the use of stock, options and warrants in lieu of cash compensation.

Our cash resources have been used to finance, develop and begin commercialization of drug product candidates, including sponsored research, conduct of human clinical trials, capital expenditures, expenses associated with development of product candidates pursuant to an agreement, dated January 15, 1997, (the "Consortium Agreement"), among the Company, UNC, and Pharm-Eco Laboratories, Inc. (to which each of Duke University, Auburn University and

Georgia State agreed shortly thereafter to become a party, and all of which, collectively with UNC, are referred to as the "Consortium") and, as contemplated by the Consortium Agreement, under a license agreement dated January 28, 2002 ("Consortium License Agreement") with the Consortium, and general and administrative expenses. Over the next several years we expect to incur substantial additional research and development costs, including costs related to research in pre-clinical (laboratory) and human clinical trials,

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

administrative expenses to support our research and development operations and marketing expenses to launch the sale of any commercialized product that may be developed.

Our future working capital requirements will depend upon numerous factors, including the progress of research, development and commercialization programs (which may vary as product candidates are added or abandoned), pre-clinical testing and human clinical trials, achievement of regulatory milestones, third party collaborators fulfilling their obligations to the Company, the timing and cost of seeking regulatory approvals, the level of resources that the Company devotes to the engagement or development of manufacturing capabilities, the ability of the Company to maintain existing and to establish new collaborative arrangements with others to provide funding to the Company to support these activities, and other factors. In any event, we will require substantial funds in addition to our existing working capital to develop product candidates and otherwise to meet our business objectives.

Our ability to continue as a going concern is dependent upon our ability to generate sufficient funds to meet obligations as they become due and, ultimately, to obtain profitable operations. Management's plans for the remainder of the fiscal year, in addition to normal operations, include continuing their efforts to obtain additional financing and grants, and to enter into various research, development and commercialization agreements with other entities.

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

The Company's cash and cash equivalents are maintained primarily in U.S. dollar accounts and amounts payable for research and development to research organizations are contracted in U.S. dollars. Accordingly, the Company's exposure to foreign currency risk is limited because its transactions are primarily based in U.S. dollars. The Company does not have any other exposure to market risk. The Company will develop policies and procedures to manage market risk in the future as circumstances require.

### Item 4. Controls and Procedures

The Company maintains "disclosure controls and procedures", as such term is defined under Exchange Act Rule 13a-14(c), that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. The Company has carried out an evaluation, within the 90 days prior to the date of filing of this report, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial

20

Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon their evaluation and subject to the foregoing, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in ensuring that material information relating to the Company, is made known to the Chief Executive Officer and Chief Financial Officer during the period in which this report was being prepared. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date the Company completed its evaluation.

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

### PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings.

Dale M. Geiss v. Immtech International, Inc. and Criticare Systems, Inc.

On September 19, 2002 the Court (Circuit Court of the Nineteenth Judicial Circuit, Lake County, Illinois) granted Immtech's motion to dismiss plaintiff's amended complaint, but gave plaintiff another opportunity to file and serve an amended complaint, if he so chooses. Plaintiff filed a second amended complaint dated November 1, 2002 against the Company and Criticare alleging the same allegations as before. On December 6, 2002, the Company and Criticare again filed motions to dismiss plaintiff's amended complaint. On February 6, 2003, the Court denied the motions to dismiss and granted Criticare and Immtech 30 days to answer or otherwise plead to the Second Amended Complaint. The Company intends to vigorously defend against the allegations and believes the claims have no merit.

Except as noted above, in Part I, Item 3, Legal Proceedings, of the Form 10-K filed on July 15, 2002, in Part II, Item 1 of the Form 10-Q filed on November 14, 2002 and in Part II, Item 1 of the Form 10-Q filed on August 14, 2004, the Company is not aware of any pending litigation.

#### Item 2. Changes in Securities and Use of Proceeds.

##### Common Stock.

On January 13, 2003, the Company issued 1,200,000 shares of its Common Stock pursuant to a joint venture entered with an investor ("seller") who owned 100% of the outstanding equity of Lenton Fibre Optics Development Limited ("Lenton"), a Hong Kong company. The primary purpose of the joint venture is to construct and operate a pharmaceutical manufacturing facility capable of producing commercial quantities of the Company's pharmaceutical products at competitive costs. The land is located in a "free-trade zone" called the Futian Free Trade Zone, Shenzhen, in the Peoples Republic of China. The Company intends, once the facility is built and government approvals are obtained, to engage the joint venture company to manufacture for commercial distribution, Immtech's pharmaceutical products intended for sale in Asia, Africa and other selected regions. Under the terms of the agreement, the joint venture will be operated under the name Immtech Hong Kong Limited.

21

The Company purchased 80% of the outstanding equity of Lenton from the seller pursuant to a Share Purchase Agreement relating to Shares in Lenton Fibre Optics Development Limited dated January 13, 2003 by and among the seller, Lenton and the Company for the aggregate consideration of 1,200,000 unregistered shares of Common Stock. The Common Stock was issued to the seller pursuant to an exemption from registration under Regulation S of the Securities Act. The parties have also entered into a Shareholders' Agreement relating to Lenton Fibre Optics Development Limited dated January 13, 2003 that sets forth the parties agreement as to the affairs of the joint venture and the conduct of its business. The seller has guaranteed the obligations of Lenton under a Deed of Indemnity dated January 13, 2003. In connection with the structuring of the joint venture, the Company issued 30,000 shares of Common Stock to each of Pacific Dragons Group Limited and Champion Traders Investment Limited as compensation for their services.

## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

On January 14, 2003 the Company filed a Current Report on Form 8-K attaching the Share Purchase Agreement as related to shares in Lenton Fibre Optics Development Limited, the Shareholders' Agreement relating to Lenton Fibre Optics Development Limited and the seller's Deed of Indemnity.

### Issuance of Series B Stock

On October 28, 2002 we issued 1,000 shares of our Series B Stock pursuant to an exemption from registration under Regulation D of the Securities Act at a stated value of \$25.00 per share and warrants to purchase 2,500 shares of our Common Stock at an exercise price of \$6.125 per share of Common Stock for \$25,000 in the aggregate. Each share of Series B Stock, among other things, (i) earns an 8% dividend, (ii) has a \$25.00 (plus accrued but unpaid dividends) liquidation preference pari passu with our Series A Convertible Preferred Stock, (iii) is convertible into 6.25 shares of Common Stock and (iv) may be redeemable by the Company after one year from issuance. The warrants expire five years from the date of grant and contain certain anti-dilution protections. A complete description of the designations, preferences, voting powers, qualifications, special or relative rights and privileges of the Series B Stock is contained in the Company's Series B Convertible Preferred Stock Certificate of Designation filed on a Current Report on Form 8-K on September 25, 2002.

### Option Exercise.

None.

### Conversion of Series A Stock to Common Stock.

On December 20, 2002, the holders of Series A Convertible Preferred Stock ("Series A Stock") converted 8,000 shares of Series A Stock and accrued dividends into 45,978 shares of Common Stock.

### Series A and Series B Stock Dividend Payment.

On October 15, 2002, the Company issued 31,617 shares of Common Stock in the aggregate as preferred stock dividends to the holders of outstanding shares of Series A Stock and Series B Stock, pro rata based on the number of the shares of Series A Stock and Series B Stock

22

held. On January 8, 2003 the Company discovered a miscalculation in the dividend due certain holders of Series A Stock and issued an additional 5,663 shares of Common Stock in the aggregate to those holders.

### Use of Proceeds.

Immtech will use proceeds from the sale of its stock, including the exercise of options and warrants, for general corporate purposes.

### Item 3. Defaults Upon Senior Securities.

None.

### Item 4. Submission of Matters to a Vote of Security Holders.

### VOTES OF THE SHAREHOLDERS.

The Company held its Annual Meeting on November 15, 2002 at the Westin



## Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

O'Hare in Rosemont, Illinois. The following matters were presented to the stockholders: (1) election of five directors to serve until the next annual meeting of the stockholders, (2) Proposal 1 - approval of an amendment to the Company's 2000 Stock Incentive Plan to increase the number of shares of Common Stock reserved for issuance thereunder from 350,000 shares to 1,100,000 shares, (3) Proposal 2 - approval of the conversion of Series A Stock held by certain officers and directors of the Company into Common Stock and (4) Proposal 3 - ratification of the Company's Board of Director's selection of Deloitte & Touche LLP as the Company's independent auditors for the fiscal year ending March 31, 2003. The results of the votes are as follows:

The following individuals were elected Directors by the Shareholders

	VOTES FOR
T. Stephen Thompson	4,762,046
Harvey M. Colten, M.D.	4,774,546
Eric L. Sorkin	4,762,046
Cecilia Chan	4,774,546
Frederick W. Wackerle	4,760,277

	VOTES FOR	VOTES AGAINST
Proposal 1 - Amendment to 2000 Stock Incentive Plan	1,654,160 (85.5%)	239,957 (12.38%)
Proposal 2 - Conversion of Series A Stock	1,838,179 (94.84%)	71,680 (3.70%)
Proposal 3 - Ratification of Deloitte & Touche LLP as independent auditors	4,675,879 (96.95%)	145,266 (3.01%)

23

Item 5. Other Information.

None.

Item 6. Exhibits, and Reports on Form 8-K.

1. Exhibits.

See Exhibit Index, page 25.

2. Reports on Form 8-K.

The Company filed a Current Report on Form 8-K on January 14, 2003 reporting the consummation of a joint venture whereby the Company purchased an 80% interest in a Hong Kong entity, Lenton Fibre Optics Development Limited, that owns commercial real estate in a "free trade zone" located in the Peoples Republic of China. The joint venture entity intends to construct a pharmaceutical manufacturing facility on the PRC property to be used to manufacture the Company's future products.

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

A Current Report on Form 8-K was filed on January 23, 2003 reporting the receipt of a \$2.1 million payment relating to the clinical research subcontract agreement between the Company and UNC funded by a grant from The Bill and Melinda Gates Foundation.

24

Exhibit Index

99.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

25

SIGNATURES

Pursuant to the requirements of Sections 13 and 15(d) 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.

IMMTECH INTERNATIONAL, INC.

Date: February 14, 2003

By: /s/ T. Stephen Thompson

-----  
T. Stephen Thompson  
President and Chief Executive  
Officer

Date: February 14, 2003

By: /s/ Gary C. Parks

-----  
Gary C. Parks  
Treasurer, Secretary and Chief  
Financial Officer  
(Principal Financial and  
Accounting Officer)

CERTIFICATIONS

I, T. Stephen Thompson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Immtech International, Inc.:
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 14, 2003

/s/ T. Stephen Thompson  
-----  
T. Stephen Thompson  
President & Chief Executive Officer

I, Gary C. Parks, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Immtech International, Inc.:

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 14, 2003

/s/ Gary C. Parks

-----  
Gary C. Parks  
Chief Financial Officer

clude that he should be a member of our Board. His strong financial background was also considered, as Mr. Schad serves as Vice Chairperson of our Audit Committee.

**Dale J. Visser**, age 74  
*Director since 1997*

Mr. Visser is Chairman and one of the owners of Visser Brothers Inc. of Grand Rapids, Michigan. He has served Visser Brothers in various officer positions since 1960. Visser Brothers is a construction

**Table of Contents**

general contractor specializing in commercial buildings. Mr. Visser also has an ownership interest in several real estate projects in the Grand Rapids area. Mr. Visser served as a director of First Michigan Bank-Grand Rapids from 1972 until June of 1997. He is a Grand Rapids native and a graduate of the University of Michigan with a degree in civil engineering. Mr. Visser is active in the community. He has previously served on the Boards of the Grand Rapids YMCA, Christian Rest Home, and West Side Christian School. Mr. Visser's very successful career and expertise in commercial real estate, combined with his 25 years of prior bank board experience, led us to conclude that he should serve on our Board.

**Donald Williams, Sr., age 74**

*Director since 1998*

Mr. Williams is Dean Emeritus of Grand Valley State University. During 2002, he was the Coordinator of the minority students teacher preparation program for the Grand Rapids Public Schools (secondary schools). Mr. Williams has over 30 years of experience in administration of educational programs with special emphasis on political sensitivity and equality. From 1989 to 2001, he was the Dean of Minority Affairs and Director of the Multicultural Center of Grand Valley State University. Mr. Williams also serves as President of the Concerned Citizens Council. He previously served as President of the Rotary Club of Grand Rapids, President of the Coalition for Representative Government (CRG), as a member of the Board of Directors of First Michigan Bank-Grand Rapids and the Grand Rapids Advisory Board of Michigan National Bank, as Treasurer and President of the Minority Affairs Council of Michigan Universities (MACMU), and as a member of the Board of Directors of the Grand Rapids Area Chamber of Commerce. Mr. Williams' service on the First Michigan Bank-Grand Rapids Board of Directors and the Grand Rapids Advisory Board of Michigan National Bank provided Mr. Williams with extensive bank board experience prior to joining our Board. Mr. Williams has been the recipient of numerous awards in the Grand Rapids and Michigan area for community service and job performance, including most recently the Giant Among Giants award. His work has been cited in the Congressional Record of the United States by the late Representative Paul Henry. Mr. Williams has a unique and valuable background in the area of minority affairs, equality, political sensitivity and community action. His point of view regarding underserved markets was especially considered in determining that he should serve on our Board.

**Table of Contents****Executive Officers**

Our executive officers are listed in the table below.

<b>Name of Executive Officer</b>	<b>Title</b>
Michael H. Price	Chairman of the Board, President and Chief Executive Officer of Mercantile, and Chairman of the Board and Chief Executive Officer of the Bank
Robert B. Kaminski, Jr.	Executive Vice President, Chief Operating Officer and Secretary of Mercantile, and President, Chief Operating Officer and Secretary of the Bank
Charles E. Christmas	Senior Vice President, Chief Financial Officer and Treasurer of Mercantile, and Senior Vice President and Chief Financial Officer of the Bank

Mr. Price is also a member of our Board of Directors, and information regarding his business experience is described above under the heading Election of Directors. Mr. Kaminski's and Mr. Christmas' business experience, for at least the past five years, is summarized below. Our executive officers are generally elected each year at the annual meeting of our Board of Directors that follows the annual meeting of the shareholders. Their terms of office are at the discretion of our Board of Directors.

**Robert B. Kaminski, Jr.,** age 49

*Executive Vice President, Chief Operating Officer and Secretary of Mercantile, and President, Chief Operating Officer and Secretary of the Bank*

Mr. Kaminski joined the Bank in 1997 and has over 20 years of commercial banking experience. Before being promoted to his current position in 2007, Mr. Kaminski served Mercantile and the Bank as Senior Vice President and Secretary from 1997 to 2003, and Executive Vice President and Secretary from 2003 to June of 2007. In addition, he has served as the Bank's Chief Operating Officer since 2000. Mr. Kaminski serves on the Boards of Directors and Executive Committees for Boys and Girls Clubs of Grand Rapids Youth Commonwealth and Camp O'Malley, the Board of Directors of VSA Arts of Michigan-Grand Rapids-Very Special Arts, and is a career mentor for Aquinas College of Grand Rapids.

**Charles E. Christmas,** age 45

*Senior Vice President, Chief Financial Officer and Treasurer of Mercantile, and Senior Vice President and Chief Financial Officer of the Bank*

Mr. Christmas joined the Bank in 1998 and has more than 20 years of banking experience. Before being promoted to his current position in 2000, Mr. Christmas served as Vice President of Finance, Treasurer and Compliance Officer of Mercantile and the Bank in 1998, and Chief Financial Officer, Treasurer and Compliance Officer of Mercantile and the Bank in 1999. Prior to joining Mercantile, he examined various financial institutions for over ten years while serving as a bank examiner with the Federal Deposit Insurance Corporation (FDIC). He began his tenure with the FDIC upon his graduation from Ferris State University. Mr. Christmas holds a Bachelor of Science degree in Accountancy. Mr. Christmas serves on the Michigan Bankers Association Funds Management Committee and as a member of the Ferris State University College of Business Advisory Board. He also serves as a fundraising volunteer

for the Make-A-Wish Foundation of Michigan, Finance Committee member for the Susan G. Komen Grand Rapids affiliate, and is an Instructor at the Robert Perry School of Banking at Central Michigan University.



**Table of Contents**

**Corporate Governance**

**Director Independence**

Applicable Nasdaq rules require that a majority of our Board of Directors be independent. In February of 2011, our Board of Directors reviewed the independence of our directors and determined that each of the directors, including those nominated for election at the annual meeting, are independent as defined by applicable Nasdaq rules, with the exception of Messrs. Price and Visser. In making this determination, our Board of Directors has concluded that none of the independent directors has a relationship that in the opinion of our Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

**Board Meetings**

During 2010, our Board of Directors held a total of 11 meetings. During 2010, each director attended at least 75% of the total number of meetings of our Board and its committees on which he or she then served.

Our Board of Directors has a policy of encouraging members of the Board of Directors to attend the annual meetings of the shareholders. All of our directors attended last year's annual meeting.

**Board Committees**

Our Board of Directors has, and appoints members to, three standing committees: the Audit Committee, the Compensation Committee, and the Governance and Nominating Committee. The membership of these committees, as of March 1, 2011, was as follows:

<b>Audit Committee</b>	<b>Compensation Committee</b>	<b>Governance and Nominating Committee</b>
David M. Cassard*	David M. Cassard	Edward J. Clark
Calvin D. Murdock	Edward J. Clark	Doyle A. Hayes*
Merle J. Prins	Lawrence W. Larsen	Susan K. Jones
Timothy O. Schad**	Calvin D. Murdock*	Lawrence W. Larsen
	Merle J. Prins	Donald Williams, Sr.

\* Committee chairperson

\*\* Committee vice chairperson

Each of the members of these committees is an independent director as defined by applicable Nasdaq rules. Each of these committees has a charter that has been approved by our Board of Directors and is available on our website, [www.mercbank.com](http://www.mercbank.com).

**Audit Committee.** The Audit Committee has four members and met five times in 2010. The Audit Committee assists our Board of Directors in overseeing our financial reporting process, internal controls and audit functions, and is directly responsible for the appointment, evaluation, retention and compensation of our independent registered public accounting firm. Our Board of Directors has determined that Messrs. Cassard, Murdock and Schad, who are members

of the Audit Committee, are qualified as audit committee financial experts, as that term is defined in the rules of the SEC. Each of them is independent, as independence for audit committee members is defined in the Nasdaq listing standards and the rules of the SEC. More information about the Audit Committee is included below under the heading Audit Committee Report.

**Compensation Committee.** The Compensation Committee has five members and met five times in 2010. The Compensation Committee assists our Board of Directors in carrying out its responsibilities

**Table of Contents**

relating to compensation and benefits for our directors, officers and employees. The Compensation Committee's responsibilities and authority include:

reviewing and approving the goals and objectives relating to the compensation of our executive officers, and evaluating their performance;

determining, or recommending to our Board for determination, all elements of compensation for our executive officers;

reviewing compensation and guidelines for directors' ownership of our stock;

recommending or making changes in cash compensation for directors;

administering and making awards under our stock-based incentive plans for directors, officers and employees, to the extent provided for in the plans;

reviewing and evaluating our senior executive officer and employee compensation plans in relation to any risks they pose, and limiting those risks, as required in connection with our participation in the Capital Purchase Program of the Troubled Asset Relief Program; and

providing the disclosures and certifications required in relation to our senior executive officer and employee compensation plans, risks they pose, perquisites, and compensation consultants, as required in connection with our participation in the Capital Purchase Program.

The Compensation Committee charter grants the Compensation Committee the authority, in its discretion, to delegate appropriate matters to subcommittees of the Compensation Committee. The Compensation Committee may confer with our Chairman, President and Chief Executive Officer regarding his compensation, and receives recommendations from him regarding the compensation for our other executive officers.

In 2010, we did not use a compensation consulting firm. No fees were paid to any compensation consulting firm in 2010.

**Governance and Nominating Committee.** The Governance and Nominating Committee has five members and met four times in 2010. The Governance and Nominating Committee advises our Board of Directors regarding corporate governance principles and practices, and recommends candidates to the Board for election as directors. It also makes recommendations to our Board of Directors regarding the composition, leadership and duties of the Board's committees.

The Governance and Nominating Committee will consider as potential nominees persons recommended by shareholders. Recommendations should be submitted to the Governance and Nominating Committee in care of the Secretary, Mercantile Bank Corporation, 310 Leonard Street NW, Grand Rapids, Michigan 49504. Each recommendation should include a personal biography of the suggested nominee, an indication of the background or experience that qualifies the person for consideration, and a statement that the person has agreed to serve if nominated and elected.

The Governance and Nominating Committee has used an informal process to identify potential candidates for nomination as directors. Candidates for nomination have been recommended by an executive officer or director, and considered by the Governance and Nominating Committee and the Board of Directors. Generally, candidates have been members of the West Michigan community who have been known to one or more of our Board members. The

Governance and Nominating Committee has not adopted specific minimum qualifications that it believes must be met by a person it recommends for nomination as a director. In evaluating candidates for nomination, the Governance and Nominating Committee will consider the factors it believes to be appropriate. These factors would generally include the candidate's personal and professional integrity, business judgment, relevant experience and skills, and potential to be an effective director in conjunction with the rest of our Board of Directors in collectively serving the long-term interests of our shareholders. We do not have a specific policy relating to the

## **Table of Contents**

consideration of diversity in identifying director candidates. However, the Governance and Nominating Committee does consider the diversity of our Board when identifying director candidates. The amount of consideration given to diversity varies with the Governance and Nominating Committee's determination of whether we would benefit from expanding the Board's diversity in a particular area. We believe that the composition of our Board has consistently demonstrated diversity as defined by race, gender, viewpoint, background and professional experience.

Although the Governance and Nominating Committee has the authority to retain a search firm to assist it in identifying director candidates, there has to date been no need to employ a search firm. The Governance and Nominating Committee does not evaluate potential nominees for director differently based on whether they are recommended by a shareholder.

Shareholders who themselves wish to effectively nominate a person for election to the Board of Directors, as contrasted with recommending a potential nominee to the Governance and Nominating Committee for its consideration, are required to comply with the advance notice and other requirements set forth in our articles of incorporation.

## **Board Leadership Structure**

Our Board is led by Michael H. Price, our Chairman of the Board, President and Chief Executive Officer. The decision as to who should serve as Chairman of the Board, and who should serve as Chief Executive Officer, and whether those offices should be combined or separate, is properly the responsibility of our Board. The members of our Board possess considerable experience and unique knowledge of the challenges and opportunities we face, and are in the best position to evaluate our needs and how best to organize the capabilities of the directors and senior officers to meet those needs. The Board believes that the most effective leadership structure for us now is for Mr. Price to serve as both Chairman of the Board and Chief Executive Officer.

Mr. Price was our founding President and Chief Operating Officer, and has been our Chairman of the Board and Chief Executive Officer since July 1, 2007; as such the Board of Directors believes that he is uniquely qualified through his experience and expertise to be the person who generally sets the agenda for, and leads discussions of, strategic issues for our Board. Mr. Price was one of the key individuals behind our formation in 1997 and his leadership was instrumental in the drafting and implementing of our strategic plan as well as our mission and vision statements. Mr. Price's leadership, in both his Chairman of the Board and Chief Executive Officer roles, continues to ensure that we remain dedicated to and focused on our mission. Our Board believes that this dedication and focus is particularly important during these unusual economic times to ensure that we continue to differentiate ourselves from our competition while navigating the difficult economic waters and keeping us well poised for future market expansion. Our Board believes that we and our shareholders can be most advantaged by leaving these roles combined.

Unlike many companies, our Board of Directors does not have an executive committee through which a chief executive officer and chairman of the board is able to undertake decisions without the participation of the full Board of Directors. Instead, our Board of Directors accomplishes most of its corporate governance role, including new director and succession planning, through its committees which are chartered to undertake significant activities and are made up entirely of independent directors.

In addition, our independent directors participate in at least two executive sessions during the year, in which our Chairman of the Board and Chief Executive Officer does not participate. Any independent director may request additional executive sessions at any meeting. Our executive sessions are led by our executive session facilitator, who is an independent director recommended by our Governance and Nominating Committee and appointed by our Board. Our executive session facilitator is responsible for setting the agenda for executive sessions and leading them. Our current executive session facilitator is David M. Cassard.



## **Table of Contents**

### **Board Role in Risk Oversight**

Our Board oversees our risk management practices. In carrying out its responsibilities, our Board appointed a Risk Management Director (our Senior Risk Officer ). Our Senior Risk Officer, with supervision from our Board, is responsible for the definition, structure, implementation, and coordination of our risk management plan. Our Senior Risk Officer reports at least monthly to our Board.

Our Senior Risk Officer is the Chairman of our Enterprise Risk Management Committee. This committee is comprised of senior management. Its purpose is to provide high-level attention and coordination to the risk management process and to discuss and address significant risks that we face.

Our Senior Risk Officer meets at least every six months with the Compensation Committee to discuss, evaluate and review our compensation plans. The Senior Risk Officer, with the Compensation Committee, assesses whether our compensation plans encourage taking unnecessary and excessive risks that threaten our value, or encourage the manipulation of reported earnings to enhance the compensation of any employee.

### **Communications with Directors**

Shareholders and other persons may send communications to members of our Board of Directors who serve on the Audit Committee by utilizing the webpage on our website, [www.mercbank.com](http://www.mercbank.com), designated for that purpose. Communications received through the webpage are reviewed by a member of our internal audit staff and the chairperson of the Audit Committee. Communications that relate to functions of our Board of Directors or its committees, or that either of them believe requires the attention of members of our Board of Directors, are provided to the entire Audit Committee and reported to our Board of Directors by a member of the Audit Committee. Directors may review a log of these communications, and request copies of any of the communications.

### **Code of Ethics**

We have adopted a written code of ethics that applies to all our directors, officers and employees, including our chief executive officer and our chief financial and accounting officer. We have posted a copy of the code on our website, [www.mercbank.com](http://www.mercbank.com). In addition, we intend to post on our website all disclosures that are required by law or Nasdaq listing standards concerning any amendments to, or waivers from, any provision of the code.

### **Compensation Committee Interlocks and Insider Participation**

The members of our Compensation Committee during 2010 were David M. Cassard, Edward J. Clark, Peter A. Cordes (for part of the year), Lawrence W. Larsen, Calvin D. Murdock and Merle J. Prins. All members of the Compensation Committee are independent directors, and none of them are present or past employees or officers of ours or any of our subsidiaries. No member of the Compensation Committee has had any relationship with us requiring disclosure under Item 404 of SEC Regulation S-K. None of our executive officers has served on the board or compensation committee (or other committee serving an equivalent function) of any other entity, one of whose executive officers served on our Board or Compensation Committee.

**Table of Contents**

**Audit Committee Report**

Each member of the Audit Committee is independent, as independence for audit committee members is defined in the Nasdaq listing standards and the rules of the SEC. The Audit Committee's primary purpose is to assist the Board of Directors in overseeing:

the accounting and financial reporting process;

audits of financial statements and internal control over financial reporting;

internal accounting and disclosure controls; and

the internal audit functions.

In carrying out its responsibilities, the Audit Committee supervises the relationship between Mercantile and its independent registered public accounting firm, including having direct responsibility for the independent registered public accounting firm's appointment, compensation and retention, and reviewing the scope of its audit services, and approving audit and permissible non-audit services. The Audit Committee reviews and discusses the annual and quarterly financial statements, as well as the internal audit plan.

Management is responsible for the preparation, presentation and integrity of Mercantile's financial statements and for the appropriateness of the accounting principles and reporting policies that are used. Management is also responsible for testing the system of internal controls, and reporting to the Audit Committee on any significant deficiencies or material weaknesses that are found. Our independent registered public accounting firm for 2010, BDO USA, LLP (BDO), is responsible for auditing Mercantile's financial statements and internal control over financial reporting and for reviewing its unaudited quarterly financial statements.

The Audit Committee reviewed with BDO the overall scope and plan of the audit. In addition, the Audit Committee met with BDO, with and without management present, to discuss the results of BDO's audit, its evaluation of Mercantile's internal control over financial reporting, the overall quality of Mercantile's financial reporting and such other matters as are required to be discussed under the standards of the Public Company Accounting Oversight Board. The Audit Committee has also received from, and discussed with, BDO the matters required to be discussed by Statement on Auditing Standards No. 61 (Communications with Audit Committees) as amended.

The Audit Committee has discussed with BDO that firm's independence from management and Mercantile, and has received from BDO the written disclosures and the letter required by applicable requirements of the Public Company Accounting Oversight Board regarding BDO's communications with the Audit Committee concerning independence. The Audit Committee has also considered the compatibility of audit related and tax services with BDO's independence.

In fulfilling its oversight responsibilities, the Audit Committee has reviewed and discussed the audited financial statements in the Annual Report on Form 10-K for the year ended December 31, 2010 with both management and our independent registered public accounting firm. The Audit Committee's review included a discussion of the quality and integrity of the accounting principles, the reasonableness of significant estimates and judgments, and the clarity of disclosures in the financial statements.



In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Annual Report on

**Table of Contents**

Form 10-K for the year ended December 31, 2010 for filing with the SEC. The Audit Committee evaluated and appointed BDO as Mercantile's independent registered public accounting firm for 2011.

Audit Committee

David M. Cassard  
Calvin D. Murdock  
Merle J. Prins  
Timothy O. Schad

**Compensation Committee Report**

**Compensation Discussion and Analysis Recommendation**

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis included in this proxy statement with management. Based on the review and discussion, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement for filing with the SEC.

**Compensation Plans**

The compensation plans that one or more of our senior executive officers participate in are our 2000 Employee Stock Option Plan, 2004 Employee Stock Option Plan, Stock Incentive Plan of 2006, 401(k) plan, deferred compensation plan, and Performance Evaluation Plan. Under the 2000 and 2004 plans, options have been issued to our senior executive officers and other employees to acquire shares of our stock. Under our 2006 plan, options and restricted stock have been issued to our senior executive officers and other employees. Options granted under the 2000 and 2004 plans typically were exercisable over a period of ten years. Options granted under the 2006 plan typically fully vest over a two year period and are exercisable over a period of seven years. Restricted stock granted under the 2006 plan typically vests in full after four years. The exercise price for stock options has been the market price when the options were granted. The awards that have been made under the 2000, 2004 and 2006 plans have not included performance criteria. Contributions to our 401(k) plan and the deferred compensation plan are made by participants from compensation they receive from us. We have not provided any matching contribution for the 401(k) plan since the first quarter of 2009. Amounts contributed to our deferred compensation plan are credited with interest monthly at the prime rate. Our Performance Evaluation Plan is described below.

Many employees who are not senior executive officers participate in one or more of the plans identified above, as well as one or more of our Merc Pays Incentive Plan, Mortgage Commission Plan, and Employee Stock Purchase Plan of 2002. Some or all of these plans may be considered employee compensation plans. Our Merc Pays Incentive Plan, Mortgage Commission Plan, Performance Evaluation Plan, and Employee Stock Purchase Plan of 2002 are described below.

The Merc Pays Incentive Plan provides payments to employees ranging from \$5 to \$50 for products and services sold for each customer. The plan is primarily intended to encourage employees to better serve customers, and to help grow our core deposits and consumer customer base. Annual incentives granted to branch employees for 2010 under this plan typically ranged from \$0 to \$1,492 per employee.

The Mortgage Commission Plan applies to our mortgage lenders. It allows for commissions to be paid on mortgages that are closed and sold on the secondary market. Strict underwriting criteria is in place for the mortgages, and intended to encourage sound lending practices. The criteria is included in our internal policies and the requirements

for mortgages to be sold to the secondary market. A

**Table of Contents**

commission schedule has been established based on mortgages closed each month, and our mortgage lenders are paid basis points in relationship to the dollar volume of mortgages closed. In 2010, the average annual commission payout under the plan for our mortgage lenders was \$87,400.

The Performance Evaluation Plan is used to evaluate employees annually for merit salary increases. The evaluation criteria used under the plan has five performance factors for non-supervisory employees and eight performance factors for supervisory employees. Employees are rated on a scale of 1-10 for each performance factor. The total score is applied to a salary grid that determines the merit increase. During 2010, only non-supervisory employees were eligible for increases, and when awarded, typically ranged from 1% to 3%.

The Employee Stock Purchase Plan of 2002 provides a convenient way for employees to purchase our stock through regular payroll deductions. Participation by employees is voluntary. Purchases are made for employees quarterly, at fair market value, using amounts, if any, that they have elected to withhold from their pay during the quarter.

The Compensation Committee has reviewed all of the plans described above, and does not believe that any of them encourage our senior executive officers to take unnecessary or excessive risks that threaten our value. The features of these plans do not make it likely that taking unnecessary or excessive risks that threaten our value will provide greater compensation than actions that involve a prudent level of risk. The equity-based plans encourage our senior executive officers and other employees to focus on increasing shareholder value over a period of years. The deferred compensation and 401(k) plans provide helpful ways for our employees to save for retirement. The Compensation Committee believes that the plans described above do not pose any unnecessary risks, and do not encourage employees to manipulate reported earnings to enhance the compensation of any employee. The features of our Merit Incentive Plan, Mortgage Commission Plan and Performance Evaluation Plan primarily encourage employees to perform their jobs better and increase the value of our business. None of the plans provide compensation that is based on the level of our reported earnings.

**Committee Certification**

The Compensation Committee certifies that:

it has reviewed with our Senior Risk Officer the senior executive officer compensation plans and has made all reasonable efforts to ensure that these plans do not encourage senior executive officers to take unnecessary and excessive risks that threaten our value;

it has reviewed with our Senior Risk Officer our employee compensation plans and has made all reasonable efforts to limit any unnecessary risks that these plans pose to us; and

it has reviewed the employee compensation plans to eliminate any features of these plans that would encourage the manipulation of our reported earnings to enhance the compensation of any employee.

Compensation Committee

David M. Cassard  
Edward J. Clark  
Lawrence W. Larsen  
Calvin D. Murdock  
Merle J. Prins



**Table of Contents**

**Executive Compensation**

**Compensation Discussion and Analysis**

*Philosophy*

Our philosophy in setting compensation policies for executive officers is to align pay with performance, while at the same time providing competitive compensation that will attract and retain executive talent. Our Compensation Committee believes that executive compensation should be directly linked to continuous improvements in corporate performance and increasing shareholder value over the long term. The design of executive compensation programs affects all employees by setting general levels of compensation and helping to create an environment of goals, rewards and expectations. Because we believe the performance of every employee is important to our success, we are mindful of the effect of executive compensation and incentive programs on all our employees.

We believe that the compensation of our executive officers should reflect their performance as a management team and as individuals. By setting key operating objectives, such as growth in revenues, growth of operating earnings and earnings per share, and growth or maintenance of market share, we expect to be successful in providing increasing value to our shareholders. We believe that the performance of our executive officers in managing our business, when considered in light of general economic and specific company, industry and competitive conditions, should be the basis for determining their overall compensation. We also believe that their compensation should not be based on short-term results, whether favorable or unfavorable, but rather on long-term operating results which truly reflect the ability of our executives to manage our business. Long-term gains in shareholder value will be reflected in executive compensation through our stock-based compensation and other equity incentive programs.

Our policy for allocating between currently paid and long-term compensation is to provide adequate base compensation to attract and retain personnel, while offering incentives to maximize long-term value for our shareholders. We provide cash compensation in the form of a base salary to meet competitive salary norms and reward good performance on an annual basis, and, in years when the Compensation Committee determines it appropriate, in the form of bonus compensation to reward superior performance against short-term goals. We have provided stock-based compensation to reward superior performance against specific objectives and long-term strategic goals; however, no stock-based compensation awards were granted in 2009 or 2010 reflecting stressed economic conditions and the resulting impact on our earnings performance and financial condition.

Our Compensation Committee reviews and takes into consideration elements such as the following in setting compensation policies:

peer group comparisons with our financial performance, including net interest margin, efficiency ratio, return on average assets, return on average equity, one and five year total shareholder returns, stock price, stock price to earnings ratios and stock yield;

regulatory requirements and results of audits and examinations;

amount of time and effort expended by employees for our communities;

rate of employee turnover;

content and effectiveness of our employee training;

results of any employee surveys;

general attitude of employees;

ability to retain and attract new employees;

number of new accounts being opened and the rate of turnover;

**Table of Contents**

results of any customer surveys;

any customer complaints that come to our attention;

level and commitment of our executive officers to our communities;

financial commitment to our communities; and

community support in comparison to that of our competitors.

Our Compensation Committee's goal is to establish salary compensation for the executive officers based upon our operating performance relative to comparable peer companies over a three year period. In setting base salaries, consideration is given to salary compensation of executive officers with comparable qualification, experience and responsibilities at financial institutions within our peer group. Our peer group consists of 18 financial institutions of similar size conducting business in the Midwest. Operating performance and salary compensation information is obtained from the annual SNL Executive Compensation Review for Banks and Thrifts. We also utilize industry compensation studies prepared by the Michigan Bankers Association and an independent public accounting firm, but to a lesser degree. The peer group comparisons are used for guidance purposes only, with the Compensation Committee taking the peer group information into consideration in determining base salaries for the executive officers; however, the Compensation Committee does not utilize benchmarks in establishing our executive officer salary compensation. In addition, in 2009, our Compensation Committee utilized the services of an independent consultant in reviewing the compensation levels of our executive officers. The Compensation Committee intends to pay base salaries to our executive officers that are commensurate with their qualifications and demonstrated performance that bring continuing and increasing value to our shareholders and the communities that we serve.

*Executive Officer Bonus Compensation*

For most years, it has been our policy to provide cash bonus awards for eligible executive officers and employees based on predetermined performance goals. We believe that paying such cash awards:

promotes the growth, profitability and expense control necessary to accomplish corporate strategic long-term plans;

encourages superior results by providing a meaningful incentive; and

supports teamwork among employees.

Stressed economic conditions during the past several years have put significant pressure on our earnings performance and financial condition. Although we recognize the benefits of establishing bonus plans, we neither established a plan, nor paid our executive officers bonuses, for 2009 or 2010. Given these unprecedented times, we realize that it is not realistic to increase the salaries or establish bonus plans for our executive officers when we are not profitable. Due to economic and market conditions, and our current level of earnings, we have not increased the salaries of our executive officers or established a bonus plan for 2011.

*Stock Incentive Plan*

The overall objective for our stock-based compensation is to provide an equitable and competitive means to reward our executive and other officers for their contribution to our long-range success. Our goal is to meet the following



objectives:

link each participant's remuneration to our long-term success through the appreciation of stock price;

align the interests of our officers with the interests of our shareholders by linking the long-term value of the compensation to shareholder returns;

**Table of Contents**

provide annual long-term incentive awards that are market competitive; and

improve our ability to attract and retain officers.

There is a direct relationship between the value of a stock option and the market price of our common stock. We believe that granting stock options is an effective method of motivating our executive and other officers to manage our business in a manner consistent with the interests of our shareholders. Due to the evolution of regulatory, tax and accounting treatment of stock-based compensation, and the importance of stock-based compensation in retaining and motivating our key employees, we have utilized other forms of stock-based compensation in addition to stock options. In 2006, 2007 and 2008, we granted restricted stock to our executive officers and other key employees. We believe this is an excellent way to reward them for, and to motivate them toward, superior performance. Restricted stock is an important retention instrument in that it has immediate value to the recipient. Unlike stock option grants that create economic value only if the stock price appreciates above the price at the date of grant, restricted stock provides value and motivation to the recipient even if the stock price declines.

Historically, we have made stock-based awards annually in the Fall in conjunction with the performance review of our executive and other officers. It has been our practice, when awards of stock options and restricted stock are made, to make them to all recipients on the same date. We made no stock-based compensation awards in 2009 or 2010, reflecting the stressed economic conditions and resulting impact on our earnings performance and financial condition.

We do not have stock ownership requirements or guidelines for our executive officers.

*Perquisites*

We limit the perquisites that we make available to our executive officers. We believe that providing excessive perquisites to executive officers sends mixed messages to the rest of our employees and can destroy the team effort. Our executive officers are entitled to a few benefits that are not generally available to all of our employees. We do not provide a defined benefit pension plan, post-retirement health coverage, or similar benefits for our executive officers or other employees.

During 2010, we provided the following perquisites for our executive officers:

in addition to the general health and insurance plan that we maintain for all of our employees, we provided our executive officers with additional life and disability insurance, and long term care insurance; and

one local country club membership was provided for Mr. Price, which he made significant use of in connection with our business.

*IRC Section 162(m)*

Section 162(m) of the Internal Revenue Code generally disallows a tax deduction to public companies for compensation in excess of \$1 million paid to their chief executive officer or certain other highly compensated officers. Qualifying performance-based compensation is not subject to the deduction limitation if certain requirements are met. We periodically review the potential consequences of Section 162(m) and may structure some or all of the performance-based portion of our executive compensation so that it will not be subject to the deduction limitations of Section 162(m).

We are also subject to a lower threshold on the deduction of executive compensation due to our participation in the Capital Purchase Program of the Troubled Asset Relief Program. This lower threshold is set forth in Internal Revenue Code Section 162(m)(5) and applies while we participate in the program. Section 162(m)(5) generally limits the amount we can deduct for compensation paid to each of our senior executive officers attributable to services performed in a year to \$500,000. In calculating compensation for purposes of this \$500,000 limit, there is no exception for performance-based

## **Table of Contents**

compensation. For Section 162(m)(5) purposes, a company's senior executive officers are the chief executive officer, chief financial officer and the next three most highly compensated executive officers. Under Section 162(m)(5), compensation that is earned but deferred and paid to a senior executive officer in a later year cannot be deducted in the later year except to the extent of any unused portion of the \$500,000 deduction limit in the year the compensation was earned. We consider the potential impact of Section 162(m)(5) when determining compensation for senior executive officers.

### *Post-Employment Compensation*

We do not provide a defined benefit pension plan or post-retirement health insurance coverage for our executive officers or other employees. Our executive officers and most of our other employees are eligible to participate in our 401(k) plan. Through the first quarter of 2009, we provided for each eligible participant a matching contribution to the 401(k) plan. The matching contribution was dollar for dollar for the first 5% of the participant's contribution to the 401(k) plan. To help reduce our compensation expenses, we suspended our matching contribution effective April 1, 2009, and it has remained suspended. All our executive officers participated in our 401(k) plan during 2010.

All employees, except our executive officers, are employees-at-will and do not have an employment agreement. The employment agreements that we have with our executive officers are described below under the heading *Employment Agreements*. We do not provide post-employment health insurance coverage or other benefits to any employee, except those provided for executive officers in their employment agreements.

### *Overview of the Compensation Process*

The composition of compensation for our executive officers can include: salary, cash bonus, stock-based awards, health, disability and life insurance and perquisites. The elements of executive compensation are discussed at the meetings of our Compensation Committee. During the Fall of each year, the Compensation Committee discusses the base salaries and cash bonus plan, if any, for the next year for our executive officers, and makes recommendations to the Board of Directors for its approval. The Board of Directors usually approves the Compensation Committee's recommendations; though if it does not, it could ask the Compensation Committee to prepare revised recommendations. At or about the same time, in years when stock-based awards are to be made, the Compensation Committee grants stock-based awards to our executive and other officers.

As part of the Compensation Committee's process, it meets with our Human Resource Director and reviews the elements of each executive officer's compensation during the preceding three years. Typically, the Human Resource Director makes compensation recommendations to the Compensation Committee for each of our executive officers. The Compensation Committee may accept or reject all or any part of such recommendations. As part of our Human Resource Director's process of formulating her recommendations, she may confer with our Chairman of the Board, President and Chief Executive Officer. Our executive officers are not present when our Human Resource Director makes her recommendations, or during the Compensation Committee's deliberations on the compensation of our executive officers.

### *Restrictions on Executive Compensation under Federal Law*

On May 15, 2009, we sold 21,000 shares of our preferred stock and a warrant to purchase 616,438 shares of our common stock to the United States Department of the Treasury for \$21 million. This sale was made under the Treasury's Capital Purchase Program of the Troubled Asset Relief Program (the *Capital Purchase Program*). Participants in the Capital Purchase Program are subject to a number of limitations and restrictions on executive compensation that are set forth in the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 ( *EESA* ), and in related rules issued by the Treasury.



**Table of Contents**

As a general matter, until such time as we no longer participate in the Capital Purchase Program, we will be subject to the following requirements, among others:

Our compensation programs may not include incentives for our senior executive officers to take unnecessary and excessive risks that threaten our value. Our senior executive officers are Messrs. Price, Kaminski and Christmas, who are our executive officers named in the Summary Compensation Table below.

We must be entitled to recover any bonus, retention award, or incentive compensation paid to any of our senior executive officers or next 20 most highly compensated employees if the payment is based upon materially inaccurate financial statements or any other materially inaccurate performance metric criteria.

We are prohibited from making any golden parachute payments to any of our senior executive officers or any of our next five most highly compensated employees. Golden parachute payments include any payments for departure from us for almost any reason, other than death or disability; or any payment due to a change in control.

We are prohibited from paying to any senior executive officer or any of the next 20 most highly compensated employees any tax gross-ups on compensation.

Our compensation programs may not encourage the manipulation of reported earnings to enhance the compensation of our employees.

We cannot pay or accrue any bonus, retention award, or incentive compensation to our most highly compensated employee, who is Mr. Price, other than payments made in the form of long-term restricted stock that does not have a value greater than one-third of his total annual compensation, and meets specific vesting and other criteria.

Our shareholders must be given the opportunity to vote on an advisory (non-binding) resolution at our annual meetings to approve the compensation of our executives.

The Compensation Committee must conduct reviews of our senior executive officer and employee compensation plans with our Senior Risk Officer relating to risks of the plans.

We are required to establish a company-wide policy regarding excessive or luxury expenditures.

Our compensation arrangements for executive officers and other employees are intended to comply with the requirements of the Capital Purchase Program, while we participate in the program. We expect to be a participant in the program for as long as any of the preferred stock that we issued under the program remains outstanding. We have the right to redeem the preferred stock, subject to certain conditions.

**Table of Contents****Summary Compensation Table**

The following table provides information regarding the compensation earned by the named executive officers for the three years ended December 31, 2010.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)(1)	Non-Equity Incentive Compensation			All Other Compensation (\$)(4)	Total (\$)
					Option Award (\$)(1)	Plan Compensation (\$)(2)	Deferred Compensation Earnings (\$)(3)		
Michael H. Price	2010	474,000						22,848	496,848
Chairman of the Board,	2009	474,000						23,321	497,321
President and Chief Executive Officer of Mercantile, and Chairman of the Board and Chief Executive Officer of the Bank	2008	474,000		16,249	24,310		3,354	32,261	550,174
Robert B. Kaminski, Jr.	2010	305,000						13,201	318,201
Executive Vice President,	2009	305,000						14,888	319,888
Chief Operating Officer and Secretary of Mercantile, and President, Chief Operating Officer and Secretary of the Bank	2008	305,000		10,484	15,775		14	23,479	354,752
Charles E. Christmas	2010	255,000						12,903	267,903
Senior Vice President, Chief Financial Officer and Treasurer of Mercantile, and Senior Vice President and Chief Financial Officer of the Bank	2009	255,000						14,028	269,028
	2008	255,000		8,730	13,204		282	21,546	298,762

(1) Amounts are determined based on the grant date fair value of the stock awards and option awards. Refer to Note 9, Stock-Based Compensation, in the Notes to our Consolidated Financial Statements included in our Annual Report to the SEC on Form 10-K for the year ended December 31, 2010, for the relevant assumptions used to determine the valuation of the stock awards and option awards.

(2) We did not establish a non-equity incentive plan for executive officers for 2010, 2009 or 2008.

(3) The amounts shown are the above-market interest credited to the accounts of the executive officers for the applicable year on compensation they have deferred under our non-qualified deferred compensation plan. Interest

is considered to be above-market interest to the extent that it exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under section 1274(d) of the Internal Revenue Code), at the rate that corresponds most closely to the rate under the plan at the beginning of each quarter.

- (4) Includes for 2010 (a) life, disability, and long term care insurance premiums paid on policies insuring Messrs. Price, Kaminski, and Christmas; (b) a country club membership for Mr. Price; and (c) cash dividends paid on restricted stock.

#### *Employment Agreements*

The Bank and Mercantile have entered into employment agreements with our executive officers, Messrs. Price, Kaminski and Christmas, that provide for their employment, annual base compensation, and severance, confidentiality and non-compete arrangements. Each agreement establishes an employment period that extends an additional year, each December 31, so that as of each December 31, there are three years remaining in the employment period. The annual extension of the employment period can be avoided by the Bank, Mercantile, or the officer giving notice to the others that the employment period is not to be extended.

The employment agreements provide the officers with annual base salaries for each year in the amounts established from year to year by the Board of Directors of the Bank. The annual base salary for



**Table of Contents**

each year may not be less than the amount established for the immediately preceding year. The Board of Directors established the annual base salaries of each of the executive officers for 2010 as follows: for Mr. Price \$474,000, for Mr. Kaminski, \$305,000, and for Mr. Christmas, \$255,000; and set their salaries at the same amounts for 2011. In addition to the annual base salary, the employment agreements provide that the officers are entitled to participate in our employee benefit and incentive compensation plans, including health insurance, life and disability insurance, stock option, profit sharing and retirement plans.

Additional information regarding the employment agreements, including compensation and benefits payable to the officers on termination of employment and officer confidentiality and non-compete obligations, are included below under the heading Potential Payments Upon Termination or Change In Control.

*Salary and Bonus Compared to Total Compensation*

We have not established a proportion that salary and bonus should be of an executive officer's total compensation. As indicated in the Summary Compensation Table above, the proportion for 2010 that salary and bonus were of total compensation was from 95% to 96% for our executive officers.

**Grants Of Plan-Based Awards In 2010**

As indicated in the following table, no plan-based awards were made to the named executive officers during the year ended December 31, 2010.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards		Maximum or Threshold	Maximum or	All Other Stock Awards: Number of Shares	All Other Option Awards: Number of Underlying Securities	Exercise or Base Price of	Grant Date Fair Value of Stock and Option Awards
		Threshold	Target	Maximum	Threshold	Target						
		(\$)	(\$)	(\$)	(#)	(#)	(#)	Units (#)	(#)	(\$/ Sh)	(\$)	
Michael H. Price												
Robert B. Kaminski,												
Jr.												
Charles E. Christmas												

**Table of Contents****Outstanding Equity Awards At 2010 Fiscal Year-End**

The following table provides information as of December 31, 2010 regarding equity awards, including unexercised stock options and restricted stock that had not vested, for each of the named executive officers.

Name	Option Awards				Option Expiration Date	Stock Awards			
	Number of Securities Underlying Unexercised Options (#) (1)	Number of Securities Underlying Unexercised Options (#) (2)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#) (3)	Price (\$)		Number of Shares or Units of Stock That Have Not Vested (#) (3)	Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Shares, Units or Other Rights That Have Not Vested (#) (3)	Equity Incentive Plan Awards: Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
Michael H. Price	3,645			26.612	10/22/2013	2,445	20,049		
	2,893			33.674	10/27/2014	2,960	24,272		
	867			33.674	10/27/2014				
	1,852			35.883	11/16/2015				
	2,006			35.883	11/16/2015				
	2,625			37.943	11/15/2013				
	1,365			37.943	11/15/2013				
	2,600			17.740	11/28/2014				
	5,400			17.740	11/28/2014				
		560		17.740	11/28/2014				
		9,000		6.210	11/24/2015				
		2,260		6.210	11/24/2015				
Robert B. Kaminski, Jr.	4,018			12.444	10/17/2011	1,575	12,915		
	3,827			16.135	10/16/2012	1,910	15,662		
	2,721			26.612	10/22/2013				
	2,893			33.674	10/27/2014				
	288			33.674	10/27/2014				

Edgar Filing: IMMTECH INTERNATIONAL INC - Form 10-Q

2,364	35.883	11/16/2015
941	35.883	11/16/2015
2,310	37.943	11/15/2013
5,515	17.740	11/28/2014
7,240	6.210	11/24/2015

Charles E.  
Christmas

4,018	12.444	10/17/2011	1,325	10,865
3,827	16.135	10/16/2012	1,590	13,038
2,721	26.612	10/22/2013		
2,893	33.674	10/27/2014		
2,623	35.883	11/16/2015		
683	35.883	11/16/2015		
1,942	37.943	11/15/2013		
4,630	17.740	11/28/2014		
6,060	6.210	11/24/2015		

- (1) The vesting dates for the options shown, in the order listed in the column for each officer, are for (a) Mr. Price: October 23, 2004, October 28, 2005, January 1, 2006, November 17, 2006, January 1, 2007, November 16, 2008, January 1, 2009, November 29, 2009, and January 1, 2010; (b) Mr. Kaminski: October 18, 2002, October 17, 2003, October 23, 2004, October 28, 2005, January 1, 2006, November 17, 2006, January 1, 2007, November 16, 2008, November 29, 2009, and November 25, 2010; and (c) Mr. Christmas: October 18, 2002, October 17, 2003, October 23, 2004, October 28, 2005, November 17, 2006, January 1, 2007, November 16, 2008, November 29, 2009, and November 25, 2010.
- (2) The vesting dates for the options shown, in the order listed in the column, are for Mr. Price: January 1, 2011, January 1, 2011, and January 1, 2012.

**Table of Contents**

- (3) The vesting dates for the shares of restricted stock shown, in the order listed in the column for each officer, are November 29, 2011, and November 25, 2012. The shares of restricted stock are subject to forfeiture and restrictions on transfer until they vest.

**Option Exercises And Stock Vested In 2010**

The following table provides information regarding the exercise of stock options and vesting of restricted stock during 2010 for each of the named executive officers. None of the named executive officers exercised any stock options during 2010.

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)(1)
Michael H. Price			1,417	8,502
Robert B. Kaminski, Jr.			787	4,722
Charles E. Christmas			682	4,092

- (1) The value realized is based on the number of shares vesting times the market value of the shares on the vesting date. The vesting date was November 16, 2010, and the market value per share on that date was \$6.00.

**Nonqualified Deferred Compensation For 2010**

The following table provides information regarding our plan that provides for the deferral of compensation for the named executive officers on a basis that is not tax-qualified.

Name	Executive Contributions in Last FY (\$)	Registrant Contributions in Last FY (\$)	Aggregate Earnings in Last FY (\$)(1)	Aggregate Withdrawals/Distributions (\$)	Aggregate Balance at Last FYE (\$)(2)
Michael H. Price					
Robert B. Kaminski, Jr.			129		4,038
Charles E. Christmas					

- (1)

The earnings consist of interest credited monthly at a rate equal to the prime rate as published in the Wall Street Journal, determined quarterly, as of the first day of each quarter. There was no above-market portion of this interest, and none of this interest was reported in the Summary Compensation Table for Mr. Kaminski for 2010. The above-market portion would be the amount of the interest that exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under section 1274(d) of the Internal Revenue Code), at the rate that corresponds most closely to the rate established under the deferred compensation plan.

- (2) The amount for Mr. Kaminski that was reported as compensation in the Summary Compensation Tables for previous years is \$3,055.

*Executive Deferred Compensation Plan*

The information in the table above pertains to our executive officers' participation in the Bank's non-qualified deferred compensation plan. Participants in the plan may elect to defer up to 100% of their salary and other cash compensation each year. Under the plan, the amount of any compensation deferred is credited with interest monthly at a rate equal to the prime rate as published in the Wall Street Journal, determined quarterly, on the first day of each quarter.

## **Table of Contents**

The plan provides that the Bank will pay to each executive officer, from his deferred compensation account, a lump sum payment or installment payments, whichever he elected, after he leaves employment with us due to normal retirement, early termination, disability, or change of control. If the executive officer dies before leaving employment, the Bank will distribute the payments to the executive officer's designated beneficiary in a lump sum, or installments, if installments were elected. If death occurs during the time that payments are being made, the Bank will distribute the remaining payments to the executive officer's designated beneficiary at the same time and in the same amounts that would have been distributed if the executive officer had not died.

The plan was amended in 2008 to provide participating executive officers with additional options to select specified dates for withdrawal. The ability to select specified withdrawal dates applies to amounts already deferred, as well as amounts that are deferred in the future. The plan and the new withdrawal options are subject to Section 409A of the Internal Revenue Code, which specifies requirements that non-qualified deferred compensation plans must meet in order to avoid adverse tax consequences for participants.

### **Potential Payments Upon Termination Or Change In Control**

We have entered into employment agreements with our executive officers, Messrs. Price, Kaminski and Christmas. Each agreement establishes an employment period that extends an additional year, each December 31, so that as of each December 31, there are three years remaining in the employment period. The annual extension of the employment period can be avoided by giving notice that the employment period is not to be extended. These agreements include provisions that provide compensation and benefits to the executive officers in the event that their employment with us is terminated:

during the employment period, voluntarily by the executive officer for Good Reason, or by us without Cause;

during the employment period, due to disability or death; or

after the employment period and before they reach the age of 65, voluntarily by them if their annual base salary is reduced without Cause, or by us without Cause.

The terms *Cause* and *Good Reason* are defined in the employment agreements. *Cause* includes certain acts of dishonesty and intentional gross neglect, conviction of a felony, and certain intentional breaches of the officer's obligations in the employment agreement relating to confidentiality of our information and not competing with us. *Good Reason* includes an assignment to the officer of a title or duties that are materially inconsistent with the officer's position, titles, duties or responsibilities, and certain failure by us to comply in a material respect, even after notice to us, with our obligations to the officer under the employment agreement.

### *Termination During the Employment Period*

Except for terminations that occur while we are a participant in the Capital Purchase Program, each employment agreement provides the executive officer with compensation and benefits in the event that his employment is terminated by us without Cause or the officer elects to terminate his employment for Good Reason during the employment period. In such event, the officer is entitled to receive the greater of (i) his annual base salary through the end of the employment period or (ii) for Mr. Price, \$500,000, and for Mr. Kaminski or Mr. Christmas, \$250,000; in either case payable over 18 months. In addition, in the case of such a termination of employment, and provided we are not then a participant in the Capital Purchase Program, the officer is entitled to continue his participation in our life, disability and health insurance plans for 18 months, to the extent permitted under the plans, to an assignment of any assignable term life insurance policies owned by us insuring his life, and to \$10,000 for out-placement, interim office and related expenses. In the event that a termination occurs without Cause or for Good



## **Table of Contents**

Reason while we are a participant in the Capital Purchase Program, the officer is not entitled to any compensation or benefits under his employment agreement.

For a termination by us during the employment period to be with Cause, it must be done within 90 days of our learning of the Cause. For a termination by the officer during the employment period to be with Good Reason, it must be done by the officer within 90 days of the officer learning of the Good Reason.

If an executive officer becomes disabled or dies during the employment period, he is entitled to compensation and benefits under his employment agreement. In the event of disability, the officer continues to receive his then current annual base salary through the end of the employment period, and any disability benefits payable under disability plans that we provide. The officer also continues to participate in our life, disability, and health insurance plans, through age 65, to the extent permitted under the plans. If the officer dies during the employment period, we are obligated to pay the officer's legal representative a death benefit. The death benefit for Mr. Price is \$250,000. The death benefit for Mr. Kaminski and Mr. Christmas is \$100,000. In addition, if we own any life insurance insuring the life of the officer, the proceeds of the policies are payable to the named beneficiaries.

In general, stock options granted under the 2000 Employee Stock Option Plan, 2004 Employee Stock Option Plan and Stock Incentive Plan of 2006 that are vested at the time employment terminates may be exercised by the executive officer within three months after his termination of employment. However, if his employment terminates due to death or disability, his vested stock options may be exercised within 12 months after the date of termination, but not later than the expiration date of the option.

Under the employment agreements, in the event that an officer's employment is terminated for Cause, the officer is not entitled to any accrued rights that he may then have under any of our stock option plans. In addition, the Stock Incentive Plan of 2006 provides that all outstanding options granted under the plan are forfeited if an officer's employment is terminated for cause, whether or not the options are vested.

If an executive officer terminates employment due to death or disability, then restricted stock granted to him under the Stock Incentive Plan of 2006 will be partially vested. Also, except while we are a participant in the Capital Purchase Program, if an executive officer terminates employment due to retirement, or we terminate his employment other than for cause, then restricted stock granted to him under the plan will be partially vested. The number of shares that will be vested is equal to the number of shares granted to the executive officer multiplied by the number of months that have elapsed since the grant date divided by the number of months in the vesting period. Our Compensation Committee also has discretion to accelerate the vesting of restricted stock.

Each executive officer will also receive a distribution of his account under the deferred compensation plan upon his termination of employment. Distributions will generally be delayed for six months after the termination of employment, to the extent required by Section 409A of the Internal Revenue Code. However, if employment is terminated due to cause, or if an executive officer is subject to a final removal or prohibition order issued by a federal banking agency, then the executive officer will only receive a distribution of his own deferrals, without any interest credits.

### *Termination After the Employment Period*

Except for terminations that occur while we are a participant in the Capital Purchase Program, the employment agreements provide compensation and benefits in the event that after the employment period and prior to the officer reaching the age of 65, the officer's employment is terminated by us without Cause or the officer's annual base salary is reduced without Cause, and the officer terminates his employment within 90 days of the reduction. In such event, the officer is entitled to receive an amount, for Mr. Price of \$500,000, and for Mr. Kaminski or Mr. Christmas of



\$125,000; payable over 18 months.

**Table of Contents**

In addition, in the case of such a termination of employment, and provided we are not then a participant in the Capital Purchase Program, the officer is entitled to continue his participation in our life, disability and health insurance plans for 18 months, to the extent permitted under the plans, to an assignment of any assignable term life insurance policies owned by us insuring his life, and to \$10,000 for out-placement, interim office and related expenses. In the event that a termination occurs after the employment period, while we are a participant in the Capital Purchase Program, the officer is not entitled to any compensation or benefits under his employment agreement.

*Obligations of Executive Officers*

Under the employment agreements, the officers agree not to disclose, except as required by law, any confidential information relating to our business or customers, or use any confidential information in any manner adverse to us. In addition, each has agreed that for 18 months following his employment with us, he will not be employed by, or act as a director or officer of, any business engaged in banking within a 50 mile radius of Grand Rapids, Michigan that solicits customers of the Bank.

The employment agreements also provide that any bonus, retention award or incentive compensation paid to the officers while we are a participant in the Capital Purchase Program is subject to recovery, or clawback, from the officers if the payment is based on statements of earnings, revenues, gains or other criteria that are later found to be materially inaccurate. Our employment agreement with Mr. Price also includes a provision confirming that we will not pay or accrue any bonus, retention award or incentive compensation to or for him, while we are a participant in the Capital Purchase Program, that would violate the applicable provision of EESA.

*Table of Potential Payments Upon Termination of Employment*

The following table provides information regarding compensation and benefits payable to Messrs. Price, Kaminski and Christmas under the employment agreements or the Stock Incentive Plan of 2006 upon termination of their employment. The amounts shown assume that termination of employment was effective as of December 31, 2010, the last business day of our 2010 fiscal year, and include estimates of the amounts that would be paid. The actual amounts would only be determined upon an officer's termination of employment. The value of restricted stock that would have become vested due to death or disability is based on the closing stock price of \$8.20 on December 31, 2010. The table below takes into account that we are a participant in the Capital Purchase Program and subject to the EESA restrictions on payments relating to termination of employment.

Name	During Employment Period			After Employment Period and Before Age 65, Termination Without	
	Termination Without Cause or for Good Reason (\$)	Termination Due to Death (\$)	Termination Due to Disability (\$)(3)	Base Salary Reduction (\$)	Cause or Due to Retirement at or After Age 65 (\$)
Michael H. Price		628,183(1)	1,717,571		

Robert B. Kaminski, Jr.	468,212(2)	1,239,772
Charles E. Christmas	465,260(2)	1,140,167

- (1) Includes payment of death benefit from us of \$250,000, and from the applicable insurance companies, supplemental life insurance proceeds of \$300,000 and group term life insurance proceeds of \$50,000, and the value of restricted shares that would have become vested due to death of \$28,183.
- (2) Includes payment of death benefit from us of \$100,000, and from the applicable insurance companies, supplemental life insurance proceeds of \$300,000 and group term life insurance proceeds of \$50,000, and the value of restricted shares that would have become vested due to death of \$18,212 for Mr. Kaminski and \$15,260 for Mr. Christmas.

**Table of Contents**

- (3) Includes (a) annual base salary through the end of 2013 for Mr. Price, \$1,422,000, Mr. Kaminski, \$915,000, and Mr. Christmas, \$765,000; (b) life, disability and medical insurance premiums until age 65 for Mr. Price, \$151,228 (calculated at \$13,748 annually), Mr. Kaminski, \$210,560 (calculated at \$13,160 annually) and Mr. Christmas, \$270,207 (calculated at \$12,867 annually); and (c) the value of restricted shares that would have become vested due to disability, for Mr. Price, \$28,183, for Mr. Kaminski, \$18,212, and for Mr. Christmas, \$15,260. In addition, the executive officers would receive long term disability benefits from the applicable insurance companies for as long as the officer is disabled up to age 65, in the following annual amounts, for Mr. Price, \$116,160, Mr. Kaminski, \$96,000, and Mr. Christmas, \$89,700. If the disability were catastrophic as defined in the disability insurance policies, the annual disability benefits in the prior sentence would be about 32% to 53% more, depending on the executive officer.

*Change in Control*

The employment agreements do not contain provisions that provide payments based on the occurrence of a change in control of Mercantile. Options granted under the Stock Incentive Plan of 2006, according to their terms when granted, become fully vested upon a change in control and are exercisable during their remaining term, even if an executive officer's employment terminates during the option term. According to their terms when awarded, shares of restricted stock awarded under the Stock Incentive Plan of 2006 become fully vested upon a change in control. However, while we are a participant in the Capital Purchase Program, we are subject to restrictions that preclude accelerated vesting of options or restricted stock upon a change in control. These restrictions apply to options and restricted stock held by our executive officers and our next five most highly compensated employees. A change in control is defined in the Stock Incentive Plan of 2006 as (a) the failure of the continuing directors to constitute a majority of the Board of Directors; (b) the acquisition by any person of ownership of 40% or more of the outstanding common stock of Mercantile; (c) a reorganization, merger or consolidation after which the Mercantile shareholders do not own at least 50% of the value and voting power of the outstanding capital stock of the entity surviving the transaction; (d) a liquidation or dissolution of Mercantile, or a sale of all or substantially all of its assets; or (e) any other change in control transaction that is reportable to the SEC under Item 6(e) of Schedule 14A of Regulation 14A issued under the Securities Exchange Act of 1934.

Each executive officer will receive a distribution of his account under the deferred compensation plan, if his employment terminates within 12 months after a change in control. The value of each officer's account as of December 31, 2010 is shown above in the table under the heading Nonqualified Deferred Compensation For 2010.

*Potential Payments Upon a Change in Control*

If a change in control occurred as of December 31, 2010, the last business day of our 2010 fiscal year, Messrs. Price, Kaminski and Christmas would receive no payments or benefits relating to that change in control. If the change in control were to occur at a time when we were not participating in the Capital Purchase Program and were not subject to the EESA restrictions on payments relating to changes in control, there could be benefits relating to the accelerated vesting of options and restricted stock.

**Table of Contents****Director Compensation For 2010**

The following table provides information about the compensation of our directors for the year ended December 31, 2010.

Name(1)	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)(2)	Non-Equity Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred	All Other Compensation (\$)	Total (\$)
					Compensation Earnings (\$)(3)		
Betty S. Burton	9,950						9,950
David M. Cassard	17,600						17,600
Edward J. Clark	13,850						13,850
Peter A. Cordes	5,650						5,650
Doyle A. Hayes	15,300						15,300
Susan K. Jones	14,100						14,100
Lawrence W. Larsen	12,600						12,600
Calvin D. Murdock	14,850						14,850
Richard E. Posthumus	1,392						1,392
Merle J. Prins	14,800						14,800
Timothy O. Schad	11,850						11,850
Dale J. Visser	10,600						10,600
Donald Williams, Sr.	12,800						12,800

- (1) Our Chairman of the Board, President and Chief Executive Officer, Mr. Price, who is also a director, has been omitted from this table because he received no special compensation for serving on our Board of Directors. His compensation is included in the Summary Compensation Table.
- (2) No option awards were made to our non-employee directors during 2010. As of December 31, 2010, our non-employee directors, and Mrs. Burton and Mr. Cordes, who retired from our Board during 2010, held the following option awards to acquire our common stock: Mr. Clark, Mr. Cordes, Mr. Larsen, Mr. Visser and Mr. Williams, four option awards each, covering for each an aggregate of 2,487 shares; Mrs. Burton, Mr. Cassard, Mr. Hayes, Mrs. Jones and Mr. Murdock, three option awards each, covering for each an aggregate of 1,820 shares; and Mr. Prins, one option award, covering 578 shares.
- (3) No above-market interest was credited to the accounts of the directors for 2010 on compensation they have deferred under our non-qualified deferred compensation plan for directors. Interest is considered to be above-market interest to the extent that it exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under section 1274(d) of the Internal Revenue Code), at the rate that corresponds most closely to the rate under the plan at the beginning of each quarter.

*Compensation Arrangements for Non-employee Directors*

Each of our directors is also a director of the Bank, which is a wholly owned subsidiary of Mercantile. The table above includes compensation earned for service on the Boards of Directors of Mercantile and the Bank. For 2010, our non-employee directors of the Bank were paid an annual retainer of \$5,000, and a fee of \$350 for each meeting of the Board of Directors of the Bank that they attended. In addition, non-employee directors were paid a meeting fee of \$350 for each meeting of the Audit Committee, \$300 for each meeting of the Compensation Committee and the Governance and Nominating Committee, and \$200 for each meeting of other committees of the Board of Directors of the Bank that they attended. Non-employee directors were also paid fees of the same amount for meetings of Mercantile's Board of Directors and its committees, when for Board meetings there was not also a

## **Table of Contents**

meeting of the Board of Directors of the Bank on the same day, and for committee meetings when there was not also a meeting of a committee of the Board of Directors of the Bank having the same name or function on the same day. For meetings that were held by telephone or other remote communications equipment, the meeting fees were half the amount described above. One annual retainer fee was also paid to each director who served as Chairman of the Audit Committees, the Compensation Committees and the Governance and Nominating Committees of Mercantile s and the Bank s Boards of Directors. The annual retainer is, for the Chairman of the Audit Committees \$3,000, for the Chairman of the Compensation Committees \$2,000, and for the Chairman of the Governance and Nominating Committees \$2,000.

Directors are eligible to receive stock-based awards under our Stock Incentive Plan of 2006 that was approved by our shareholders at their 2006 annual meeting, but no awards were made to directors under the plan for 2010. These director compensation arrangements, which were in effect for 2010, are also currently in effect. The Compensation Committee of our Board of Directors reviews director compensation at least annually, and recommends to our Board of Directors for approval any changes that the Compensation Committee deems appropriate.

### *Director Deferred Compensation Plan*

Directors are eligible to participate in the Bank s non-qualified deferred compensation plan for directors. Directors who participate in the plan may elect to defer up to 100% of their annual retainer and meeting fees. Under the plan, the amount of any director s fees that are deferred are credited with interest quarterly at a rate equal to the prime rate as published in the Wall Street Journal, determined quarterly, on the first day of each quarter.

The plan provides that the Bank will pay to each director, from his or her deferred compensation account, a lump sum payment, or installment payments, whichever is elected, after the director s term of office as a director ends. If installment payments are elected, the maximum payment period is ten years. In the event that a director dies before his or her term of office ends, the Bank will distribute the payments to the director s designated beneficiary in a lump sum, or installments, if installments were elected. If death occurs during the time that payments are being made, the Bank will distribute the remaining payments to the director s designated beneficiary at the same time and in the same amounts that would have been distributed if the director had not died.

The plan was amended in 2008 to provide participating directors with additional options to select specified dates for withdrawal. The ability to select specified withdrawal dates applies to amounts already deferred, as well as amounts that are deferred in the future. The plan and the new withdrawal options are subject to Section 409A of the Internal Revenue Code, which specifies requirements that non-qualified deferred compensation plans must meet in order to avoid adverse tax consequences for participants.

## **Transactions with Related Persons**

We have a written policy requiring that our Audit Committee review and approve related person transactions that involve us and are of the type that are required to be disclosed in our proxy statement by SEC rules. A transaction may be a related person transaction if any of our directors, executive officers, owners of more than 5% of our common stock, or their immediate family have a material interest in the transaction and the amount involved exceeds \$120,000. The policy authorizes the Audit Committee to approve a related person transaction if it determines that the transaction is at least as favorable to us as would have been expected if the transaction had been with a person who is not related to us, or is in our best interest. The policy does not cover loan transactions described in the next paragraph, which are generally subject to approval by the Bank s Board of Directors to the extent required by applicable banking laws and regulations.





**Table of Contents**

The Bank has had, and expects in the future to have, loan transactions in the ordinary course of business with our directors, executive officers, or their immediate family, or companies they have a material interest in, on substantially the same terms as those prevailing for comparable transactions with others. All such transactions (i) were made in the ordinary course of business, (ii) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the Bank, and (iii) did not involve more than the normal risk of collectibility or present other unfavorable features.

We have a correspondent banking relationship with Wells Fargo Bank, National Association ( Wells Fargo Bank ). Wells Fargo & Company, with several of its subsidiaries, including Wells Fargo Bank, reported that they beneficially owned in aggregate more than 5% of our outstanding common stock as of December 31, 2008, and through not later than February 27, 2009. Since 2004, we have had a correspondent banking relation with Wells Fargo Bank. We maintain a correspondent checking account with it through which we conduct certain foreign currency transactions, including wire transfers, drafts and check processing. During 2009, the average balance of our correspondent checking account with Wells Fargo Bank was \$77,000, and we paid service charges totaling \$5,500. In addition, certain of our commercial loan customers have entered into interest rate swap agreements with our correspondent banks, including Wells Fargo Bank. To assist our commercial customers in these transactions, and to encourage our correspondent banks to enter into the swap transactions with minimal credit underwriting analyses on their part, we have entered into risk participation agreements with the correspondent banks. These agreements obligate us to make payments to the correspondent banks under the interest rate swap agreement in the event that our customer does not make the payments. As of December 31, 2009, the total notional amount of interest rate swap agreements between Wells Fargo Bank and our customers for which we had agreed to make payments in the event that our customers did not was approximately \$12.5 million. At no time during 2009 did we have a lending arrangement with Wells Fargo Bank. We had relationships and transactions and agreements with Wells Fargo Bank in 2010, and expect to continue our relationship with Wells Fargo Bank in 2011, and to have transactions and agreements with them in 2011 that are similar in nature to those that occurred in 2009 and 2010, though varying with our needs and best interests.

**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires our officers and directors, and persons who own more than 10% of our common stock, to file reports of ownership and changes in ownership with the SEC. Based on a review of filings, we believe that all reports required to be filed under Section 16(a) for 2010 were timely filed, except that our director, Dale J. Visser, filed one report late relating to one sale of Mercantile stock.

**Ratification of Appointment of Independent Registered Public Accounting Firm**

Our Audit Committee has selected BDO as our independent registered public accounting firm for the year ending December 31, 2011. BDO began serving as our independent auditor for the fiscal year ended December 31, 2007. Services provided to us by BDO in 2010 are described under the heading Principal Accountant Fees and Services below.

Our Board of Directors is asking our shareholders to ratify the selection of BDO as our independent registered public accounting firm. Although ratification is not required by our bylaws or otherwise, our Board is submitting the selection of BDO to our shareholders for ratification as a matter of good corporate practice.

Representatives of BDO plan to attend the annual meeting of shareholders, will have the opportunity to make a statement if they desire to do so, and will respond to appropriate questions by shareholders.

**Table of Contents**

**Our Board of Directors recommends that you vote FOR ratification of the appointment of BDO as our independent registered public accounting firm for 2011. Unless otherwise instructed, the persons named as proxies intend to vote all proxies received for ratification of the appointment of BDO.**

In the event shareholders do not ratify the appointment, the appointment will be reconsidered by the Audit Committee. Even if the selection is ratified, the Audit Committee in its discretion may select a different registered public accounting firm at any time during the year if it determines that such a change would be in our best interest and the best interest of our shareholders.

**Principal Accountant Fees and Services**

The following table shows the fees for audit and other professional services provided to us by BDO for 2010 and 2009.

	2010	2009
Audit Fees (1)	\$ 261,919	\$ 257,707
Audit-Related Fees (2)	16,000	16,000
Tax Fees	0	0
All other fees	0	0

(1) Includes the fees billed for professional services rendered for the audit of our annual financial statements and internal control over financial reporting, review of financial statements included in our quarterly reports on Form 10-Q and accounting related consultations.

(2) Principally audit of employee benefit plan for 2010 and 2009.

The Audit Committee's policy is to pre-approve all audit services and non-audit services that are to be performed for us by our independent auditor. Under the Audit Committee's policy, authority to pre-approve permitted services has been delegated to two members of the Audit Committee, either of whom can act alone, for circumstances when pre-approval is not obtained from the full Audit Committee. Any pre-approval by the delegated authority is required to be reported to the Audit Committee at its next meeting. All of the services described in the table above were pre-approved by the Audit Committee.

**Advisory Vote on Executive Compensation**

Our executive compensation program is intended to attract, motivate, reward and retain the senior management talent required to achieve our corporate objectives and increase shareholder value. Our philosophy in setting compensation policies for executive officers is to align pay with performance, while at the same time providing competitive compensation. We believe that our compensation policies and procedures are aligned with the long-term interests of our shareholders.

Under EESA, we are currently required to provide shareholders with the right to cast an advisory vote on the compensation of our executives at each annual meeting of shareholders. As a result, we are presenting this proposal, which gives you as a shareholder the opportunity to endorse or not endorse our executive pay program by voting for or against the following resolution:

RESOLVED, that the shareholders approve the compensation of Mercantile Bank Corporation's executives, as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosure contained in the proxy statement.

Our Board of Directors urges you to endorse the compensation program for our executive officers by voting FOR the above resolution. The Compensation Committee of the Board of Directors believes that the executive compensation for 2010 is reasonable and appropriate, and is justified by Mercantile's performance in an extremely difficult environment.

**Table of Contents**

In deciding how to vote on this proposal, please consider that because of the economic and market conditions, and our recent lack of profitability, we have not increased the salaries of our executive officers during 2008, 2009, or 2010, or for 2011, have not paid any cash bonuses for 2008, 2009 or 2010, and have made no grants of stock options or restricted stock in 2009 or 2010.

Because your vote is advisory, it will not be binding upon the Board of Directors. However, the Compensation Committee will take into account the outcome of the vote when considering future executive compensation arrangements.

**Our Board of Directors recommends that you vote FOR approval of our executive compensation program as described in the Compensation Discussion and Analysis and the compensation tables and otherwise in this proxy statement. Unless otherwise instructed, the persons named as proxies intend to vote all proxies received for approval of our executive compensation program.**

**Shareholder Proposals for 2012 Annual Meeting**

A proposal submitted by a shareholder for the 2012 annual meeting of shareholders must be sent to the Secretary, Mercantile Bank Corporation, 310 Leonard Street NW, Grand Rapids, Michigan 49504 and received by November 18, 2011 in order to be eligible to be included in our proxy statement for that meeting.

A shareholder who intends to present a proposal for the 2012 annual meeting of shareholders, other than pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, must provide us with notice of such intention by at least February 1, 2012, or the persons named in the proxy to vote the proxies will have discretionary voting authority at the 2012 annual meeting with respect to any such proposal without discussion of the matter in our proxy statement.

**Other Matters**

Our Board of Directors does not know of any other matters to be brought before the annual meeting. If other matters are presented upon which a vote may properly be taken, it is the intention of the persons named in the proxy to vote the proxies in accordance with their best judgment.

**Table of Contents**

002CS10759

---

**Table of Contents**

**Annual Meeting Proxy Card**

**IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.**

**Proposals** The Board of Directors recommends a vote **FOR** all the nominees listed and **FOR** Proposals 2 and 3.

1. Election of Directors:	<b>For</b>	<b>Withhold</b>		<b>For</b>	<b>Withhold</b>		<b>For</b>	<b>Withhold</b>	<b>+</b>
	<input type="radio"/>	<input type="radio"/>		<input type="radio"/>	<input type="radio"/>	03 -	<input type="radio"/>	<input type="radio"/>	
01 - David M. Cassard			02 - Edward J. Clark			Doyle A. Hayes			

		<b>For</b>	<b>Against</b>	<b>Abstain</b>		<b>For</b>	<b>Against</b>	<b>Abstain</b>
2. Ratification of BDO USA, LLP as our independent registered public accounting firm.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>		3. Approval of the compensation of our executives.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

4. In their discretion, the Proxies are authorized to vote upon such other matters as may properly come before the meeting, or at any adjournment or postponement of the meeting.

**Non-Voting Items**

**Change of Address** Please print your new address below. **Comments** Please print your comments below. **Meeting Attendance** Mark the box to the right if you plan to attend the annual meeting.

**Authorized Signatures** This section must be completed for your vote to be counted. **Date and Sign Below** Please date and sign exactly as your name(s) appear(s) on this proxy and mail it promptly. When signing as an attorney, executor, administrator, trustee or guardian, please give your full title as such. If shares are held jointly, each joint owner should sign. If a corporation or other entity, the signature should be that of an authorized person who should state his or her title.

Date (mm/dd/yyyy) Please print date below. Signature 1 Please keep signature within the box. Signature 2 Please keep signature within the box.

/ /

**Table of Contents**

**Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to be Held on April 28, 2011:**  
**Our notice and proxy statement and 2010 annual report are available at [www.envisionreports.com/MBWM](http://www.envisionreports.com/MBWM).**

**IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.**

**Proxy Mercantile Bank Corporation**

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

**Proxy Solicited on Behalf of the Board of Directors  
Annual Meeting of Shareholders to be held April 28, 2011**

The undersigned hereby appoints David M. Cassard and Merle J. Prins, or either of them, with power of substitution in each, proxies of the undersigned to vote all common stock of the undersigned in Mercantile Bank Corporation, at the annual meeting of shareholders to be held on April 28, 2011, and at all adjournments or postponements thereof, with all powers that the undersigned would have if present at the meeting.

**This proxy will be voted as specified by the undersigned. If no choice is specified, this proxy will be voted as to all shares of the undersigned, FOR the election of all nominees for directors, FOR the ratification of the independent registered public accounting firm, FOR the approval of the compensation of our executives, and according to the discretion of the Proxies on any other matters that may properly come before the meeting or any adjournment or postponement of the meeting.**

**PLEASE VOTE, DATE AND SIGN ON REVERSE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.**

(Continued and to be voted on reverse side.)

---

**Table of Contents**

**Shareholder Meeting Notice**

**Important Notice Regarding the Availability of Proxy Materials for the  
Mercantile Bank Corporation Shareholder Meeting to be Held on April 28, 2011**

Under Securities and Exchange Commission rules, you are receiving this notice that the proxy materials for the annual shareholders meeting are available on the Internet. Follow the instructions below to view the materials and vote online or request a copy. The items to be voted on and location of the annual meeting are on the reverse side. Your vote is important!

**This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting. The notice of meeting, proxy statement, and annual report to shareholders are available at:**

**Easy Online Access A Convenient Way to View Proxy Materials and Vote**

**When you go online to view materials, you can also vote your shares.**

**Step 1:** Go to [www.envisionreports.com/MBWM](http://www.envisionreports.com/MBWM) to view the materials.

**Step 2:** Click on **Cast Your Vote or Request Materials**.

**Step 3:** Follow the instructions on the screen to log in.

**Step 4:** Make your selection as instructed on each screen to select delivery preferences and vote.

**When you go online, you can also help the environment by consenting to receive electronic delivery of future materials.**

**Obtaining a Copy of the Proxy Materials** If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed on the reverse side on or before April 18, 2011 to facilitate timely delivery.

---



**Table of Contents**

**Shareholder Meeting Notice**

**Mercantile Bank Corporation's Annual Meeting of Shareholders will be held on April 28, 2011 at Kent Country Club, 1600 College Avenue NE, Grand Rapids, MI 49505, at 9:00 a.m. local time.**

**Proposals to be voted on at the meeting are listed below along with the Board of Directors' recommendations. The Board of Directors recommends a vote FOR all the nominees listed and FOR Proposals 2 and 3.**

1. Election of Directors: David M. Cassard, Edward J. Clark, Doyle A. Hayes, Susan K. Jones, Lawrence W. Larsen, Calvin D. Murdock, Michael H. Price, Merle J. Prins, Timothy O. Schad, Dale J. Visser and Donald Williams, Sr.
2. Ratification of the appointment of BDO USA, LLP as our independent registered public accounting firm for 2011.
3. Approval of the compensation of our executives disclosed in the proxy statement.
4. In their discretion, the Proxies are authorized to vote upon such other matters as may properly come before the meeting, or at any adjournment or postponement of the meeting.

**PLEASE NOTE YOU CANNOT VOTE BY RETURNING THIS NOTICE. To vote your shares you must vote online or request a paper copy of the proxy materials to receive a proxy card. If you wish to attend and vote at the meeting, please bring this notice with you.**

**Directions to the Mercantile Bank Corporation 2011 Annual Meeting of Shareholders**

If you have questions about attending or would like directions to the Annual Meeting, please write to the Secretary, Mercantile Bank Corporation, 310 Leonard Street NW, Grand Rapids, Michigan 49504 or call 616-726-1601.

**Here's how to order a copy of the proxy materials and select a future delivery preference:**

**Paper copies:** Current and future paper delivery requests can be submitted via the telephone, Internet or email options below.

**Email copies:** Current and future email delivery requests must be submitted via the Internet following the instructions below. If you request an email copy of current materials you will receive an email with a link to the materials.

**PLEASE NOTE:** You must use the number in the shaded bar on the reverse side when requesting a set of proxy materials.

→

**Internet** Go to [www.envisionreports.com/MBWM](http://www.envisionreports.com/MBWM). Click Cast Your Vote or Request Materials. Follow the instructions to log in and order a paper or email copy of the current meeting materials and submit your preference for email or paper delivery of future meeting materials.

- **Telephone** Call us free of charge at 1-866-641-4276 using a touch-tone phone and follow the instructions to log in and order a paper copy of the materials by mail for the current meeting. You can also submit a preference to receive a paper copy for future meetings.
- **Email** Send email to [investorvote@computershare.com](mailto:investorvote@computershare.com) with Proxy Materials Mercantile Bank Corporation in the subject line. Include in the message your full name and address, plus the number located in the shaded bar on the reverse, and state in the email that you want a paper copy of current meeting materials. You can also state your preference to receive a paper copy for future meetings.

To facilitate timely delivery, all requests for a paper copy of the proxy materials must be received by April 18, 2011.