

INDEPENDENT BANK CORP /MI/

Form 10-Q

August 07, 2007

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**SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934  
FOR THE QUARTERLY PERIOD ENDED June 30, 2007**

**Commission file number 0-7818  
INDEPENDENT BANK CORPORATION  
(Exact name of registrant as specified in its charter)**

Michigan 38-2032782

(State or jurisdiction of  
Incorporation or Organization) (I.R.S. Employer Identification  
Number)  
30 West Main Street, P.O. Box 491, Ionia, Michigan 48846

(Address of principal executive offices)  
(616) 527-9450  
(Registrant's telephone number, including area code)  
NONE

Former name, address and fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 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 a large accelerated filer, an accelerated filer or non-accelerated filer. Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, par value \$1 22,635,346

Class Outstanding at August 3, 2007

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES  
INDEX

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*Any statements in this document that are not historical facts are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Words such as expect, believe, intend, estimate, project, may and similar expressions are intended to identify forward-looking statements. These forward-looking statements are predicated on management's beliefs and assumptions based on information known to Independent Bank Corporation's management as of the date of this document and do not purport to speak as of any other date. Forward-looking statements may include descriptions of plans and objectives of Independent Bank Corporation's management for future or past operations, products or services, and forecasts of the Company's revenue, earnings or other measures of economic performance, including statements of profitability, business segments and subsidiaries, and estimates of credit quality trends. Such statements reflect the view of Independent Bank Corporation's management as of this date with respect to future events and are not guarantees of future performance; involve assumptions and are subject to substantial risks and uncertainties, such as the changes in Independent Bank Corporation's plans, objectives, expectations and intentions. Should one or more of these risks materialize or should underlying beliefs or assumptions prove incorrect, the Company's actual results could differ materially from those discussed. Factors that could cause or contribute to such differences are changes in interest rates, changes in the accounting treatment of any particular item, the results of regulatory examinations, changes in industries where the Company has a concentration of loans, changes in the level of fee income, changes in general economic conditions and related credit and market conditions, and the impact of regulatory responses to any of the foregoing. Forward-looking statements speak only as of the date they are made. Independent Bank Corporation does not undertake to update forward-looking statements to reflect facts, circumstances, assumptions or events that occur after the date the forward-looking statements are made. For any forward-looking statements made in this document, Independent Bank Corporation claims the protection of the*

*safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.*

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**Table of Contents**Part I  
Item 1.INDEPENDENT BANK CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Financial Condition

|  | June 30,<br>2007 | December 31,<br>2006 |
|--|------------------|----------------------|
|  | (unaudited)      |                      |
|  | (in thousands)   |                      |
| Assets                                 |                  |                      |
| Cash and due from banks                | \$ 66,431        | \$ 73,142            |
| Securities available for sale          | 415,677          | 434,785              |
| Federal Home Loan Bank stock, at cost  | 14,325           | 14,325               |
| Loans held for sale                    | 39,065           | 31,846               |
| Loans                                  |                  |                      |
| Commercial                             | 1,079,769        | 1,083,921            |
| Real estate mortgage                   | 849,783          | 865,522              |
| Installment                            | 364,195          | 350,273              |
| Finance receivables                    | 199,862          | 183,679              |
| Total Loans                            | 2,493,609        | 2,483,395            |
| Allowance for loan losses              | (38,213)         | (26,879)             |
| Net Loans                              | 2,455,396        | 2,456,516            |
| Property and equipment, net            | 72,020           | 67,992               |
| Bank owned life insurance              | 42,001           | 41,109               |
| Goodwill                               | 66,754           | 48,709               |
| Other intangibles                      | 17,130           | 7,854                |
| Assets of discontinued operations      | 336              | 189,432              |
| Accrued income and other assets        | 72,122           | 64,188               |
| Total Assets                           | \$ 3,261,257     | \$ 3,429,898         |
| Liabilities and Shareholders' Equity   |                  |                      |
| Deposits                               |                  |                      |
| Non-interest bearing                   | \$ 321,903       | \$ 282,632           |
| Savings and NOW                        | 984,358          | 875,541              |
| Time                                   | 1,487,890        | 1,444,618            |
| Total Deposits                         | 2,794,151        | 2,602,791            |
| Federal funds purchased                | 17,517           | 84,081               |
| Other borrowings                       | 55,228           | 163,681              |
| Subordinated debentures                | 72,269           | 64,197               |
| Financed premiums payable              | 38,252           | 32,767               |
| Liabilities of discontinued operations | 462              | 183,676              |
| Accrued expenses and other liabilities | 39,344           | 40,538               |
| Total Liabilities                      | 3,017,223        | 3,171,731            |

Shareholders' Equity

Preferred stock, no par value 200,000 shares authorized; none outstanding

Common stock, \$1.00 par value 40,000,000 shares authorized; issued and  
outstanding: 22,635,346 shares at June 30, 2007 and 22,864,587 shares at

|  |         |         |
|--|---------|---------|
| December 31, 2006                      | 22,586  | 22,865  |
| Capital surplus                        | 195,014 | 200,241 |
| Retained earnings                      | 26,138  | 31,420  |
| Accumulated other comprehensive income | 296     | 3,641   |

|                            |         |         |
|----------------------------|---------|---------|
| Total Shareholders' Equity | 244,034 | 258,167 |
|----------------------------|---------|---------|

|  |              |              |
|--|--------------|--------------|
| Total Liabilities and Shareholders' Equity | \$ 3,261,257 | \$ 3,429,898 |
|--|--------------|--------------|

See notes to interim consolidated financial statements

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Operations

|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 30,<br>2007   | June 30,<br>2006 | June 30,<br>2007 | June 30,<br>2006 |
|  | (unaudited)        |                  |                  |                  |
|  | (in thousands)     |                  |                  |                  |
| Interest Income  |                    |                  |                  |                  |
| Interest and fees on loans                                 | \$ 50,576          | \$ 48,437        | \$ 100,529       | \$ 94,483        |
| Securities available for sale                              |                    |                  |                  |                  |
| Taxable  | 2,592              | 2,797            | 5,069            | 5,645            |
| Tax-exempt   | 2,535              | 2,851            | 5,135            | 5,720            |
| Other investments  | 464                | 199              | 778              | 422              |
| <b>Total Interest Income</b>                               | <b>56,167</b>      | <b>54,284</b>    | <b>111,511</b>   | <b>106,270</b>   |
| Interest Expense   |                    |                  |                  |                  |
| Deposits   | 23,378             | 16,971           | 45,786           | 32,898           |
| Other borrowings   | 2,313              | 5,707            | 5,617            | 10,031           |
| <b>Total Interest Expense</b>                              | <b>25,691</b>      | <b>22,678</b>    | <b>51,403</b>    | <b>42,929</b>    |
| <b>Net Interest Income</b>                                 | <b>30,476</b>      | <b>31,606</b>    | <b>60,108</b>    | <b>63,341</b>    |
| Provision for loan losses                                  | 14,893             | 2,511            | 23,032           | 3,897            |
| <b>Net Interest Income After Provision for Loan Losses</b> | <b>15,583</b>      | <b>29,095</b>    | <b>37,076</b>    | <b>59,444</b>    |
| Non-interest Income  |                    |                  |                  |                  |
| Service charges on deposit accounts                        | 6,380              | 5,031            | 11,268           | 9,499            |
| Mepco litigation settlement                                |                    |                  |                  | 2,800            |
| Net gains on assets  |                    |                  |                  |                  |
| Real estate mortgage loans                                 | 1,238              | 1,188            | 2,319            | 2,214            |
| Securities   | 128                | 171              | 207              | 171              |
| VISA check card interchange income                         | 1,292              | 871              | 2,242            | 1,662            |
| Real estate mortgage loan servicing                        | 712                | 621              | 1,239            | 1,274            |
| Title insurance fees                                       | 430                | 440              | 844              | 882              |
| Other income   | 2,593              | 2,523            | 5,324            | 4,881            |
| <b>Total Non-interest Income</b>                           | <b>12,773</b>      | <b>10,845</b>    | <b>23,443</b>    | <b>23,383</b>    |
| Non-interest Expense                                       |                    |                  |                  |                  |
| Compensation and employee benefits                         | 14,784             | 12,274           | 28,752           | 25,815           |
| Occupancy, net   | 2,735              | 2,420            | 5,349            | 5,107            |
| Furniture, fixtures and equipment                          | 1,991              | 1,733            | 3,891            | 3,516            |
| Data processing  | 1,912              | 1,418            | 3,350            | 2,760            |
| Advertising  | 1,341              | 1,016            | 2,493            | 2,003            |
| Branch acquisition and conversion costs                    | (92)               |                  | 330              |                  |
| Goodwill impairment  |                    | 612              | 343              | 612              |

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|   |         |           |          |           |
|---|---------|-----------|----------|-----------|
| Other expenses  | 7,130   | 6,067     | 13,259   | 11,965    |
| Total Non-interest Expense                                    | 29,801  | 25,540    | 57,767   | 51,778    |
| Income (Loss) From Continuing Operations Before<br>Income Tax | (1,445) | 14,400    | 2,752    | 31,049    |
| Income tax expense (benefit)                                  | (1,553) | 3,978     | (1,248)  | 7,571     |
| Income From Continuing Operations                             | 108     | 10,422    | 4,000    | 23,478    |
| Discontinued operations, net of tax                           | (151)   | 180       | 200      | (533)     |
| Net Income (Loss)   | \$ (43) | \$ 10,602 | \$ 4,200 | \$ 22,945 |
| Income Per Share From Continuing Operations                   |         |           |          |           |
| Basic   | \$ .00  | .45       | .18      | 1.02      |
| Diluted   | .00     | .45       | .17      | 1.01      |
| Net Income (Loss) Per Share                                   |         |           |          |           |
| Basic   | \$ .00  | .46       | .18      | 1.00      |
| Diluted   | .00     | .45       | .18      | .98       |
| Dividends Per Common Share                                    |         |           |          |           |
| Declared  | \$ .21  | .19       | .42      | .38       |
| Paid  | .21     | .19       | .41      | .37       |
| See notes to interim consolidated financial statements        |         |           |          |           |

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Cash Flows

|  | Six months ended<br>June 30, |           |
|--|------------------------------|-----------|
|  | 2007                         | 2006      |
|  | (unaudited)                  |           |
|  | (in thousands)               |           |
| Net Income   | \$ 4,200                     | \$ 22,945 |
| Adjustments to Reconcile Net Income to Net Cash from Operating Activities                    |                              |           |
| Proceeds from sales of loans held for sale   | 149,444                      | 135,684   |
| Disbursements for loans held for sale  | (151,044)                    | (136,230) |
| Provision for loan losses  | 23,334                       | 4,297     |
| Depreciation and amortization of premiums and accretion of discounts on securities and loans | (5,208)                      | (5,273)   |
| Net gains on sales of real estate mortgage loans   | (2,319)                      | (2,214)   |
| Net gains on securities  | (207)                        | (171)     |
| Goodwill impairment  | 343                          | 612       |
| Deferred loan fees   | (206)                        | 68        |
| Increase in accrued income and other assets  | (7,603)                      | (3,297)   |
| Decrease in accrued expenses and other liabilities   | (6,425)                      | (2,264)   |
|  | 109                          | (8,788)   |
| Net Cash from Operating Activities   | 4,309                        | 14,157    |
| Cash Flow from (used in) Investing Activities  |                              |           |
| Proceeds from the sale of securities available for sale                                      | 15,491                       | 1,283     |
| Proceeds from the maturity of securities available for sale                                  | 28,802                       | 9,914     |
| Principal payments received on securities available for sale                                 | 16,823                       | 18,548    |
| Purchases of securities available for sale   | (47,102)                     | (3,968)   |
| (Increase) decrease in portfolio loans originated, net of principal payments                 | (9,704)                      | (88,876)  |
| Acquisition of business offices, less cash paid  | 210,053                      |           |
| Settlement on business acquisition   |                              | (4,442)   |
| Proceeds from sale of insurance premium finance business                                     | 175,901                      |           |
| Capital expenditures   | (4,600)                      | (8,489)   |
| Net Cash from (used in) Investing Activities   | 385,664                      | (76,030)  |
| Cash Flow from (used in) Financing Activities  |                              |           |
| Net increase (decrease) in total deposits  | (216,302)                    | 77,176    |
| Net increase (decrease) in short-term borrowings   | (156,944)                    | (17,731)  |
| Proceeds from Federal Home Loan Bank advances  | 32,000                       | 133,700   |
| Payments of Federal Home Loan Bank advances  | (49,073)                     | (112,777) |
| Repayment of long-term debt  | (1,000)                      | (1,000)   |
| Net increase in financed premiums payable  | 1,537                        | 10,041    |
| Dividends paid   | (9,338)                      | (8,587)   |

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|  |           |           |
|--|-----------|-----------|
| Repurchase of common stock                                     | (5,989)   | (9,178)   |
| Proceeds from issuance of common stock                         | 186       | 419       |
| Proceeds from issuance of subordinated debt                    | 12,372    |           |
| Redemption of subordinated debt                                | (4,300)   |           |
| Net Cash from (used in) Financing Activities                   | (396,851) | 72,063    |
| Net Increase (Decrease) in Cash and Cash Equivalents           | (6,878)   | 10,190    |
| Change in cash and cash equivalents of discontinued operations | 167       | 29        |
| Cash and Cash Equivalents at Beginning of Period               | 73,142    | 67,522    |
| Cash and Cash Equivalents at End of Period                     | \$ 66,431 | \$ 77,741 |
| Cash paid during the period for                                |           |           |
| Interest   | \$ 53,102 | \$ 45,823 |
| Income taxes   | 7,283     | 5,641     |
| Transfer of loans to other real estate                         | 3,892     | 1,510     |
| Transfer of loans to held for sale                             | 3,300     |           |
| Common stock issued for acquisition of business                |           | 4,442     |
| See notes to interim consolidated financial statements         |           |           |

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**Table of Contents**INDEPENDENT BANK CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Shareholders' Equity

|   | Six months ended<br>June 30, |            |
|---|------------------------------|------------|
|   | 2007                         | 2006       |
|   | (unaudited)                  |            |
|   | (in thousands)               |            |
| Balance at beginning of period  | \$ 258,167                   | \$ 248,259 |
| Net income  | 4,200                        | 22,945     |
| Cash dividends declared   | (9,481)                      | (8,740)    |
| Issuance of common stock  | 482                          | 5,245      |
| Repurchase of common stock  | (5,989)                      | (9,178)    |
| Net change in accumulated other comprehensive income, net of related tax effect | (3,345)                      | (2,017)    |
| Balance at end of period  | \$ 244,034                   | \$ 256,514 |

See notes to interim consolidated financial statements.

**Table of Contents****NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

1. In our opinion, the accompanying unaudited consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of June 30, 2007 and December 31, 2006, and the results of operations for the three and six-month periods ended June 30, 2007 and 2006. Certain reclassifications have been made in the prior year financial statements to conform to the current year presentation including reclassifications in the consolidated statement of cash flows to properly reflect cash and non-cash amounts issued pursuant to an earn-out. Our critical accounting policies include the assessment for other than temporary impairment on investment securities, the determination of the allowance for loan losses, the valuation of derivative financial instruments, the valuation of originated mortgage loan servicing rights, the valuation of deferred tax assets and the valuation of goodwill. Refer to our 2006 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. Our assessment of the allowance for loan losses is based on an evaluation of the loan portfolio, recent loss experience, current economic conditions and other pertinent factors. Loans on non-accrual status, past due more than 90 days, or restructured amounted to \$54.9 million at June 30, 2007, and \$39.2 million at December 31, 2006.

3. Comprehensive income for the three- and six-month periods ended June 30 follows:

|  | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
|  | 2007                           | 2006      | 2007                         | 2006      |
|  | (in thousands)                 |           |                              |           |
| Net income (loss)  | \$ (43)                        | \$ 10,602 | \$ 4,200                     | \$ 22,945 |
| Net change in unrealized gain (loss) on securities available for sale, net of related tax effect | (3,489)                        | (2,925)   | (3,099)                      | (3,353)   |
| Net change in unrealized gain (loss) on derivative instruments, net of related tax effect        | 431                            | 1,289     | (92)                         | 1,502     |
| Reclassification adjustment for accretion on settled derivative financial instruments            | (53)                           | (81)      | (154)                        | (166)     |
| Comprehensive income (loss)  | \$ (3,154)                     | \$ 8,885  | \$ 855                       | \$ 20,928 |

The net change in unrealized gain (loss) on securities available for sale reflect net gains and losses reclassified into earnings as follows:

|   | Three months ended<br>June 30, |        | Six months ended<br>June 30, |        |
|---|--------------------------------|--------|------------------------------|--------|
|   | 2007                           | 2006   | 2007                         | 2006   |
|   | (in thousands)                 |        |                              |        |
| Gain reclassified into earnings   | \$ 128                         | \$ 171 | \$ 207                       | \$ 171 |
| Federal income tax expense as a result of the reclassification of these amounts from comprehensive income | 44                             | 60     | 72                           | 60     |

4. Our reportable segments are based upon legal entities. We currently have five reportable segments: Independent Bank ( IB ), Independent Bank West Michigan ( IBWM ), Independent Bank South Michigan ( IBSM ), Independent Bank East Michigan ( IBEM ) and Mepco Finance Corporation ( Mepco ). We evaluate performance based principally on net income of the respective reportable segments. In April 2007 we announced our intention to consolidate our four existing bank charters into one. We have filed the required regulatory applications for approval of our bank charter consolidation and expect to complete this consolidation in September 2007.

**Table of Contents****NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
(unaudited)

A summary of selected financial information for our reportable segments as of or for the three-month and six-month periods ended June 30, follows:

As of or for the three months ended June 30,

|  | IB             | IBWM       | IBSM       | IBEM       | Mepco      | Other <sup>(1)</sup> | Elimination  | Total        |
|--|----------------|------------|------------|------------|------------|----------------------|--------------|--------------|
|  | (in thousands) |            |            |            |            |                      |              |              |
| 2007   |                |            |            |            |            |                      |              |              |
| Total assets   | \$ 1,061,191   | \$ 767,458 | \$ 538,433 | \$ 694,451 | \$ 230,261 | \$ 334,533           | \$ (365,070) | \$ 3,261,257 |
| Interest income  | 17,270         | 13,841     | 8,428      | 11,620     | 5,658      | 5                    | (655)        | 56,167       |
| Net interest income  | 9,086          | 8,318      | 4,500      | 6,534      | 3,666      | (1,586)              | (42)         | 30,476       |
| Provision for loan losses                                  | 1,823          | 4,885      | 3,777      | 4,366      | 42         |                      |              | 14,893       |
| Income (loss) from continuing operations before income tax | 2,450          | 153        | (1,785)    | (2,296)    | 1,869      | (1,857)              | 21           | (1,445)      |
| Discontinued operations, net of tax                        |                |            |            |            | (151)      |                      |              | (151)        |
| Net income (loss)  | 2,129          | 333        | (942)      | (1,314)    | 1,015      | (1,241)              | (23)         | (43)         |
| 2006   |                |            |            |            |            |                      |              |              |
| Total assets   | \$ 1,039,450   | \$ 728,112 | \$ 495,381 | \$ 726,793 | \$ 446,012 | \$ 344,886           | \$ (337,913) | \$ 3,442,721 |
| Interest income  | 16,351         | 12,811     | 7,887      | 12,127     | 5,206      | 5                    | (103)        | 54,284       |
| Net interest income  | 9,932          | 8,367      | 4,528      | 7,594      | 2,825      | (1,599)              | (41)         | 31,606       |
| Provision for loan losses                                  | 558            | 591        | 287        | 965        | 110        |                      |              | 2,511        |
| Income (loss) from continuing operations before income tax | 4,310          | 4,589      | 2,433      | 2,826      | 1,146      | (933)                | 29           | 14,400       |
| Discontinued operations, net of tax                        |                |            |            |            | 180        |                      |              | 180          |
| Net income (loss)  | 3,164          | 3,223      | 1,886      | 2,100      | 889        | (645)                | (15)         | 10,602       |

**Table of Contents****NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
(unaudited)

As of or for the six months ended June 30,

|  | IB             | IBWM      | IBSM      | IBEM      | Mepco     | Other <sup>(1)</sup> | Elimination | Total       |
|--|----------------|-----------|-----------|-----------|-----------|----------------------|-------------|-------------|
|  | (in thousands) |           |           |           |           |                      |             |             |
| 2007   |                |           |           |           |           |                      |             |             |
| Total assets   | \$1,061,191    | \$767,458 | \$538,433 | \$694,451 | \$230,261 | \$334,533            | \$(365,070) | \$3,261,257 |
| Interest income  | 34,216         | 27,433    | 16,510    | 23,302    | 10,856    | 10                   | (816)       | 111,511     |
| Net interest income  | 18,024         | 16,524    | 8,611     | 13,248    | 6,934     | (3,149)              | (84)        | 60,108      |
| Provision for loan losses                                  | 2,886          | 7,340     | 5,593     | 7,042     | 171       |                      |             | 23,032      |
| Income (loss) from continuing operations before income tax | 5,242          | 2,552     | (1,835)   | (2,461)   | 3,257     | (4,083)              | 80          | 2,752       |
| Discontinued operations, net of tax                        |                |           |           |           | 200       |                      |             | 200         |
| Net income (loss)  | 4,323          | 2,122     | (714)     | (1,195)   | 2,235     | (2,562)              | (9)         | 4,200       |
| 2006   |                |           |           |           |           |                      |             |             |
| Total assets   | \$1,039,450    | \$728,112 | \$495,381 | \$726,793 | \$446,012 | \$344,886            | \$(337,913) | \$3,442,721 |
| Interest income  | 32,122         | 25,112    | 15,377    | 23,411    | 10,513    | 10                   | (275)       | 106,270     |
| Net interest income  | 19,833         | 16,750    | 8,976     | 14,890    | 6,086     | (3,111)              | (83)        | 63,341      |
| Provision for loan losses                                  | 898            | 823       | 829       | 1,183     | 164       |                      |             | 3,897       |
| Income (loss) from continuing operations before income tax | 9,016          | 9,325     | 4,396     | 5,346     | 2,870     | 46                   | 50          | 31,049      |
| Discontinued operations, net of tax                        |                |           |           |           | (533)     |                      |             | (533)       |
| Net income (loss)  | 6,767          | 6,549     | 3,465     | 3,999     | 1,244     | 960                  | (39)        | 22,945      |

(1) Includes items relating to the Registrant and

certain insignificant operations. 2006 net income includes \$2.8 million of non-interest income related to the settlement of litigation involving the former owners of Mepco. This amount is not taxable.

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5. Basic income per share is based on weighted average common shares outstanding during the period. Diluted income per share includes the dilutive effect of additional potential common shares to be issued upon the exercise of stock options and stock units for a deferred compensation plan for non-employee directors.

A reconciliation of basic and diluted earnings per share for the three-month and the six-month periods ended June 30 follows:

|   | Three months<br>ended<br>June 30,           |           | Six months<br>ended<br>June 30, |           |
|---|---|-----------|---------------------------------|-----------|
|   | 2007  | 2006      | 2007                            | 2006      |
|   | (in thousands, except per share<br>amounts) |           |                                 |           |
| Income from continuing operations   | 108   | 10,422    | 4,000                           | 23,478    |
| Net income (loss)   | \$ (43)                                     | \$ 10,602 | \$ 4,200                        | \$ 22,945 |
| Shares outstanding  | 22,585                                      | 22,944    | 22,706                          | 22,941    |
| Effect of stock options   | 156   | 326       | 208                             | 334       |
| Stock units for deferred compensation plan for<br>non- employee directors | 60  | 51        | 59                              | 51        |
| Shares outstanding for calculation of diluted<br>earnings per share       | 22,801                                      | 23,321    | 22,973                          | 23,326    |
| Income (loss) per share from continuing<br>operations                     |   |           |                                 |           |
| Basic   | \$ .00                                      | \$ .45    | \$ .18                          | \$ 1.02   |
| Diluted <sup>(1)</sup>  | .00   | .45       | .17                             | 1.01      |
| Net income (loss) per share   |   |           |                                 |           |
| Basic   | \$ .00                                      | \$ .46    | \$ .18                          | \$ 1.00   |
| Diluted <sup>(1)</sup>  | .00   | .45       | .18                             | .98       |

<sup>(1)</sup> For any period in which a loss is recorded, the assumed exercise of stock options and stock units for deferred compensation plan for non-employee directors would have an anti-dilutive impact on the loss per share and thus



are ignored in the diluted per share calculation.

Weighted average stock options outstanding that were anti-dilutive totaled 1.0 million and 0.5 million for the three-months ended June 30, 2007 and 2006, respectively. During the six-month periods ended June 30, 2007 and 2006, weighted-average anti-dilutive stock options totaled 0.9 million and 0.5 million respectively.

Per share data has been restated for a 5% stock dividend in 2006.

6. Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, ( SFAS #133 ) which was subsequently amended by SFAS #138, requires companies to record derivatives on the balance sheet as assets and liabilities measured at their fair value. The accounting for increases and decreases in the value of derivatives depends upon the use of derivatives and whether the derivatives qualify for hedge accounting.

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Our derivative financial instruments according to the type of hedge in which they are designated under SFAS #133 follows:

|  | Notional<br>Amount     | June 30,<br>2007<br>Average<br>Maturity<br>(years) | Fair<br>Value |
|--|------------------------|--|---------------|
|  | (dollars in thousands) |  |               |
| Fair Value Hedges  |                        |  |               |
| pay variable interest-rate swap agreements               | \$430,159              | 2.5  | \$(3,709)     |
| Cash Flow Hedges   |                        |  |               |
| Pay fixed interest-rate swap agreements                  | \$ 46,000              | 2.1  | \$ 995        |
| Interest-rate cap agreements                             | 193,500                | 1.8  | 1,182         |
|  | \$239,500              | 1.9  | \$ 2,177      |
| No hedge designation                                     |                        |  |               |
| Pay fixed interest-rate swap agreements                  | \$ 5,000               | 0.9  | \$ 54         |
| Pay variable interest-rate swap agreements               | 45,000                 | 0.7  | (59)          |
| Interest-rate cap agreements                             | 72,000                 | 1.3  | 114           |
| Rate-lock real estate mortgage loan commitments          | 54,065                 | 0.1  | (150)         |
| Mandatory commitments to sell real estate mortgage loans | 52,912                 | 0.1  | 200           |
| Total  | \$228,977              | 0.6  | \$ 159        |

We have established management objectives and strategies that include interest-rate risk parameters for maximum fluctuations in net interest income and market value of portfolio equity. We monitor our interest rate risk position via simulation modeling reports. The goal of our asset/liability management efforts is to maintain profitable financial leverage within established risk parameters.

We use variable rate and short-term fixed-rate (less than 12 months) debt obligations to fund a portion of our balance sheet, which exposes us to variability in cash flows due to changes in interest rates. To meet our objectives, we may periodically enter into derivative financial instruments to mitigate exposure to fluctuations in cash flows resulting from changes in interest rates ( Cash Flow Hedges ). Cash Flow Hedges currently include certain pay-fixed interest-rate swaps and interest-rate cap agreements.

Pay-fixed interest-rate swaps convert the variable-rate cash flows on debt obligations to fixed-rates. Under interest-rate caps, we will receive cash if interest rates rise above a predetermined level. As a result, we effectively have variable rate debt with an established maximum rate.

We record the fair value of Cash Flow Hedges in accrued income and other assets and accrued expenses and other liabilities. On an ongoing basis, we adjust our balance sheet to reflect the then current fair value of Cash Flow Hedges. The related gains or losses are reported in other comprehensive income and are subsequently reclassified into earnings, as a yield adjustment in the same period in which the related interest on the hedged items (primarily variable-rate debt obligations) affect earnings. It is anticipated that approximately \$0.3 million, net of tax, of unrealized gains on Cash Flow Hedges at June 30, 2007 will be reclassified to earnings over the next twelve months. To the extent that the Cash Flow Hedges are not effective, the ineffective portion of the Cash Flow Hedges are

immediately recognized as interest expense. The maximum term of any Cash Flow Hedge at June 30, 2007 is 4.9 years.

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**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
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We also use long-term, fixed-rate brokered CDs to fund a portion of our balance sheet. These instruments expose us to variability in fair value due to changes in interest rates. To meet our objectives, we may enter into derivative financial instruments to mitigate exposure to fluctuations in fair values of such fixed-rate debt instruments ( Fair Value Hedges ). Fair Value Hedges currently include pay-variable interest rate swaps.

Also, we record Fair Value Hedges at fair value in accrued income and other assets and accrued expenses and other liabilities. The hedged items (primarily fixed-rate debt obligations) are also recorded at fair value through the statement of operations, which offsets the adjustment to Fair Value Hedges. On an ongoing basis, we will adjust our balance sheet to reflect the then current fair value of both the Fair Value Hedges and the respective hedged items. To the extent that the change in value of the Fair Value Hedges do not offset the change in the value of the hedged items, the ineffective portion is immediately recognized as interest expense.

During the first six months of 2007 we discontinued hedge accounting on \$88.0 million and \$20.0 million in notional amount of cash flow and fair value hedges, respectively due to the payoff or maturity of the hedged items. The hedged items were paid off or not renewed due to the increase in liquidity resulting from the sale of substantially all of the assets of Mepco's insurance premium finance business (see note #11) and the acquisition of ten branches from TCF National Bank (see note #12). As a result of the terminations \$0.3 million of gains were recognized in earnings during the first six months of 2007.

Certain financial derivative instruments are not designated as hedges. The fair value of these derivative financial instruments have been recorded on our balance sheet and are adjusted on an ongoing basis to reflect their then current fair value. The changes in the fair value of derivative financial instruments not designated as hedges, are recognized currently in earnings.

In the ordinary course of business, we enter into rate-lock real estate mortgage loan commitments with customers ( Rate Lock Commitments ). These commitments expose us to interest rate risk. We also enter into mandatory commitments to sell real estate mortgage loans ( Mandatory Commitments ) to reduce the impact of price fluctuations of mortgage loans held for sale and Rate Lock Commitments. Mandatory Commitments help protect our loan sale profit margin from fluctuations in interest rates. The changes in the fair value of Rate Lock Commitments and Mandatory Commitments are recognized currently as part of gains on the sale of real estate mortgage loans. We obtain market prices from an outside third party on Mandatory Commitments and Rate Lock Commitments. Net gains on the sale of real estate mortgage loans, as well as net income may be more volatile as a result of these derivative instruments, which are not designated as hedges.

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(unaudited)

The impact of SFAS #133 on net income and other comprehensive income for the three-month and six-month periods ended June 30, 2007 and 2006 is as follows:

|  | Net<br>Income | Income (Expense)<br>Other<br>Comprehensive<br>Income<br>(in thousands) | Total  |
|--|---------------|--|--------|
| Change in fair value during the three- month period ended June 30,<br>2007 |               |  |        |
| Interest-rate swap agreements not designated as hedges                     | \$ 12         |  | \$ 12  |
| Interest-rate cap agreements not designated as hedges                      | 64            |  | 64     |
| Rate Lock Commitments  | (169)         |  | (169)  |
| Mandatory Commitments  | 176           |  | 176    |
| Ineffectiveness of Fair value hedges                                       | (14)          |  | (14)   |
| Ineffectiveness of Cash flow hedges  | (1)           |  | (1)    |
| Cash flow hedges   |               | \$ 349   | 349    |
| Reclassification adjustment  |               | 232  | 232    |
| Total  | 68            | 581  | 649    |
| Income tax   | 23            | 203  | 226    |
| Net  | \$ 45         | \$ 378   | \$ 423 |

|  | Net<br>Income | Income (Expense)<br>Other<br>Comprehensive<br>Income<br>(in thousands) | Total   |
|--|---------------|--|---------|
| Change in fair value during the six- month period ended June 30,<br>2007 |               |  |         |
| Interest-rate swap agreements not designated as hedges                   | \$ 29         |  | \$ 29   |
| Interest-rate cap agreements not designated as hedges                    | 26            |  | 26      |
| Rate Lock Commitments  | (119)         |  | (119)   |
| Mandatory Commitments  | 101           |  | 101     |
| Ineffectiveness of Fair value hedges                                     | (9)           |  | (9)     |
| Ineffectiveness of Cash flow hedges                                      | 2             |  | 2       |
| Cash flow hedges   |               | \$ (1,076)   | (1,076) |
| Reclassification adjustment  |               | 698  | 698     |
| Total  | 30            | (378)  | (348)   |
| Income tax   | 10            | (132)  | (122)   |

Net \$ 20 \$ (246) \$ (226)

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**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
(unaudited)

|  | Net     | Income (Expense)<br>Other<br>Comprehensive |          |
|--|---------|--|----------|
|  | Income  | Income                                     | Total    |
|  |         | (in thousands)                             |          |
| Change in fair value during the three- month period ended June 30,<br>2006 |         |  |          |
| Interest-rate swap agreements not designated as hedges                     | \$ (52) |  | \$ (52)  |
| Interest-rate cap agreements not designated as hedges                      | 227     |  | 227      |
| Rate Lock Commitments  | 12      |  | 12       |
| Mandatory Commitments  | (108)   |  | (108)    |
| Ineffectiveness of Fair value hedges                                       | (45)    |  | (45)     |
| Cash flow hedges   |         | \$ 975                                     | 975      |
| Reclassification adjustment  |         | 884  | 884      |
| Total  | 34      | 1,859                                      | 1,893    |
| Income tax   | 12      | 651  | 663      |
| Net  | \$ 22   | \$ 1,208                                   | \$ 1,230 |

|  | Net      | Income (Expense)<br>Other<br>Comprehensive |          |
|--|----------|--|----------|
|  | Income   | Income                                     | Total    |
|  |          | (in thousands)                             |          |
| Change in fair value during the six- month period ended June 30,<br>2006 |          |  |          |
| Interest-rate swap agreements not designated as hedges                   | \$ (114) |  | \$ (114) |
| Interest-rate cap agreements not designated as hedges                    | 256      |  | 256      |
| Rate Lock Commitments  | (148)    |  | (148)    |
| Mandatory Commitments  | 208      |  | 208      |
| Ineffectiveness of Fair value hedges                                     | (39)     |  | (39)     |
| Cash flow hedges   |          | \$ 343                                     | 343      |
| Reclassification adjustment  |          | 1,713                                      | 1,713    |
| Total  | 163      | 2,056                                      | 2,219    |
| Income tax   | 57       | 720  | 777      |
| Net  | \$ 106   | \$ 1,336                                   | \$ 1,442 |





**Table of Contents****NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
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7. Statement of Financial Accounting Standards No. 141, Business Combinations, ( SFAS #141 ) and Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, ( SFAS #142 ) effects how organizations account for business combinations and for the goodwill and intangible assets that arise from those combinations or are acquired otherwise.

Intangible assets, net of amortization, were comprised of the following at June 30, 2007 and December 31, 2006:

|  | June 30, 2007               |   | December 31, 2006           |                             |
|--|-----------------------------|---|-----------------------------|-----------------------------|
|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization<br>(dollars in thousands) | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
| Amortized intangible assets              |                             |   |                             |                             |
| Core deposit                             | \$ 31,326                   | \$ 14,982   | \$ 20,545                   | \$ 13,679                   |
| Customer relationship                    | 1,302                       | 1,049   | 1,302                       | 999                         |
| Covenants not to compete                 | 1,520                       | 987   | 1,520                       | 835                         |
| Total                                    | \$ 34,148                   | \$ 17,018   | \$ 23,367                   | \$ 15,513                   |
| Unamortized intangible assets - Goodwill | \$ 66,754                   |   | \$ 48,709                   |                             |

Amortization of intangibles has been estimated through 2012 and thereafter in the following table, and does not take into consideration any potential future acquisitions or branch purchases.

|                                    | (dollars in<br>thousands) |
|------------------------------------|---------------------------|
| Six months ended December 31, 2007 | \$ 1,868                  |
| Year ending December 31:           |                           |
| 2008                               | 3,072                     |
| 2009                               | 1,838                     |
| 2010                               | 1,310                     |
| 2011                               | 1,398                     |
| 2012 and thereafter                | 7,644                     |
| Total                              | \$ 17,130                 |

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Changes in the carrying amount of goodwill and core deposit intangible by reporting segment for the periods presented were as follows:

|                                       | IB                     | IBWM  | IBSM     | IBEM      | Mepco              | Other <sup>(1)</sup> | Total     |
|---------------------------------------|------------------------|-------|----------|-----------|--------------------|----------------------|-----------|
|                                       | (dollars in thousands) |       |          |           |                    |                      |           |
| <b>Goodwill</b>                       |                        |       |          |           |                    |                      |           |
| Balance, December 31, 2006            | \$ 8,394               | \$ 32 |          | \$ 23,205 | \$ 16,735          | \$ 343               | \$ 48,709 |
| Acquired during period <sup>(2)</sup> | 11,352                 |       | \$ 7,036 |           |                    |                      | 18,388    |
| Impairment during period              | (343)                  |       |          |           |                    |                      | (343)     |
| Balance, June 30, 2007                | \$ 19,403              | \$ 32 | \$ 7,036 | \$ 23,205 | \$ 16,735          | \$ 343               | \$ 66,754 |
| <b>Core deposit</b>                   |                        |       |          |           |                    |                      |           |
| Balance, December 31, 2005            | \$ 9,560               | \$ 32 |          | \$ 23,205 | \$ 18,673          | \$ 343               | \$ 51,813 |
| Acquired during period                |                        |       |          |           | 471 <sup>(3)</sup> |                      | 471       |
| Impairment                            | (612)                  |       |          |           |                    |                      | (612)     |
| Balance, June 30, 2006                | \$ 8,948               | \$ 32 |          | \$ 23,205 | \$ 19,144          | \$ 343               | \$ 51,672 |
| Balance, December 31, 2006            | \$ 1,562               | \$ 33 | \$ 174   | \$ 5,072  |                    | \$ 25                | \$ 6,866  |
| Acquired during period <sup>(2)</sup> | 6,098                  |       | 4,683    |           |                    |                      | 10,781    |
| Amortization                          | (433)                  | (6)   | (232)    | (624)     |                    | (8)                  | (1,303)   |
| Balance, June 30, 2007                | \$ 7,227               | \$ 27 | \$ 4,625 | \$ 4,448  |                    | \$ 17                | \$ 16,344 |

(1) Includes items relating to the Registrant and certain insignificant operations.

(2) Goodwill and deposit customer relationship value, including core deposit

value associated  
with the  
acquisition of  
10 branches  
from TCF  
National Bank.  
The weighted  
average  
amortization  
period of the  
deposit  
customer  
relationship  
value, including  
core deposit  
value is 6.8  
years.

- (3) Goodwill  
associated with  
contingent  
consideration  
accrued  
pursuant to an  
earnout.

During the first quarter of 2007 we recorded a goodwill impairment charge of \$0.3 million at First Home Financial (FHF) which was acquired in 1998. We test goodwill for impairment and based on the fair value of FHF the goodwill associated with FHF was reduced to zero at March 31, 2007. This amount is included in Goodwill Impairment in the Consolidated Statements of Operations. FHF was a loan origination company based in Grand Rapids, Michigan that specialized in the financing of manufactured homes located in mobile home parks or communities and was a subsidiary of our IB segment above. Revenues and profits have declined at FHF over the last few years and have continued to decline through the second quarter of 2007. As a result of these declines, the operations of FHF ceased effective June 15, 2007 and was dissolved on June 30, 2006.

8. We maintain performance-based compensation plans that includes a long-term incentive plan that permits the issuance of share based compensation awards, including stock options and non-vested share awards. Share based compensation awards, including stock options and non-vested share awards, are measured at fair value at the date of grant and expensed over the requisite service period.

Pursuant to our performance-based compensation plans we granted 0.2 million stock options and 0.1 million shares of non-vested common stock to officers of the company on April, 24, 2007. The stock options have an exercise price equal to the market value of the common stock on the date of grant, vest ratably over a three year period and expire 10 years from date of grant. The restricted stock cliff vests in five years. The company uses the Black-Scholes option pricing model to measure compensation cost for stock options and uses the market value of the common

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stock on date of grant to measure compensation cost for non-vested share awards. The company also estimates expected forfeitures over the vesting period.

During the second quarter of 2007 we modified 0.1 million stock options originally issued in prior years for one former officer. These modified options vested immediately and the expense associated with this modification of \$0.1 million was included in compensation and benefits expense for the three month period ended June 30, 2007. The modification consisted of extending the date of exercise subsequent to resignation of the officer from 3 months to 18 months.

All share based compensation awards outstanding at December 31, 2005 were fully vested and there were no new or modified share based grants during 2006.

A summary of outstanding stock option grants and transactions for the six month period ended June 30, 2007 follows:

|                                | Number of<br>Shares | Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term<br>(years) | Aggregated<br>Intrinsic<br>Value (in<br>thousands) |
|--------------------------------|---------------------|------------------------------|---|--|
| Outstanding at January 1, 2007 | 1,481,276           | \$ 19.82                     |   |  |
| Granted                        | 227,268             | 16.69                        |   |  |
| Exercised                      | 9,233               | 10.67                        |   |  |
| Forfeited                      |                     |                              |   |  |
| Outstanding at June 30, 2007   | 1,699,311           | \$ 19.45                     | 6.12  | \$ 3,101   |
| Exercisable at June 30, 2007   | 1,472,043           | \$ 19.88                     | 5.56  | \$ 2,983   |

A summary of non-vested restricted stock and transactions for the six month period ended June 30, 2007 follows:

|                                | Number of<br>Shares | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--------------------------------|---------------------|---|
| Outstanding at January 1, 2007 | 0                   |   |
| Granted                        | 50,596              | \$ 16.69  |
| Exercised                      |                     |   |
| Forfeited                      |                     |   |
| Outstanding at June 30, 2007   | 50,596              | \$ 16.69  |

A summary of the weighted-average assumptions used in the Black-Scholes option pricing model for grants of stock options during the first six months of 2007 are as follows:

|                          |        |
|--------------------------|--------|
| Expected dividend yield  | 3.76%  |
| Risk-free interest rate  | 4.55%  |
| Expected life (in years) | 5.99   |
| Expected volatility      | 27.64% |



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Total compensation cost recognized during the first six months of 2007 for stock option and restricted stock grants was \$0.1 million and the corresponding tax benefit relating to this expense was \$0.03 million.

At June 30, 2007, the total expected compensation cost related to non vested stock option and restricted stock awards not yet recognized was \$1.2 million. The weighted-average period over which this amount will be recognized was 3.2 years.

Common shares issued upon exercise of stock options come from currently authorized but unissued shares. The following summarizes certain information regarding options exercised during the three and six-month periods ending June 30:

|                        | Three months ended |        | Six months ended |        |
|------------------------|--------------------|--------|------------------|--------|
|                        | June 30,           |        | June 30,         |        |
|                        | 2007               | 2006   | 2007             | 2006   |
|                        | (in thousands)     |        |                  |        |
| Intrinsic value        | \$ 2               | \$ 356 | \$ 82            | \$ 617 |
| Cash proceeds received | \$                 | \$ 205 | \$ 68            | \$ 419 |
| Tax benefit realized   | \$                 | \$ 124 | \$ 28            | \$ 216 |

9. On January 1, 2007 we adopted Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an Interpretation of FASB Statement No. 109, ( *FIN #48* ), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS #109, *Accounting for Income Taxes* . FIN #48 prescribes a recognition and measurement threshold for a tax position taken or expected to be taken in a tax return. FIN #48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The adoption of FIN #48 at January 1, 2007 did not have an impact on our financial statements.

At January 1, 2007 (date of adoption) and June 30, 2007 we had approximately \$2.4 million and \$2.6 million, respectively, of gross unrecognized tax benefits. Included in both of these amounts is approximately \$0.1 million of interest. We classify penalties and interest in our financial statements as income taxes. All gross unrecognized tax benefits, if recognized, would affect our effective tax rate.

At January 1, 2007, U.S. Federal tax years 2003 through the present date remain open.

10. In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, ( *SFAS #159* ). This statement allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain non-financial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. The statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Earlier adoption of the Statement is permitted as of the beginning of an entity's fiscal year, provided the choice to early adopt is made within 120 days of the beginning of the fiscal year of adoption and the entity has not yet issued financial statements for any interim period of that fiscal year. We expect to adopt SFAS #159 on January 1, 2008.

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**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
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11. On January 15, 2007 we sold substantially all of the assets of Mepco's insurance premium finance business to Premium Financing Specialists, Inc. ( PFS ). We received \$176 million of cash that was utilized to payoff Brokered CD's and short-term borrowings at Mepco's parent company, Independent Bank. Under the terms of the sale, PFS also assumed approximately \$11.7 million in liabilities. Revenues and expenses associated with Mepco's insurance premium finance business have been presented as discontinued operations in the Consolidated Statements of Operations. Likewise, in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the assets and liabilities associated with this business have been reclassified to discontinued operations in the Consolidated Statements of Financial Condition. Funding for Mepco's insurance premium finance business was accomplished by loans from its parent company, Independent Bank. Those loans were primarily funded with brokered certificates of deposit which are included in liabilities of discontinued operations at December 31, 2006. We have elected to not make any reclassifications in the Consolidated Statements of Cash Flows for the six months ended June 30, 2006.

12. On March 23, 2007, we completed the acquisition of ten branches with total deposits of \$241.4 million from TCF National Bank. In accordance with Statement of Financial Accounting Standards No. 141 Business Combinations and related interpretations, this acquisition was considered a business acquisition, as the acquired assets and assumed liabilities enable us to sustain a revenue stream and provide products and services to these customers without significant disruption or difficulty. We paid a premium of approximately \$29.2 million, including capitalizable costs of acquisition, for this business. Approximately \$10.8 million of this premium is attributable to the value of deposit customer relationships acquired, including core deposit value. This will be amortized over its expected life of 15 years. The remaining \$18.4 million was recorded as goodwill and represents the intangible value of the work force in place and other attributes. This acquisition provides us with funds to payoff higher cost short term borrowings and brokered certificates of deposit and provides additional branch facilities from which to serve our customers and expand our services. Proforma information with respect to the estimated impact of this acquisition on our results of operations is not presented as it is not material.

13. The results of operations for the three- and six-month periods ended June 30, 2007, are not necessarily indicative of the results to be expected for the full year.

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Item 2.

**Management's Discussion and Analysis  
of Financial Condition and Results of Operations**

The following section presents additional information that may be necessary to assess our financial condition and results of operations. This section should be read in conjunction with our consolidated financial statements contained elsewhere in this report as well as our 2006 Annual Report on Form 10-K. The Form 10-K includes a list of risk factors that you should consider in connection with any decision to buy or sell our securities.

**Bank charter consolidation** In April 2007 we announced our intention to consolidate our four existing bank charters into one. The primary reasons for this bank charter consolidation are:

To better streamline our operations and corporate governance structure;

To enhance our risk management processes, particularly credit risk management through more centralized credit management functions;

To allow for more rapid development and deployment of new products and services; and

To improve productivity and resource utilization leading to lower non-interest expenses.

We have filed the required regulatory applications for approval of our bank charter consolidation and expect to complete this consolidation in September 2007. Other than an estimated \$4 million to \$4.5 million (pre-tax) in annual reductions in non-interest expenses, we do not expect the bank charter consolidation to have a material impact on our financial condition or results of operations.

**Branch acquisition** We completed the acquisition of ten branches with total deposits of approximately \$241.4 million from TCF National Bank on March 23, 2007. These branches are located in or near Battle Creek, Bay City and Saginaw, Michigan. As a result of this transaction, we received \$210.1 million of cash. We used the proceeds from this transaction primarily to payoff higher costing short term borrowings and brokered certificates of deposit ( Brokered CD s). As a result, our interest expense as a percentage of average interest earning assets (our cost of funds ) declined in the second quarter of 2007 when compared to the first quarter. The acquisition of these branches also resulted in an increase in non-interest income, particularly service charges on deposit accounts and VISA check card interchange income in the second quarter of 2007. However, non-interest expenses also increased in the second quarter of 2007 due to compensation and benefits for the employees at these branches as well as occupancy, furniture and equipment, data processing, communications, supplies and advertising expenses. We paid an 11.5% premium (\$28.1 million), based on the deposit balances one week prior to closing, to acquire these branches and also reimbursed the seller \$0.2 million for certain transaction related costs. Approximately \$10.8 million of the premium paid was recorded as deposit customer relationship value, including core deposit value and will be amortized over 15 years. This has resulted in an increase in the amount of amortization of intangible assets. We also incurred other transaction costs (primarily investment banking fees, legal fees, severance costs and data processing conversion fees) of approximately \$0.8 million, of which \$0.5 million was capitalized as part of the acquisition price and \$0.3 million was expensed (\$0.4 million was expensed in the first quarter and we had a \$0.1 million reversal of expenses in the second quarter due to overestimating certain of these expected costs in the first quarter). In addition, the transaction included \$3.7 million for the personal property and real-estate associated with these branches.

**Discontinued operations** On January 15, 2007, Mepco Insurance Premium Financing, Inc., now known as Mepco Finance Corporation ( Mepco ), a wholly-owned subsidiary of Independent



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Bank Corporation, sold substantially all of its assets related to the insurance premium finance business to Premium Financing Specialists, Inc. ( PFS ). Mepco continues to own and operate its warranty payment plan business. As a result of this transaction, we received \$176.0 million of cash that was utilized to payoff Brokered CD s and short-term borrowings at Mepco s parent company, Independent Bank. Under the terms of the sale, PFS also assumed approximately \$11.7 million in liabilities. In the fourth quarter of 2006, we recorded a loss of \$0.2 million and accrued for approximately \$1.1 million of expenses related to the disposal of this business. We also allocated \$4.1 million of goodwill and \$0.3 million of other intangible assets to this business. Revenues and expenses associated with Mepco s insurance premium finance business have been presented as discontinued operations in the Consolidated Statements of Operations. Likewise, the assets and liabilities associated with this business have been reclassified to discontinued operations in the Consolidated Statements of Financial Condition. We have elected to not make any reclassifications for discontinued operations in the Consolidated Statements of Cash Flows.

**Financial Condition**

**Summary** Our total assets decreased by \$168.6 million during the first six months of 2007. The decrease in total assets primarily reflects the aforementioned sale of our insurance premium finance business. Loans, excluding loans held for sale ( Portfolio Loans ), totaled \$2.494 billion at June 30, 2007, an increase of \$10.2 million from December 31, 2006. (See Portfolio Loans and asset quality. ) Deposits totaled \$2.794 billion at June 30, 2007, compared to \$2.603 billion at December 31, 2006. The \$191.4 million increase in total deposits during the period principally reflects the aforementioned branch acquisition, partially offset by a decline in Brokered CD s. Other borrowings totaled \$55.2 million at June 30, 2007, a decrease of \$108.5 million from December 31, 2006. This was primarily attributable to the payoff of maturing borrowings with funds from the branch acquisition.

**Securities** We maintain diversified securities portfolios, which may include obligations of the U.S. Treasury and government-sponsored agencies as well as securities issued by states and political subdivisions, corporate securities, mortgage-backed securities and asset-backed securities. We also invest in capital securities, which include preferred stocks and trust preferred securities. We regularly evaluate asset/liability management needs and attempt to maintain a portfolio structure that provides sufficient liquidity and cash flow. We believe that the unrealized losses on securities available for sale are temporary in nature and due primarily to changes in interest rates and are expected to be recovered within a reasonable time period. We also believe that we have the ability to hold securities with unrealized losses to maturity or until such time as the unrealized losses reverse. (See Asset/liability management. )

**Securities**

|                               | Amortized<br>Cost | Unrealized |         | Fair<br>Value |
|-------------------------------|-------------------|------------|---------|---------------|
|                               |                   | Gains      | Losses  |               |
| Securities available for sale |                   |            |         |               |
| June 30, 2007                 | \$415,921         | \$4,799    | \$5,043 | \$415,677     |
| December 31, 2006             | 430,262           | 7,367      | 2,844   | 434,785       |

Securities available for sale declined during the first six months of 2007 because the lack of slope in the yield curve has created a difficult environment for constructing investment security transactions that meet our profitability objectives. Generally we cannot earn the same interest-

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rate spread on securities as we can on Portfolio Loans. As a result, purchases of securities will tend to erode some of our profitability measures, including our return on assets.

At June 30, 2007 and December 31, 2006, we had \$11.3 million and \$12.5 million, respectively, of asset-backed securities included in securities available for sale. All of our asset-backed securities are backed by mobile home loans and all are rated as investment grade (by the major rating agencies) except for one security with a book value of \$1.6 million at June 30, 2007 that was down graded during 2004 to a below investment grade rating. We did not record any impairment charges on this security during 2007 or 2006 but we did record an impairment charge of \$0.2 million on this security in 2005 due primarily to credit related deterioration on the underlying mobile home loan collateral. We continue to closely monitor this particular security as well as our entire mobile home loan asset-backed securities portfolio. We do not foresee, at the present time, any significant risk of loss (related to credit issues) with respect to any of our other asset-backed securities. We did not record impairment charges on any other investment securities during the first six months of 2007 or 2006.

Sales of securities available for sale were as follows (See Non-interest income. ):

|                    | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|--------------------|--------------------------------|----------|------------------------------|----------|
|                    | 2007                           | 2006     | 2007                         | 2006     |
|                    | (in thousands)                 |          |                              |          |
| Proceeds           | \$ 9,124                       | \$ 1,283 | \$ 15,491                    | \$ 1,283 |
| Gross gains        | \$ 128                         | \$ 171   | \$ 225                       | \$ 171   |
| Gross losses       |                                |          | (18)                         |          |
| Impairment charges |                                |          |                              |          |
| Net Gains          | \$ 128                         | \$ 171   | \$ 207                       | \$ 171   |

**Portfolio loans and asset quality** In addition to the communities served by our bank branch networks, our principal lending markets also include nearby communities and metropolitan areas. Subject to established underwriting criteria, we also participate in commercial lending transactions with certain non-affiliated banks and may also purchase real estate mortgage loans from third-party originators.

Currently the management and board of directors of each of our banks retain authority and responsibility for credit decisions, although we have adopted uniform underwriting standards for each of the banks. Further, our loan committee structure as well as the centralization of commercial loan credit services and the loan review process, attempt to provide requisite controls and promote compliance with such established underwriting standards. Such centralized functions also facilitate compliance with consumer protection laws and regulations. There can be no assurance that the aforementioned centralization of certain lending procedures and the use of uniform underwriting standards will prevent us from the possibility of incurring significant credit losses in our lending activities and in fact the provision for loan losses increased significantly in the first six months of 2007 (as well as in the fourth quarter of 2006).

One of the purposes of the aforementioned bank charter consolidation is to promote even stronger risk management practices, particularly in the area of credit risk management. We hired a new Chief Lending Officer (CLO) in April 2007. The CLO has or is in the process of implementing several changes in our credit processes, including:

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Functional alignment of lending and credit across all of our markets in anticipation of our bank charter consolidation;

The strategic direction of commercial lending has been focused on the need for more diversification in the commercial loan portfolio to reduce the weighting of commercial real estate in the portfolio; and

Expansion of certain functions including implementation of a special assets group to provide stronger management of our most troubled loans.

Our 2003 acquisition of Mepco added the financing of insurance premiums for businesses and payment plans to purchase vehicle service contracts for consumers (warranty finance) to our lending activities. In January 2007 we sold Mepco's insurance premium finance business. Mepco conducts its warranty finance activities across the United States. Mepco generally does not evaluate the creditworthiness of the individual customer but instead primarily relies on the payment plan collateral (the unearned vehicle service contract and unearned sales commission) in the event of default. As a result, we have established and monitor counterparty concentration limits in order to manage our collateral exposure. The counterparty concentration limits are primarily based on the AM Best rating and statutory surplus level for an insurance company and on other factors, including financial evaluation and distribution of concentrations, for warranty administrators and warranty sellers/dealers. The sudden failure of one of Mepco's major counterparties (an insurance company or warranty administrator) could expose us to significant losses.

Mepco also has established procedures for payment plan servicing/administration and collections, including the timely cancellation of the vehicle service contract, in order to protect our collateral position in the event of default. Mepco also has established procedures to attempt to prevent and detect fraud since the payment plan origination activities and initial customer contact is entirely done through unrelated third parties (automobile warranty administrators and sellers or automobile dealerships). There can be no assurance that the aforementioned risk management policies and procedures will prevent us from the possibility of incurring significant credit or fraud related losses in this business segment.

We generally retain loans that may be profitably funded within established risk parameters. (See Asset/liability management. ) As a result, we may hold adjustable-rate and balloon real estate mortgage loans as Portfolio Loans, while 15- and 30-year, fixed-rate obligations are generally sold to mitigate exposure to changes in interest rates. (See Non-interest income. )

Future growth of overall Portfolio Loans is dependent upon a number of competitive and economic factors. There was little growth in Portfolio loans during the first six months of 2007 reflecting both weak economic conditions in Michigan as well as a very competitive pricing climate. Declines in Portfolio Loans or continuing competition that leads to lower relative pricing on new Portfolio Loans could adversely impact our future operating results. We continue to view loan growth consistent with established quality and profitability standards as a major short and long-term challenge.

**Table of Contents****Non-performing assets**

|  | June 30,<br>2007       | December<br>31,<br>2006 |
|--|------------------------|-------------------------|
|  | (dollars in thousands) |                         |
| Non-accrual loans  | \$ 47,544              | \$ 35,683               |
| Loans 90 days or more past due and still accruing interest     | 7,165                  | 3,479                   |
| Restructured loans   | 181                    | 60                      |
| <br>   |                        |                         |
| Total non-performing loans                                     | 54,890                 | 39,222                  |
| Other real estate  | 5,363                  | 3,153                   |
| <br>   |                        |                         |
| Total non-performing assets                                    | \$ 60,253              | \$ 42,375               |
| <br>   |                        |                         |
| As a percent of Portfolio Loans                                |                        |                         |
| Non-performing loans   | 2.20%                  | 1.58%                   |
| Allowance for loan losses                                      | 1.53                   | 1.08                    |
| Non-performing assets to total assets                          | 1.85                   | 1.24                    |
| Allowance for loan losses as a percent of non-performing loans | 70                     | 69                      |

The increase in non-performing loans since year end 2006 is due primarily to an increase in non-performing commercial loans (up \$11.1 million) and real estate mortgage loans (up \$5.4 million). The increase in non-performing commercial loans is primarily attributable to the addition of several large credits with real estate developers becoming past due in the first six months of 2007. These delinquencies largely reflect cash flow difficulties encountered by many real estate developers in Michigan associated with a significant decline in sales of residential real estate.

The increase in non-performing real estate mortgage loans is primarily due to a rise in foreclosures reflecting both weak economic conditions and soft residential real estate values in many parts of Michigan.

Other real estate ( ORE ) and repossessed assets totaled \$5.4 million and \$3.2 million at June 30, 2007 and December 31, 2006, respectively. This increase is primarily a result of a \$2.1 million rise in commercial ORE.

We will place a loan that is 90 days or more past due on non-accrual, unless we believe the loan is both well secured and in the process of collection. Accordingly, we have determined that the collection of the accrued and unpaid interest on any loans that are 90 days or more past due and still accruing interest is probable.

The ratio of loan net charge-offs to average loans was 0.92% on an annualized basis in the first half of 2007 (or \$11.3 million) compared to 0.24% in the first half of 2006 (or \$2.8 million). The rise in loan net charge-offs reflect increases in the following categories: commercial loans \$7.1 million; real estate mortgage loans \$0.7 million; and installment/consumer loans \$0.7 million.

The increase in commercial loan net charge-offs in the second half of 2007 primarily reflects \$4.1 million of charge-offs on four credits during the second quarter. The single largest charge-off was \$1.7 million on a commercial real estate development loan with a net balance of \$3.3 million (after the charge-off) that was included in loans held for sale as of June 30, 2007. An agreement to sell this loan was executed on June 29, 2007 and the sale was completed (funded) in early July. The commercial loan net charge-offs also include a \$1.0 million charge-off relating to a commercial lending relationship in the Lansing, Michigan area that involved borrower fraud.

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The remainder of the increases in loan net charge-offs primarily reflect higher levels of non-performing assets and lower collateral liquidation values, particularly on residential real estate. At June 30, 2007, the allowance for loan losses totaled \$38.2 million, or 1.53% of Portfolio Loans compared to \$26.9 million, or 1.08% of Portfolio Loans at December 31, 2006.

Impaired loans totaled approximately \$37.7 million and \$12.2 million at June 30, 2007 and 2006, respectively. At those same dates, certain impaired loans with balances of approximately \$31.2 million and \$9.1 million, respectively had specific allocations of the allowance for loan losses, which totaled approximately \$8.9 million and \$2.0 million, respectively. Our average investment in impaired loans was approximately \$30.2 million and \$9.6 million for the six-month periods ended June 30, 2007 and 2006, respectively. Cash receipts on impaired loans on non-accrual status are generally applied to the principal balance. Interest income recognized on impaired loans was approximately \$0.2 million and \$0.1 million in the first six months of 2007 and 2006, respectively, of which the majority of these amounts were received in cash.

**Allowance for loan losses**

|  | Six months ended<br>June 30, |                         |           |                         |
|--|------------------------------|-------------------------|-----------|-------------------------|
|  | 2007                         |                         |           | 2006                    |
|  | Loans                        | Unfunded<br>Commitments | Loans     | Unfunded<br>Commitments |
|  | (in thousands)               |                         |           |                         |
| Balance at beginning of period         | \$ 26,879                    | \$ 1,881                | \$ 22,420 | \$ 1,820                |
| Additions (deduction)                  |                              |                         |           |                         |
| Provision charged to operating expense | 22,658                       | 374                     | 3,979     | (82)                    |
| Recoveries credited to allowance       | 1,140                        |                         | 1,225     |                         |
| Loans charged against the allowance    | (12,464)                     |                         | (4,056)   |                         |
| Balance at end of period               | \$ 38,213                    | \$ 2,255                | \$ 23,568 | \$ 1,738                |

Net loans charged against the allowance to average Portfolio Loans (annualized)

0.92%

0.24%

In determining the allowance and the related provision for loan losses, we consider four principal elements:

(i) specific allocations based upon probable losses identified during the review of the loan portfolio, (ii) allocations established for other adversely rated loans, (iii) allocations based principally on historical loan loss experience, and (iv) additional allowances based on subjective factors, including local and general economic business factors and trends, portfolio concentrations and changes in the size, mix and/or the general terms of the loan portfolios.

The first element reflects our estimate of probable losses based upon our systematic review of specific loans. These estimates are based upon a number of objective factors, such as payment history, financial condition of the borrower, and discounted collateral exposure.

The second element reflects the application of our loan rating system. This rating system is similar to those employed by state and federal banking regulators. Loans that are rated below a certain predetermined classification are assigned a loss allocation factor for each loan classification category that is based upon a historical analysis of losses incurred. The lower the rating assigned to a loan or category, the greater the allocation percentage that is applied.

The third element is determined by assigning allocations based principally upon the ten-year average of loss experience for each type of loan. Recent years are weighted more heavily in this average. Average losses may be further adjusted based on the current delinquency rate. Loss analyses are conducted at least annually.

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The fourth element is based on factors that cannot be associated with a specific credit or loan category and reflects our attempt to ensure that the overall allowance for loan losses appropriately reflects a margin for the imprecision necessarily inherent in the estimates of expected credit losses. We consider a number of subjective factors when determining the unallocated portion, including local and general economic business factors and trends, portfolio concentrations and changes in the size, mix and the general terms of the loan portfolios. (See Provision for credit losses. )

Mepco's allowance for loan losses is determined in a similar manner as discussed above and takes into account delinquency levels, net charge-offs, unsecured exposure and other subjective factors deemed relevant to their lending activities.

**Allocation of the Allowance for Loan Losses**

|  | June 30,<br>2007 | December<br>31,<br>2006 |
|--|------------------|-------------------------|
|  | (in thousands)   |                         |
| Specific allocations                               | \$ 9,070         | \$ 2,631                |
| Other adversely rated loans                        | 10,905           | 9,303                   |
| Historical loss allocations                        | 10,089           | 7,482                   |
| Additional allocations based on subjective factors | 8,149            | 7,463                   |
|  | \$38,213         | \$26,879                |

**Deposits and borrowings** Our competitive position within many of the markets served by our bank branch networks limits the ability to materially increase deposits without adversely impacting the weighted-average cost of core deposits. Accordingly, we compete principally on the basis of convenience and personal service, while employing pricing tactics that are intended to enhance the value of core deposits.

To attract new core deposits, we have implemented a high-performance checking program that utilizes a combination of direct mail solicitations, in-branch merchandising, gifts for customers opening new checking accounts or referring business to our banks and branch staff sales training. This program has generated increases in customer relationships as well as deposit service charges. We believe that the new relationships that result from these marketing and sales efforts provide valuable opportunities to cross sell related financial products and services.

Over the past two to three years we have also expanded our treasury management products and services for commercial businesses and municipalities or other governmental units and have also increased our sales calling efforts in order to attract additional deposit relationships from these sectors. Despite these efforts our core deposit growth has generally not kept pace with the growth of our Portfolio Loans and we have primarily utilized brokered certificates of deposit ( Brokered CD s ) to fund this Portfolio Loan growth. We view long-term core deposit growth as a significant challenge. To partially address this challenge, in March 2007 we completed the acquisition of ten branches with deposits totaling \$241.4 million as described above. Core deposits generally provide a more stable and lower cost source of funds than alternate sources such as short-term borrowings. As a result, the continued funding of Portfolio Loan growth with alternative sources of funds (as opposed to core deposits) may erode certain of our profitability measures, such as return on assets, and may also adversely impact our liquidity. (See Liquidity and capital resources. ) We have implemented strategies that incorporate federal funds purchased, other borrowings and Brokered CDs to fund a portion of our increases in interest earning assets. The use of such alternate sources of funds supplements our core deposits and is also an integral part of our asset/liability management efforts.

**Table of Contents****Alternative Sources of Funds**

|   | Amount    | June 30,<br>2007<br>Average<br>Maturity | Rate  | Amount<br>(dollars in thousands) | December 31,<br>2006<br>Average<br>Maturity | Rate  |
|---|-----------|---|-------|----------------------------------|---|-------|
| Brokered CDs <sup>(1, 2)</sup>                                      | \$812,929 | 1.7<br>years                            | 4.71% | \$1,055,010                      | 1.9<br>years                                | 4.72% |
| Fixed rate FHLB<br>advances <sup>(1, 3)</sup>                       | 43,199    | 5.6<br>years                            | 6.08  | 58,272                           | 4.6<br>years                                | 5.66  |
| Variable rate FHLB<br>advances <sup>(1)</sup>                       |           |   |       | 2,000                            | 0.5<br>years                                | 5.31  |
| Securities sold under<br>agreements to<br>Repurchase <sup>(1)</sup> |           |   |       | 83,431                           | 0.1<br>years                                | 5.34  |
| Federal funds purchased   | 17,517    | 1 day                                   | 5.50  | 84,081                           | 1 day                                       | 5.40  |
| Total   | \$873,645 | 1.9<br>years                            | 4.80% | \$1,282,794                      | 1.8<br>years                                | 4.85% |

(1) Certain of these items have had their average maturity and rate altered through the use of derivative instruments, including pay-fixed and pay-variable interest rate swaps.

(2) The balance of Brokered CD s at December 31, 2006 includes \$165.496 million related to discontinued operations.

(3) Advances totaling \$10.0 million at both June 30,

2007 and  
December 31,  
2006,  
respectively, have  
provisions that  
allow the FHLB  
to convert  
fixed-rate  
advances to  
adjustable rates  
prior to stated  
maturity.

Other borrowed funds, principally advances from the Federal Home Loan Bank (the FHLB ) and securities sold under agreements to repurchase ( Repurchase Agreements ), totaled \$55.2 million at June 30, 2007, compared to \$163.7 million at December 31, 2006. The \$108.5 million decrease in other borrowed funds principally reflects the payoff of maturing FHLB advances and Repurchase Agreements with proceeds from the aforementioned branch acquisition as does the \$66.6 million decrease in federal funds purchased.

At June 30, 2007, we were out of compliance with certain financial covenants relating to our \$10.0 million unsecured revolving credit agreement. The failure to meet certain of these covenants is due to our earnings performance for the second quarter, as well as the relative amount of our non-performing loans and non-performing assets. Based upon communications from our lender, it is expected that we will obtain the necessary waivers of noncompliance and/or modification of our loan covenants.

Derivative financial instruments are employed to manage our exposure to changes in interest rates. (See Asset/liability management. ) At June 30, 2007, we employed interest-rate swaps with an aggregate notional amount of \$526.2 million and interest rate caps with an aggregate notional amount of \$265.5 million. (See note #6 of Notes to Interim Consolidated Financial Statements.)

**Liquidity and capital resources** Liquidity risk is the risk of being unable to timely meet obligations as they come due at a reasonable funding cost or without incurring unacceptable losses. Our liquidity management involves the measurement and monitoring of a variety of sources and uses of funds. Our Consolidated Statements of Cash Flows categorize these sources and uses into operating, investing and financing activities. We primarily focus our liquidity management on developing access to a variety of borrowing sources to supplement our deposit gathering activities and provide funds for growing our investment and loan portfolios as well as to be able to respond to unforeseen liquidity needs.

Our sources of funds include a stable deposit base, secured advances from the Federal Home Loan Bank of Indianapolis, both secured and unsecured federal funds purchased borrowing facilities with other commercial banks, an unsecured holding company credit facility and access to the capital markets (for trust preferred securities and Brokered CD s).



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At June 30, 2007, we had \$857.1 million of time deposits that mature in the next twelve months. Historically, a majority of these maturing time deposits are renewed by our customers or are Brokered CD s that we expect to replace. Additionally, \$1.306 billion of our deposits at June 30, 2007, were in account types from which the customer could withdraw the funds on demand. Changes in the balances of deposits that can be withdrawn upon demand are usually predictable and the total balances of these accounts have generally grown over time as a result of our marketing and promotional activities. There can be no assurance that historical patterns of renewing time deposits or overall growth in deposits will continue in the future. In addition, since our recent acquisition of ten branches and initial assumption of \$241.4 million of deposits we have experienced a higher level of deposit account attrition at these branches. We have endeavored to make the transition for these new customers as smooth as possible in order to try and minimize this attrition. Since the date of acquisition (through June 30, 2007) we have experienced approximately 6.3% attrition in these deposit balances. Most of this attrition occurred in March, April and May 2007 (shortly after the data processing conversion) and these deposit balances rose modestly in June. The loss of a large amount of these deposits could have an adverse impact on our results of operations.

We have developed contingency funding plans that stress tests our liquidity needs that may arise from certain events such as an adverse credit event, rapid loan growth or a disaster recovery situation. Our liquidity management also includes periodic monitoring of each bank that segregates assets between liquid and illiquid and classifies liabilities as core and non-core. This analysis compares our total level of illiquid assets to our core funding. It is our goal to have core funding sufficient to finance illiquid assets.

Effective management of capital resources is critical to our mission to create value for our shareholders. The cost of capital is an important factor in creating shareholder value and, accordingly, our capital structure includes unsecured debt and cumulative trust preferred securities.

We also believe that a diversified portfolio of quality loans will provide superior risk-adjusted returns. Accordingly, we have implemented balance sheet management strategies that combine efforts to originate Portfolio Loans with disciplined funding strategies. Acquisitions have also been an integral component of our capital management strategies.

We have three special purpose entities that have issued \$70.1 million of cumulative trust preferred securities outside of Independent Bank Corporation that currently qualify as Tier 1 capital. These entities have also issued common securities and capital to Independent Bank Corporation. Independent Bank Corporation, in turn, issued subordinated debentures to these special purpose entities equal to the trust preferred securities, common securities and capital issued. The subordinated debentures represent the sole asset of the special purpose entities. The common securities, capital and subordinated debentures are included in our Consolidated Statements of Financial Condition at June 30, 2007, and December 31, 2006.

We redeemed (at par) \$5.0 million of existing trust preferred securities (including \$0.75 million owned by IB) on May 31, 2007. On May 31, 2007 we also issued \$12.0 million in new trust preferred securities in a pooled offering through a newly formed entity IBC Capital Finance III. The rate on the new trust preferred securities was approximately 2% lower than the existing trust preferred securities that were redeemed on May 31, 2007. We also anticipate redeeming an additional \$7.5 million of existing trust preferred securities in November 2007.

In March 2006, the Federal Reserve Board issued a final rule that retains trust preferred securities in the Tier 1 capital of bank holding companies. After a transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements will be limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated

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deferred tax liability). The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. Based upon our existing levels of Tier 1 capital, trust preferred securities and goodwill, this final Federal Reserve Board rule would have reduced our Tier 1 capital to average assets ratio by approximately 52 basis points at June 30, 2007, (this calculation assumes no transition period).

To supplement our balance sheet and capital management activities, we periodically repurchase our common stock. The level of share repurchases in a given year generally reflects changes in our need for capital associated with our balance sheet growth. We previously disclosed that our board of directors had authorized the repurchase of up to 750,000 shares. This authorization expires on December 31, 2007. We did not repurchase any shares during the second quarter of 2007, however, during the first quarter of 2007 we repurchased 295,000 shares at a weighted average price of \$20.30 per share. As a result of an increase in intangible assets associated with the above described branch acquisition our tangible capital ratio declined to 5.03% at June 30, 2007. Our internal Capital Policy requires a minimum tangible capital ratio of at least 5% and a targeted tangible capital ratio range of 5.50% to 6.50%. Since we are currently outside of this range, it is unlikely that we will be repurchasing any shares of our common stock over the next two quarters (or until such time as our tangible capital ratio returns to the targeted range).

**Capitalization**

|   | June 30,<br>2007 | December<br>31,<br>2006 |
|---|------------------|-------------------------|
|   | (in thousands)   |                         |
| Unsecured debt                              | \$ 4,000         | \$ 5,000                |
| Subordinated debentures                     | 72,269           | 64,197                  |
| Amount not qualifying as regulatory capital | (2,169)          | (1,847)                 |
| Amount qualifying as regulatory capital     | 70,100           | 62,350                  |
| Shareholders' Equity                        |                  |                         |
| Preferred stock, no par value               |                  |                         |
| Common stock, par value \$1.00 per share    | 22,586           | 22,865                  |
| Capital surplus                             | 195,014          | 200,241                 |
| Retained earnings                           | 26,138           | 31,420                  |
| Accumulated other comprehensive income      | 296              | 3,641                   |
| Total shareholders' equity                  | 244,034          | 258,167                 |
| Total capitalization                        | \$ 318,134       | \$ 325,517              |

Total shareholders' equity at June 30, 2007 decreased \$14.1 million from December 31, 2006, due primarily to share repurchases and cash dividends declared as well as a \$3.3 million decrease in accumulated other comprehensive income. Shareholders' equity totaled \$244.0 million, equal to 7.48% of total assets at June 30, 2007. At December 31, 2006, shareholders' equity was \$258.2 million, which was equal to 7.53% of total assets.

**Capital ratios**

|   | June 30,<br>2007 | December 31,<br>2006 |
|---|------------------|----------------------|
| Equity capital                            | 7.48%            | 7.53%                |
| Tier 1 leverage (tangible equity capital) | 7.19             | 7.62                 |

|                           |       |       |
|---------------------------|-------|-------|
| Tier 1 risk-based capital | 9.24  | 9.62  |
| Total risk-based capital  | 10.50 | 10.75 |

**Asset/liability management** Interest-rate risk is created by differences in the cash flow characteristics of our assets and liabilities. Options embedded in certain financial instruments,

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including caps on adjustable-rate loans as well as borrowers' rights to prepay fixed-rate loans also create interest-rate risk.

Our asset/liability management efforts identify and evaluate opportunities to structure the balance sheet in a manner that is consistent with our mission to maintain profitable financial leverage within established risk parameters. We evaluate various opportunities and alternate balance-sheet strategies carefully and consider the likely impact on our risk profile as well as the anticipated contribution to earnings. The marginal cost of funds is a principal consideration in the implementation of our balance-sheet management strategies, but such evaluations further consider interest-rate and liquidity risk as well as other pertinent factors. We have established parameters for interest-rate risk. We regularly monitor our interest-rate risk and report quarterly to our respective banks' boards of directors.

We employ simulation analyses to monitor each bank's interest-rate risk profiles and evaluate potential changes in each bank's net interest income and market value of portfolio equity that result from changes in interest rates. The purpose of these simulations is to identify sources of interest-rate risk inherent in our balance sheets. The simulations do not anticipate any actions that we might initiate in response to changes in interest rates and, accordingly, the simulations do not provide a reliable forecast of anticipated results. The simulations are predicated on immediate, permanent and parallel shifts in interest rates and generally assume that current loan and deposit pricing relationships remain constant. The simulations further incorporate assumptions relating to changes in customer behavior, including changes in prepayment rates on certain assets and liabilities.

**Results of Operations**

**Summary** Net income from continuing operations totaled \$0.1 million and \$4.0 million during the three- and six-month periods ended June 30, 2007. The declines in net income from continuing operations from the comparative periods in 2006 are primarily a result of significant increases in the provision for loan losses. Decreases in net interest income and increases in non-interest expenses also contributed to the decline in net income. Partially offsetting these items were increases in service charges on deposits and VISA check card interchange income and a decrease in income tax expense. The second quarter of 2007 included \$1.0 million of severance expenses associated with our staff reduction initiatives. The second quarter of 2006 included a \$0.6 million goodwill impairment charge (included in non-interest expense). Year to date 2006 results from continuing operations also include \$2.8 million of other income related to the settlement of litigation involving the former owners of Mepco.

**Table of Contents****Key performance ratios**

|  | Three months ended<br>June 30, |         | Six months ended<br>June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2007                           | 2006    | 2007                         | 2006    |
| Net income from continuing operations<br>(annualized) to |                                |         |                              |         |
| Average assets   | 0.01%                          | 1.23%   | 0.25%                        | 1.40%   |
| Average equity   | 0.17                           | 16.37   | 3.14                         | 18.80   |
| Net income (loss) (annualized) to                        |                                |         |                              |         |
| Average assets   | (0.01)%                        | 1.25%   | 0.26%                        | 1.37%   |
| Average equity   | (0.07)                         | 16.65   | 3.30                         | 18.37   |
| Income per common share from continuing<br>operations    |                                |         |                              |         |
| Basic  | \$ 0.00                        | \$ 0.45 | \$0.18                       | \$ 1.02 |
| Diluted  | 0.00                           | 0.45    | 0.17                         | 1.01    |
| Net income (loss) per common share                       |                                |         |                              |         |
| Basic  | \$ 0.00                        | \$ 0.46 | \$0.18                       | \$ 1.00 |
| Diluted  | 0.00                           | 0.45    | 0.18                         | 0.98    |

We believe that our earnings per share growth rate over a long period of time (five years or longer) is the best single measure of our performance. We strive to achieve an average annual long term earnings per share growth rate of approximately 10%. Accordingly, our focus is on long-term results taking into consideration that certain components of our revenues are cyclical in nature (such as mortgage-banking) which can cause fluctuations in our earnings per share from one period to another. Our primary strategies for achieving long-term growth in earnings per share include: earning asset growth (both organic and through acquisitions), diversification of revenues (within the financial services industry), effective capital management (efficient use of our shareholders' equity) and sound risk management (credit, interest rate, liquidity and regulatory risks). As we have grown in size, and also considering the relatively low economic growth rates in Michigan (our primary market for banking), we believe achieving a 10% average annual long-term growth rate in earnings per share will be challenging. Based on these standards, we did not achieve our profitability objectives in the first half of 2007 (or in the last three quarters of 2006). We did however achieve an average annual compound growth rate in earnings per share of 18% for the five year period from 2000 through 2005. Our discussion and analysis of results of operations and financial condition will focus on these elements.

**Net interest income** Net interest income is the most important source of our earnings and thus is critical in evaluating our results of operations. Changes in our tax equivalent net interest income are primarily influenced by our level of interest-earning assets and the income or yield that we earn on those assets and the manner by which we fund (and the related cost of funding) such interest-earning assets. Certain macro-economic factors can also influence our net interest income such as the level and direction of interest rates, the difference between short-term and long-term interest rates (the steepness of the yield curve) and the general strength of the economies in which we are doing business. Finally, risk management plays an important role in our level of net interest income. The ineffective management of credit risk and interest-rate risk in particular can adversely impact our net interest income.

Tax equivalent net interest income decreased by 3.7% to \$32.1 million and by 5.2% to \$63.3 million, respectively, during the three- and six-month periods in 2007 compared to 2006. These decreases reflect a decline in tax equivalent net interest income as a percent of average interest-earning assets ( Net Yield ) that was partially offset by an increase in average interest-earning assets.

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We review yields on certain asset categories and our net interest margin on a fully taxable equivalent basis. This presentation is not in accordance with generally accepted accounting principles ( GAAP ) but is customary in the banking industry. In this non-GAAP presentation, net interest income is adjusted to reflect tax-exempt interest income on an equivalent before-tax basis. This measure ensures comparability of net interest income arising from both taxable and tax-exempt sources. The adjustments to determine tax equivalent net interest income were \$1.6 million and \$1.7 million for the second quarters of 2007 and 2006, respectively, and were \$3.2 million and \$3.4 million for the first six months of 2007 and 2006, respectively. These adjustments were computed using a 35% tax rate. Average interest-earning assets totaled \$3.005 billion and \$2.987 billion during the three- and six-month periods in 2007, respectively. The increases in average interest-earning assets are due primarily to growth in loans. Our Net Yield decreased by 26 basis points to 4.27% during the second quarter of 2007 and also by 33 basis points to 4.25% during the first six months of 2007 as compared to the like periods in 2006. These declines primarily reflect the impact of a relatively flat yield curve environment. Our yields on interest-earning assets have increased in 2007 compared to 2006 which primarily reflects increased short-term interest rates that has resulted in variable rate loans re-pricing at higher rates. However, the increases in the yields on average interest-earning assets were more than offset by rises in our cost of funds. The increase in our cost of funds also primarily reflects higher short-term interest rates that has resulted in increased rates on certain short-term and variable rate borrowings and higher rates on deposits.

**Table of Contents****Average Balances and Tax Equivalent Rates**

|  | Three Months Ended<br>June 30, |                  |              |                     |                  |              |
|--|--------------------------------|------------------|--------------|---------------------|------------------|--------------|
|  | 2007                           |                  |              | 2006                |                  |              |
|  | Average<br>Balance             | Interest         | Rate         | Average<br>Balance  | Interest         | Rate         |
|  | (dollars in thousands)         |                  |              |                     |                  |              |
| <b>Assets</b>  |                                |                  |              |                     |                  |              |
| Taxable loans <sup>(1)</sup>   | \$ 2,523,614                   | \$ 50,468        | 8.01%        | \$ 2,461,397        | \$ 48,362        | 7.87%        |
| Tax-exempt loans <sup>(1,2)</sup>  | 9,761                          | 166              | 6.82         | 6,577               | 115              | 7.01         |
| Taxable securities   | 202,342                        | 2,592            | 5.14         | 210,785             | 2,797            | 5.32         |
| Tax-exempt securities <sup>(2)</sup>                                     | 230,873                        | 4,069            | 7.07         | 248,301             | 4,498            | 7.27         |
| Other investments  | 38,068                         | 464              | 4.89         | 17,359              | 199              | 4.60         |
| <b>Interest Earning Assets - Continuing Operations</b>                   | <b>3,004,658</b>               | <b>57,759</b>    | <b>7.70</b>  | <b>2,944,419</b>    | <b>55,971</b>    | <b>7.62</b>  |
| Cash and due from banks  | 49,947                         |                  |              | 52,906              |                  |              |
| Taxable loans discontinued operations                                    | 744                            |                  |              | 201,017             |                  |              |
| Other assets, net  | 230,147                        |                  |              | 210,694             |                  |              |
| <b>Total Assets</b>  | <b>\$ 3,285,496</b>            |                  |              | <b>\$ 3,409,036</b> |                  |              |
| <b>Liabilities</b>   |                                |                  |              |                     |                  |              |
| Savings and NOW  | \$ 994,116                     | 4,728            | 1.91         | \$ 850,491          | 3,077            | 1.45         |
| Time deposits  | 1,521,496                      | 18,650           | 4.92         | 1,354,352           | 13,894           | 4.11         |
| Long-term debt   | 2,495                          | 29               | 4.66         | 4,495               | 52               | 4.64         |
| Other borrowings   | 129,781                        | 2,284            | 7.06         | 398,925             | 5,655            | 5.69         |
| <b>Interest Bearing Liabilities- Continuing Operations</b>               | <b>2,647,888</b>               | <b>25,691</b>    | <b>3.89</b>  | <b>2,608,263</b>    | <b>22,678</b>    | <b>3.49</b>  |
| Demand deposits  | 300,329                        |                  |              | 277,340             |                  |              |
| Time deposits discontinued operations                                    | 527                            |                  |              | 176,316             |                  |              |
| Other liabilities  | 82,591                         |                  |              | 91,716              |                  |              |
| Shareholders equity  | 254,161                        |                  |              | 255,401             |                  |              |
| <b>Total liabilities and shareholders equity</b>                         | <b>\$ 3,285,496</b>            |                  |              | <b>\$ 3,409,036</b> |                  |              |
| <b>Tax Equivalent Net Interest Income</b>                                |                                | <b>\$ 32,068</b> |              |                     | <b>\$ 33,293</b> |              |
| <b>Tax Equivalent Net Interest Income as a Percent of Earning Assets</b> |                                |                  | <b>4.27%</b> |                     |                  | <b>4.53%</b> |

(1) All domestic

- (2) Interest on tax-exempt loans and securities is presented on a fully tax equivalent basis assuming a marginal tax rate of 35%



**Table of Contents****Average Balances and Tax Equivalent Rates**

|  | Six Months Ended<br>June 30, |                  |              |                     |                  |              |
|--|------------------------------|------------------|--------------|---------------------|------------------|--------------|
|  | 2007                         |                  |              | 2006                |                  |              |
|  | Average<br>Balance           | Interest         | Rate         | Average<br>Balance  | Interest         | Rate         |
|  | (dollars in thousands)       |                  |              |                     |                  |              |
| <b>Assets</b>  |                              |                  |              |                     |                  |              |
| Taxable loans <sup>(1)</sup>   | \$ 2,517,273                 | \$ 100,317       | 8.01%        | \$ 2,434,790        | \$ 94,340        | 7.79%        |
| Tax-exempt loans <sup>(1,2)</sup>  | 9,639                        | 326              | 6.82         | 6,237               | 220              | 7.11         |
| Taxable securities   | 193,787                      | 5,069            | 5.27         | 216,082             | 5,645            | 5.27         |
| Tax-exempt securities <sup>(2)</sup>                                     | 234,741                      | 8,190            | 7.04         | 251,482             | 9,031            | 7.24         |
| Other investments  | 31,850                       | 778              | 4.93         | 17,398              | 422              | 4.89         |
| <b>Interest Earning Assets - Continuing Operations</b>                   |                              |                  |              |                     |                  |              |
|  | 2,987,290                    | 114,680          | 7.72         | 2,925,989           | 109,658          | 7.54         |
| Cash and due from banks  | 51,907                       |                  |              | 54,012              |                  |              |
| Taxable loans discontinued operations                                    | 16,737                       |                  |              | 198,099             |                  |              |
| Other assets, net  | 218,120                      |                  |              | 207,656             |                  |              |
| <b>Total Assets</b>  | <b>\$ 3,274,054</b>          |                  |              | <b>\$ 3,385,756</b> |                  |              |
| <b>Liabilities</b>   |                              |                  |              |                     |                  |              |
| Savings and NOW  | \$ 949,021                   | 8,977            | 1.91         | \$ 864,533          | 6,065            | 1.41         |
| Time deposits  | 1,514,266                    | 36,809           | 4.90         | 1,358,177           | 26,833           | 3.98         |
| Long-term debt   | 2,743                        | 63               | 4.63         | 4,743               | 109              | 4.63         |
| Other borrowings   | 164,529                      | 5,554            | 6.81         | 360,862             | 9,922            | 5.54         |
| <b>Interest Bearing Liabilities- Continuing Operations</b>               |                              |                  |              |                     |                  |              |
|  | 2,630,559                    | 51,403           | 3.94         | 2,588,315           | 42,929           | 3.34         |
| Demand deposits  | 291,598                      |                  |              | 276,647             |                  |              |
| Time deposits discontinued operations                                    | 12,173                       |                  |              | 172,051             |                  |              |
| Other liabilities  | 82,828                       |                  |              | 96,930              |                  |              |
| Shareholders equity  | 256,896                      |                  |              | 251,813             |                  |              |
| <b>Total liabilities and shareholders equity</b>                         | <b>\$ 3,274,054</b>          |                  |              | <b>\$ 3,385,756</b> |                  |              |
| <b>Tax Equivalent Net Interest Income</b>                                |                              | <b>\$ 63,277</b> |              |                     | <b>\$ 66,729</b> |              |
| <b>Tax Equivalent Net Interest Income as a Percent of Earning Assets</b> |                              |                  | <b>4.25%</b> |                     |                  | <b>4.58%</b> |

- (1) All domestic
- (2) Interest on tax-exempt loans and securities is presented on a fully tax equivalent basis assuming a marginal tax rate of 35%

**Provision for loan losses** The provision for loan losses was \$14.9 million and \$2.5 million during the three months ended June 30, 2007 and 2006, respectively. During the six-month periods ended June 30, 2007 and 2006, the provision was \$23.0 million and \$3.9 million, respectively. The provisions reflect our assessment of the allowance for loan losses taking into consideration factors such as loan mix, levels of non-performing and classified loans and loan net charge-offs. While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors. (See Portfolio loans and asset quality. ) The substantial increases in the provision for loan losses in 2007 primarily reflect higher levels of non-performing loans and loan net charge-offs.

**Non-interest income** Non-interest income is a significant element in assessing our results of operations. On a long-term basis we are attempting to grow non-interest income in order to

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diversify our revenues within the financial services industry. We regard net gains on real estate mortgage loan sales as a core recurring source of revenue but they are quite cyclical and volatile. We regard net gains (losses) on securities as a non-operating component of non-interest income. As a result, we believe it is best to evaluate our success in growing non-interest income and diversifying our revenues by also comparing non-interest income when excluding net gains (losses) on assets (real estate mortgage loans and securities).

Non-interest income totaled \$12.8 million during the three months ended June 30, 2007, a \$1.9 million increase from the comparable period in 2006. This increase was primarily due to increases in service charges on deposits and in VISA check card interchange income as a result of the aforementioned branch acquisition. Non-interest income was \$23.4 million during both the six months ended June 30, 2007 and 2006. The first quarter of 2006 included \$2.8 million of non-recurring income from a litigation settlement. The balance of changes in the components of non-interest income for the comparative year to date periods are generally commensurate with the quarterly comparative changes.

**Non-Interest Income**

|   | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2007                           | 2006      | 2007                         | 2006      |
|   | (in thousands)                 |           |                              |           |
| Service charges on deposit accounts                     | \$ 6,380                       | \$ 5,031  | \$ 11,268                    | \$ 9,499  |
| Mepco litigation settlement                             |                                |           |                              | 2,800     |
| Net gains on assets sales                               |                                |           |                              |           |
| Real estate mortgage loans                              | 1,238                          | 1,188     | 2,319                        | 2,214     |
| Securities  | 128                            | 171       | 207                          | 171       |
| VISA check card interchange income                      | 1,292                          | 871       | 2,242                        | 1,662     |
| Real estate mortgage loan servicing                     | 712                            | 621       | 1,239                        | 1,274     |
| Mutual fund and annuity commissions                     | 467                            | 351       | 946                          | 646       |
| Bank owned life insurance                               | 448                            | 401       | 897                          | 793       |
| Title insurance fees                                    | 430                            | 440       | 844                          | 882       |
| Manufactured home loan origination fees and commissions | 115                            | 247       | 229                          | 486       |
| Other   | 1,563                          | 1,524     | 3,252                        | 2,956     |
| Total non-interest income                               | \$ 12,773                      | \$ 10,845 | \$ 23,443                    | \$ 23,383 |

Service charges on deposit accounts increased by 26.8% to \$6.4 million and by 18.6% to \$11.3 million during the three- and six-month periods ended June 30, 2007, respectively, from the comparable periods in 2006. The increases in such service charges principally relate to the aforementioned branch acquisition as well as to growth in checking accounts as a result of deposit account promotions, including direct mail solicitations.

Our mortgage lending activities have a substantial impact on total non-interest income. Net gains on the sale of real estate mortgage loans were relatively consistent for all periods presented. Based on current interest rates and economic conditions in Michigan, we would expect the level of mortgage loan origination and sales activity in the last half of 2007 to be similar to what we experienced in the first half of the year.

**Table of Contents****Real Estate Mortgage Loan Activity**

|  | Three months ended<br>June 30, |            | Six months ended<br>June 30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2007                           | 2006       | 2007                         | 2006       |
|  | (in thousands)                 |            |                              |            |
| Real estate mortgage loans originated  | \$ 129,613                     | \$ 135,783 | \$ 246,428                   | \$ 254,434 |
| Real estate mortgage loans sold  | 77,913                         | 73,223     | 147,125                      | 133,470    |
| Real estate mortgage loans sold with servicing rights released                 | 12,604                         | 8,936      | 24,283                       | 16,380     |
| Net gains on the sale of real estate mortgage loans                            | 1,238                          | 1,188      | 2,319                        | 2,214      |
| Net gains as a percent of real estate mortgage loans sold ( Loan Sale Margin ) | 1.59%                          | 1.62%      | 1.58%                        | 1.66%      |
| SFAS #133 adjustments included in the Loan Sale Margin                         | 0.00                           | (0.13)     | 0.00                         | 0.05       |

The volume of loans sold is dependent upon our ability to originate real estate mortgage loans as well as the demand for fixed-rate obligations and other loans that we cannot profitably fund within established interest-rate risk parameters. (See Portfolio loans and asset quality. ) Net gains on real estate mortgage loans are also dependent upon economic and competitive factors as well as our ability to effectively manage exposure to changes in interest rates. As a result, this category of revenue can be quite cyclical and volatile.

The second quarter of 2007 included \$0.1 million in securities gains on the sale of approximately \$9.1 million of securities. The second quarter of 2006 included \$0.2 million in securities gains due primarily to the sale of \$1.1 million of Fannie Mae preferred stock. We had previously recorded a \$0.1 million other than temporary impairment charge on this security.

VISA check card interchange income increased in 2007 compared to 2006. These results can be primarily attributed to an increase in the size of our card base due to the aforementioned branch acquisition and growth in checking accounts. In addition, the frequency of use of our VISA check card product by our customer base has increased due to our marketing efforts.

Real estate mortgage loan servicing generated income of \$0.7 million and \$1.2 million in the second quarter and first six months of 2007 respectively, compared to \$0.6 million and \$1.3 million in the corresponding periods of 2006, respectively. These variances are primarily due to changes in the impairment reserve on and the amortization of capitalized mortgage loan servicing rights. The period end impairment reserve is based on a third-party valuation of our real estate mortgage loan servicing portfolio and the amortization is primarily impacted by prepayment activity.

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Activity related to capitalized mortgage loan servicing rights is as follows:

**Capitalized Real Estate Mortgage Loan Servicing Rights**

|   | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2007                           | 2006      | 2007                         | 2006      |
|   | (in thousands)                 |           |                              |           |
| Balance at beginning of period            | \$ 14,961                      | \$ 13,728 | \$ 14,782                    | \$ 13,439 |
| Originated servicing rights capitalized   | 776                            | 760       | 1,462                        | 1,394     |
| Amortization                              | (432)                          | (371)     | (839)                        | (716)     |
| (Increase)/decrease in impairment reserve | 138                            | 11        | 38                           | 11        |
| Balance at end of period                  | \$ 15,443                      | \$ 14,128 | \$ 15,443                    | \$ 14,128 |
| Impairment reserve at end of period       | \$ 30                          | \$        | \$ 30                        | \$        |

The increases in originated mortgage loan servicing rights capitalized are due to slightly higher levels of real estate mortgage loan sales in 2007 compared to 2006. The changes in the impairment reserve reflect the valuation of capitalized mortgage loan servicing rights at each period end. At June 30, 2007, we were servicing approximately \$1.59 billion in real estate mortgage loans for others on which servicing rights have been capitalized. This servicing portfolio had a weighted average coupon rate of approximately 6.03%, a weighted average service fee of 25.7 basis points and an estimated fair market value of \$21.1 million.

Mutual fund and annuity commissions rose in 2007 compared to 2006 due to increased sales of these products primarily as a result of growth in the number of our licensed sales representatives.

Income from bank owned life insurance increased in 2007 primarily due to a higher balance of such insurance on which the crediting rate was applied.

The slight declines in title insurance fees in 2007 compared to 2006 primarily reflect the changes in our mortgage loan origination volume.

Manufactured home loan origination fees and commissions declined in 2007 compared to 2006. This industry has faced a challenging environment for several years as several buyers of this type of loan have exited the market or materially altered the guidelines under which they will purchase such loans. Further, regulatory changes have reduced the opportunity to generate revenues on the sale of insurance related to this type of lending. (Also see the discussion below under Non-interest expense about goodwill impairment charges associated with our mobile home lending subsidiary, First Home Financial). Primarily as a result of the continuing adverse environment for manufactured home lending, operations at First Home Financial ceased on June 15, 2007 and this entity was dissolved effective on June 30, 2007. As a result we would expect manufactured home loan origination fees and commissions to cease in the third quarter.

Other non-interest income has increased in 2007 compared to 2006. Increases in ATM, merchant deposit and money order fees have accounted for the majority of this growth. The growth is generally reflective of the overall expansion of the organization in terms of numbers of customers and accounts as well as the aforementioned branch acquisition.

**Non-interest expense** Non-interest expense is an important component of our results of operations. However, we primarily focus on revenue growth, and while we strive to efficiently manage our cost structure, our non-interest expenses may increase from year to year because we are expanding our operations through acquisitions and by opening new branches and loan production offices. As discussed earlier, we are currently in the process of consolidating our

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four bank charters into one. We have also completed certain staff reductions at our banks during the second quarter of 2007 that are primarily related to efficiencies we have gained through the implementation of enhanced data processing tools at our bank branches. Second quarter 2007 compensation and employee benefits expense include \$1.0 million of severance and other costs associated with these staff reductions. In total, we expect to reduce annual non-interest expenses by approximately \$3.3 million as a result of these staff reductions. Further, we expect to achieve an additional \$0.7 million to \$1.2 million reduction in non-interest expenses as a result of the completion of the bank charter consolidation in the third quarter of 2007. We also expect to incur approximately \$0.7 million of expenses in the third quarter related to additional severance, data processing conversion and other costs associated with the completion of the bank charter consolidation.

Non-interest expense increased by \$4.3 million to \$29.8 million and by \$6.0 million to \$57.8 million during the three- and six-month periods ended June 30, 2007, respectively, compared to the like periods in 2006. The first six months of 2007 and 2006 include \$0.3 million and \$0.6 million, respectively, in goodwill impairment charges as described below. The aforementioned branch acquisition as well as the opening of a few new branch offices account for much of the other increases in non-interest expense for the second quarter and first half of 2007 compared to the same periods in 2006.

**Non-Interest Expense**

|   | Three months ended |           | Six months ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | June 30,           | June 30,  | June 30,         | June 30,  |
|   | 2007               | 2006      | 2007             | 2006      |
|   | (in thousands)     |           |                  |           |
| Salaries                                    | \$ 10,776          | \$ 9,358  | \$ 20,777        | \$ 18,734 |
| Performance-based compensation and benefits | 1,153              | 315       | 2,474            | 1,804     |
| Other benefits                              | 2,855              | 2,601     | 5,501            | 5,277     |
| Compensation and employee benefits          | 14,784             | 12,274    | 28,752           | 25,815    |
| Occupancy, net                              | 2,735              | 2,420     | 5,349            | 5,107     |
| Furniture, fixtures and equipment           | 1,991              | 1,733     | 3,891            | 3,516     |
| Data processing                             | 1,912              | 1,418     | 3,350            | 2,760     |
| Advertising                                 | 1,341              | 1,016     | 2,493            | 2,003     |
| Loan and collection                         | 1,221              | 982       | 2,227            | 1,805     |
| Credit card and bank service fees           | 970                | 1,015     | 1,937            | 1,922     |
| Communications                              | 1,014              | 852       | 1,844            | 1,843     |
| Supplies                                    | 581                | 516       | 1,188            | 1,025     |
| Amortization of intangible assets           | 935                | 600       | 1,505            | 1,200     |
| Legal and professional                      | 457                | 396       | 963              | 884       |
| Branch acquisition and conversion costs     | (92)               |           | 330              |           |
| Goodwill impairment                         |                    | 612       | 343              | 612       |
| Other                                       | 1,952              | 1,706     | 3,595            | 3,286     |
| Total non-interest expense                  | \$ 29,801          | \$ 25,540 | \$ 57,767        | \$ 51,778 |

The increases in salaries and other benefits in 2007 compared to 2006 are primarily attributable to an increased number of employees resulting from the addition of new branch (including the aforementioned branch acquisition) offices as well as to merit pay increases and increases in certain employee benefit costs such as health care insurance. In addition, the second quarter of 2007 includes \$1.0 million of severance costs as described above.

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We accrue for performance based compensation (expected annual cash bonuses, equity based compensation and the employee stock ownership plan contribution) based on the provisions of our incentive compensation plan and the performance targets established by our Board of Directors. Performance based compensation is higher in 2007 compared to 2006 primarily because we are accruing for an estimated employee stock ownership plan contribution at 3% of eligible employee salaries compared to 1% of eligible employee salaries in 2006.

Occupancy, furniture, fixtures and equipment, data processing and supplies expenses all generally increased in 2007 compared to 2006 as a result of the growth of the organization through the opening of new branch (including the aforementioned branch acquisition) offices. In particular data processing costs in the second quarter of 2007 include \$0.1 million of one time costs related to our branch acquisition. Data processing costs have also increased in 2007 due to the implementation of a new on-line teller and branch platform system.

Advertising expense was higher in 2007 due primarily to a rebranding initiative we began in the latter half of 2006 and additional marketing and promotion we did in the communities that included our newly acquired branches.

Loan and collection expense increased in 2007 primarily as a result of our elevated level of non-performing loans.

Credit card and bank service fees primarily relate to the vehicle service payment plans administered by Mepco. Since most customers utilize credit cards to make monthly payments on these plans, Mepco incurs charges related to processing these credit card payments.

Amortization of intangible assets was higher in 2007 primarily due to the amortization of core deposit premium associated with our newly acquired branches.

The second quarter of 2006 includes a goodwill impairment charge of \$0.6 million at First Home Financial (FHF) which was acquired in 1998 (and the first quarter of 2007 had a \$0.3 million goodwill impairment charge that represented the write-off of the remaining goodwill associated with FHF). FHF was a loan origination company based in Grand Rapids, Michigan that specialized in the financing of manufactured homes located in mobile home parks or communities. As described above (see Non-interest income ) revenues and profits have declined at FHF over the last few years and have continued to decline in 2007. We test goodwill for impairment and based on the fair value of FHF, we recorded goodwill impairment charges. Since we acquired the stock of FHF, no income tax benefit was recorded related to these goodwill impairment charges.

**Income tax expense** Our effective income tax rate was lower during both the second quarter of and for the first six months of 2007 compared to the like periods in 2006. These decreases are primarily due to tax exempt interest income and income on bank owned life insurance representing a higher percentage of pre-tax earnings (or loss). In addition, the \$2.8 million in income recorded for the litigation settlement in the first quarter of 2006 is not taxable. The primary reason for the difference between our statutory and effective income tax rates results from tax exempt interest income.

#### **Critical Accounting Policies**

Our accounting and reporting policies are in accordance with accounting principles generally accepted within the United States of America and conform to general practices within the banking industry. Accounting and reporting policies for other than temporary impairment of investment securities, the allowance for loan losses, originated real estate mortgage loan servicing rights, derivative financial instruments, income taxes and goodwill are deemed critical

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since they involve the use of estimates and require significant management judgments. Application of assumptions different than those that we have used could result in material changes in our financial position or results of operations.

We are required to assess our investment securities for other than temporary impairment on a periodic basis. The determination of other than temporary impairment for an investment security requires judgment as to the cause of the impairment, the likelihood of recovery and the projected timing of the recovery. Our assessment process during the first six months of 2007 and 2006 resulted in no impairment charges for other than temporary impairment on various investment securities within our portfolio. We believe that our assumptions and judgments in assessing other than temporary impairment for our investment securities are reasonable and conform to general industry practices.

Our methodology for determining the allowance and related provision for loan losses is described above in Financial Condition Portfolio Loans and asset quality. In particular, this area of accounting requires a significant amount of judgment because a multitude of factors can influence the ultimate collection of a loan or other type of credit. It is extremely difficult to precisely measure the amount of losses that are probable in our loan portfolio. We use a rigorous process to attempt to accurately quantify the necessary allowance and related provision for loan losses, but there can be no assurance that our modeling process will successfully identify all of the losses that are probable in our loan portfolio. As a result, we could record future provisions for loan losses that may be significantly different than the levels that we have recorded in the most recent quarter or year-to-date periods.

At June 30, 2007 we had approximately \$15.4 million of real estate mortgage loan servicing rights capitalized on our balance sheet. There are several critical assumptions involved in establishing the value of this asset including estimated future prepayment speeds on the underlying real estate mortgage loans, the interest rate used to discount the net cash flows from the real estate mortgage loan servicing, the estimated amount of ancillary income that will be received in the future (such as late fees) and the estimated cost to service the real estate mortgage loans. We utilize an outside third party (with expertise in the valuation of real estate mortgage loan servicing rights) to assist us in our valuation process. We believe the assumptions that we utilize in our valuation are reasonable based upon accepted industry practices for valuing mortgage loan servicing rights and represent neither the most conservative or aggressive assumptions.

We use a variety of derivative instruments to manage our interest rate risk. These derivative instruments include interest rate swaps, collars, floors and caps and mandatory forward commitments to sell real estate mortgage loans. Under SFAS #133 the accounting for increases or decreases in the value of derivatives depends upon the use of the derivatives and whether the derivatives qualify for hedge accounting. At June 30, 2007 we had approximately \$669.7 million in notional amount of derivative financial instruments that qualified for hedge accounting under SFAS #133. As a result, generally, changes in the fair market value of those derivative financial instruments qualifying as cash flow hedges are recorded in other comprehensive income. The changes in the fair value of those derivative financial instruments qualifying as fair value hedges are recorded in earnings and, generally, are offset by the change in the fair value of the hedged item which is also recorded in earnings. The fair value of derivative financial instruments qualifying for hedge accounting was a negative \$1.5 million at June 30, 2007.

Our accounting for income taxes involves the valuation of deferred tax assets and liabilities primarily associated with differences in the timing of the recognition of revenues and expenses for financial reporting and tax purposes. At December 31, 2006 we had recorded a net deferred tax asset of \$10.6 million, which included a net operating loss carry forward of \$4.5 million. We have recorded no valuation allowance on our net deferred tax asset because we believe that the



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tax benefits associated with this asset will more likely than not, be realized. However, changes in tax laws, changes in tax rates and our future level of earnings can adversely impact the ultimate realization of our net deferred tax asset. At June 30, 2007 we had recorded \$66.8 million of goodwill. Under SFAS #142, amortization of goodwill ceased, and instead this asset must be periodically tested for impairment. Our goodwill primarily arose from the above described branch acquisition, 2004 acquisitions of two banks, the 2003 acquisition of Mepco and the past acquisitions of other banks. We test our goodwill for impairment utilizing the methodology and guidelines established in SFAS #142. This methodology involves assumptions regarding the valuation of the business segments that contain the acquired entities. We believe that the assumptions we utilize are reasonable. However, we may incur impairment charges related to our goodwill in the future due to changes in business prospects or other matters that could affect our valuation assumptions. During the first quarter of 2007 we recorded a \$0.3 million goodwill impairment charge. (See Non-interest expense. )

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Item 3.

**Quantitative and Qualitative Disclosures about Market Risk**

No material changes in the market risk faced by the Registrant have occurred since December 31, 2006.

Item 4.

**Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures.

With the participation of management, our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the period ended June 30, 2007, have concluded that, as of such date, our disclosure controls and procedures were effective.

(b) Changes in Internal Controls.

During the quarter ended June 30, 2007, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## Part II

**Item 2. Changes in securities, use of proceeds and issuer purchases of equity securities**

The following table shows certain information relating to purchases of common stock for the three-months ended June 30, 2007 pursuant to our share repurchase plan:

| Period     | Total<br>Number of<br>Shares<br>Purchased <sup>(1)</sup> | Average Price<br>Paid Per Share | Total Number of<br>Shares Purchased<br>as Part of a<br>Publicly<br>Announced Plan <sup>(2)</sup> | Remaining<br>Number of<br>Shares<br>Authorized for<br>Purchase Under<br>the Plan |
|------------|--|---------------------------------|--|--|
| April 2007 | 755  | 16.50                           | 755  |  |
| May 2007   |  |                                 |  |  |
| June 2007  | 1,859  | 17.21                           | 1,859  |  |
| Total      | 2,614  | 17.00                           | 2,614  | 441,736  |

(1) Includes shares purchased to fund our Deferred Compensation and Stock Purchase Plan for Non-employee Directors.

(2) Our current stock repurchase plan authorizes the purchase up to 750,000 shares of our common stock. The repurchase plan expires on December 31, 2007.

**Item 4. Submission of Matters to a Vote of Security-Holders**

Our Annual Meeting of Shareholders was held on April 24, 2007. As described in our proxy statement, dated March 20, 2007, the following matters were considered at that meeting:

(1) Election of directors:

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Donna J. Banks, Jeffrey A. Bratsburg, and Charles C. Van Loan were elected to serve three-year terms expiring in 2010. Votes for and votes withheld for each nominee were as follows:

|                      | Votes For  | Votes Withheld |
|----------------------|------------|----------------|
| Donna J. Banks       | 19,905,726 | 558,717        |
| Jeffrey A. Bratsburg | 19,521,662 | 942,781        |
| Charles C. Van Loan  | 19,106,933 | 1,357,510      |

Directors whose term of office as a director continued after the meeting were Stephen L. Gulis, Jr., Terry L. Haske, Charles A. Palmer, Robert L. Hetzler, Michael M. Magee, Jr., and James E. McCarty.

(2) Ratify the appointment of Crowe Chizek and Company LLC as independent auditors for the fiscal year ending December 31, 2007. Votes for, votes against and abstentions were as follows:

|                |            |
|----------------|------------|
| Votes for:     | 20,084,480 |
| Votes against: | 258,178    |
| Abstain:       | 121,785    |

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**Item 6. Exhibits**

(a) The following exhibits (listed by number corresponding to the Exhibit Table as Item 601 in Regulation S-K) are filed with this report:

- 11. Computation of Earnings Per Share.
- 31.1 Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 31.2 Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.1 Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.2 Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

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**SIGNATURES**

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

Date August 3, 2007

By: /s/ Robert N. Shuster  
Robert N. Shuster, Principal  
Financial  
Officer

Date August 3, 2007

By: /s/ James J. Twarozynski  
James J. Twarozynski, Principal  
Accounting Officer

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