# FORM 10-K
# SECURITIES AND EXCHANGE COMMISSION
# Washington, D.C. 20549

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

For the fiscal year ended December 31, 2004

OR

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

For the transition period from _______ to ________

Commission file number 000-25927

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

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

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

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

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock.

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained in this form and no disclosure will be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. [__]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [X].

The registrant's revenues for 2004 were $88,371,000. The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, based on a per share price of $27.49 as of June 30, 2004, was $214,819,000 (common stock, no par value). As of March 4, 2005, there were outstanding 8,849,996 shares of the Company's common stock (no par value). Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held April 21, 2005 are incorporated by reference into Part II and Part III of this Report.

PART I

**ITEM 1: Business**

*As used in this Annual Report, the terms "we," "us," "our" and "Macatawa" mean Macatawa Bank Corporation and its subsidiaries, unless the context indicates another meaning.*

**General**

Macatawa Bank Corporation is a Michigan corporation and is a financial holding company and the bank holding company for its wholly owned banking subsidiary, Macatawa Bank, as well as Macatawa Investment Services, Inc., Macatawa Statutory Trust I and Macatawa Statutory Trust II. Effective January 9, 2002, Macatawa Bank Corporation elected to become a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act. Macatawa Bank commenced operations on November 25, 1997. Grand Bank was formed in 1987 and operated from a single location in Grand Rapids, Michigan. Grand Bank became a wholly owned subsidiary effective April 1, 2002 upon the completion of the acquisition of Grand Bank Financial Corporation (GBFC), and its results are included in the consolidated statements of income since this effective date. To achieve further synergies from the Grand Bank acquisition, we merged Grand Bank into Macatawa Bank effective January 1, 2003 with the combined bank named Macatawa Bank. At the same time, Grand Bank Mortgage Company was merged into Macatawa Bank Mortgage Company.

Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The bank operates twenty-two branch offices and a lending and operational service facility offering commercial and personal banking services, including checking and savings accounts (including certificates of deposit), safe deposit boxes, travelers checks, money orders, trust services and commercial, mortgage and consumer loans in Kent County, Ottawa County, and northern Allegan County, Michigan. Macatawa Investment Services was formed in October 2001 and gained approval in June 2002 from the NASD to commence operations as a broker/dealer. Macatawa Investment Services provides various brokerage services including discount brokerage, personal financial planning and consultation regarding mutual funds. Macatawa Statutory Trust I is a grantor trust that issued a pooled trust preferred security in July, 2003. Macatawa Statutory Trust II is a grantor trust that issued a pooled trust preferred security in March, 2004. Macatawa Bank Mortgage Company, a subsidiary of Macatawa Bank, originates and sells residential mortgage loans into the secondary market on a servicing released basis. As of December 31, 2004, we had total assets of $1.67 billion, total deposits of $1.35 billion, approximately 79,000 deposit accounts and shareholders' equity of $129.07 million.

Our headquarters and administrative offices are located at 10753 Macatawa Drive, Holland, Michigan 49424, and our telephone number is (616) 820-1444. Our internet website address is www.macatawabank.com. We make available free of charge through this website our annual report on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after filing such reports with the Securities and Exchange Commission. The reference to our website address does not constitute incorporation by reference of the information contained on the website, and the information contained on the website is not part of this document.

**Products and Services**

***Deposit Services.*** We offer a broad range of deposit services, including checking accounts, savings accounts and time deposits of various types. Transaction accounts and time certificates are tailored to the principal market area at rates competitive with those offered in the area. All deposit accounts are insured by the FDIC up to the maximum amount permitted by law. We solicit these accounts from individuals, businesses, associations, churches, nonprofit organizations, financial institutions and government authorities. We may also use alternative funding sources as needed, including advances from Federal Home Loan Banks, certificates of deposit purchased from brokers and the packaging of loans for securitization and sale.

Deposits are gathered primarily from the communities we serve through our network of 22 branches. We offer business and consumer checking accounts, regular and money market savings accounts, and certificates of deposit having many options in their terms.

We set our deposit pricing to be competitive with other banks in our market area. This has enabled us to increase deposits from new, as well as existing customers, while maintaining a healthy net interest margin. We periodically purchase brokered deposits to supplement funding needs. These are time accounts originated outside of our local market area. Brokered deposits comprised approximately 11% of total deposits at December 31, 2004 and approximately 10% at December 31, 2003. We operate in a very competitive environment, competing with other local banks similar in size and with significantly larger regional banks. We monitor rates at other financial institutions in the area to ascertain that our rates are competitive with the market. We also attempt to offer a wide variety of products to meet the needs of our customers.

***Deposit Portfolio Composition.*** The following table sets forth the average deposit balances and the weighted average rates paid thereon.

| (Dollars in thousands) | Average for the Year | | | | | |
|---|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2002 | |
| | Amount | Average Rate | Amount | Average Rate | Amount | Average Rate |
| Noninterest bearing demand | $ 139,510 | -- | $ 110,670 | -- | $ 82,757 | -- |
| Interest bearing demand | 587,834 | 1.2% | 395,697 | 0.9% | 334,510 | 1.1% |
| savings | 38,266 | 0.2% | 35,172 | 0.4% | 24,800 | 1.1% |
| Time | 435,005 | 2.8% | 432,231 | 3.1% | 348,205 | 3.7% |
| Total deposits | $ 1,200,615 | 1.6% | $ 973,770 | 1.7% | $ 790,272 | 2.3% |

The following table summarizes time deposits in amounts of $100,000 or more by time remaining until maturity as of December 31, 2004:

| (Dollars in thousands) | Amount |
|---|---|
| Three months or less | $ 87,432 |
| Over 3 months through 6 months | 87,017 |
| Over 6 months through 1 year | 76,337 |
| Over 1 year | 80,891 |
| Total | $ 331,677 |

***Lending Activities.***

***Loan Portfolio Composition.*** The following table reflects the composition of our loan portfolio and the corresponding percentage of our total loans represented by each class of loans as of the dates indicated.

| | Year Ended December 31 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2002 | | 2001 | | 2000 | |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Commercial real estate | $ 676,637 | 48% | $ 536,884 | 46% | $417,757 | 44% | $133,428 | 25% | $ 79,444 | 19% |
| Residential real estate | 218,999 | 16% | 172,647 | 15% | 133,843 | 14% | 67,655 | 12% | 60,822 | 15% |
| Other commercial | 338,398 | 24% | 312,131 | 27% | 279,923 | 29% | 269,993 | 49% | 214,098 | 52% |
| Consumer | 162,353 | 12% | 135,445 | 12% | 129,515 | 13% | 74,617 | 14% | 56,312 | 14% |
| Total loans | $1,396,387 | 100% | $1,157,107 | 100% | $961,038 | 100% | $545,693 | 100% | $410,676 | 100% |
| Less: Allowance for loan losses | (19,251) | | (16,093) | | (13,472) | | (7,699) | | (5,854) | |
| Total loans receivable, net | $1,377,136 | | $1,141,014 | | $947,566 | | $537,994 | | $404,822 | |

***Nonperforming Assets.*** The following table shows the composition and amount of our nonperforming assets.

| (Dollars in thousands) | December 31 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Nonaccrual loans | $ 3,249 | $ 1,717 | $ 2,539 | $ 2,084 | $ 155 |
| Loans 90 days or more delinquent and still accruing | 772 | 2,308 | 259 | 298 | 41 |
| Restructured loans | -- | -- | -- | -- | -- |
| Total nonperforming loans | $ 4,021 | $ 4,025 | $ 2,798 | $ 2,382 | $ 196 |
| Foreclosed assets | 1,850 | 464 | 388 | -- | -- |
| Repossessed assets | -- | 4 | 58 | -- | -- |
| Total nonperforming assets | $ 5,871 | $ 4,493 | $ 3,244 | $ 2,382 | $ 196 |
| Nonperforming loans to total loans | .29% | .35% | .29% | .43% | .05% |
| Nonperforming assets to total assets | .35% | .32% | .28% | .36% | .04% |

***Loan Loss Experience.*** The following is a summary of our loan balances at the end of each period and the daily average balances of these loans. It also includes changes in the allowance for loan losses arising from loans charged-off and recoveries on loans previously charged-off, and additions to the allowance which we have expensed.

| (Dollars in thousands) | December 31 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Loans: | | | | | |
| Average daily balance of loans for the year | $1,295,887 | $1,046,723 | $831,709 | $474,318 | $347,351 |
| Amount of loans outstanding at end of period | 1,396,387 | 1,157,107 | 961,038 | 545,693 | 410,676 |
| Allowance for loan losses: | | | | | |
| Balance at beginning of year | $ 16,093 | $ 13,472 | $ 7,699 | $ 5,854 | $ 3,995 |
| Balances from GBFC acquisition | -- | -- | 3,464 | | |
| Addition to allowance charged to operations | 7,890 | 4,105 | 3,321 | 2,285 | 1,931 |
| Loans charged-off: | | | | | |
| Commercial | (4,833) | (1,308) | (1,143) | (485) | (67) |
| Residential Real Estate | (21) | (50) | -- | (1) | -- |
| Consumer | (91) | (187) | (128) | (27) | (20) |
| Recoveries: | | | | | |
| Commercial | 180 | 26 | 249 | 63 | 14 |
| Residential Real Estate | 11 | 17 | 0 | 1 | -- |
| Consumer | 22 | 18 | 10 | 9 | 1 |
| Balance at end of year | $ 19,251 | $ 16,093 | $ 13,472 | $ 7,699 | $ 5,854 |
| Ratios: | | | | | |
| Net charge-offs to average loans outstanding | .37% | .14% | .12% | .09% | .02% |
| Allowance for loan losses to loans outstanding at year end | 1.38% | 1.39% | 1.40% | 1.41% | 1.43% |

***Allocation of the Allowance for Loan Losses.*** The following table shows the allocation of the allowance for loan loss at the dates indicated to the extent specific allocations have been determined relative to particular loans.

| (Dollars in thousands) | Year Ended December 31 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2002 | | 2001 | | 2000 | |
| | Allowance Amount | % of Each Category to Total Loans | Allowance Amount | % of Each Category to Total Loans | Allowance Amount | % of Each Category to Total Loans | Allowance Amount | % of Each Category to Total Loans | Allowance Amount | % of Each Category to Total Loans |
| Commercial and commercial real estate | $17,324 | 78.7% | $14,371 | 78.3% | $11,207 | 72.6% | $ 6,391 | 73.9% | $ 3,902 | 71.5% |
| Real estate mortgages | 476 | 9.7% | 360 | 10.0% | 326 | 13.9% | 196 | 12.4% | 176 | 14.8% |
| Consumer | 1,243 | 11.6% | 1,074 | 11.7% | 950 | 13.5% | 564 | 13.7% | 435 | 13.7% |
| Unallocated | 208 | -- | 288 | -- | 989 | -- | 548 | -- | 1,341 | -- |
| Total | $19,251 | 100% | $16,093 | 100.0% | $13,472 | 100.0% | $ 7,699 | 100.0% | $ 5,854 | 100.0% |

***Maturities and Sensitivities of Loans to Changes in Interest Rates.*** The following table shows the amount of total loans outstanding as of December 31, 2004 which, based on remaining scheduled repayments of principal, are due in the periods indicated.

| (dollars in thousands) | Maturing | | | |
|---|---|---|---|---|
| | Within One Year | After One, But Within Five Years | After Five Years | Total |
| Commercial real estate | $ 210,644 | $ 439,789 | $ 26,204 | $ 676,637 |
| Residential real estate | 37,887 | 56,475 | 124,637 | 218,999 |
| Other commercial | 211,967 | 121,092 | 5,339 | 338,398 |
| Consumer | 26,126 | 34,923 | 101,304 | 162,353 |
| Totals | $ 486,624 | $ 652,279 | $ 257,484 | $ 1,396,387 |
| Allowance for loan losses | | | | (19,251) |
| Total loans receivable, net | | | | $ 1,377,136 |

***Interest Sensitivity.*** Below is a schedule of the loan amounts maturing or repricing which are classified according to their sensitivity to changes in interest rates at December 31, 2004.

| (dollars in thousands) | Fixed Rate | Variable Rate | Total |
|---|---|---|---|
| Due within 3 months | $ 36,210 | $ 906,626 | $ 942,836 |
| Due after 3 months, but within 1 year | 51,176 | 5,650 | 56,826 |
| Due after one but within 5 years | 289,231 | 51,867 | 341,098 |
| Due after 5 years | 52,297 | 3,330 | 55,627 |
| Total | $ 428,914 | $ 967,473 | $ 1,396,387 |
| Allowance for loan losses | | | (19,251) |
| Total loans receivable, net | | | $ 1,377,136 |

***Residential Real Estate Loans.*** We originate residential mortgage loans, which are generally long-term with either fixed or variable interest rates. Our general policy, which is subject to review by our management as a result of changing market and economic conditions and other factors, is to sell in the secondary market the majority of residential mortgage loans originated. Residential mortgage loan originations derive from a number of sources, including advertising, direct solicitation, real estate broker referrals, existing borrowers and depositors, builders and walk-in customers. Loan applications are accepted at most of our offices. The substantial majority of these loans are secured by properties in our market area.

Our variable rate mortgage loans are fully amortizing loans with contractual maturities of up to 30 years. These loans generally carry interest rates which are reset to a stated margin over an independent index, generally the one-, three- or five-year constant maturity treasury index. Increases or decreases in the interest rate of our variable rate mortgage loans are generally limited to 2% annually with lifetime interest rate caps of 6% over the initial interest rate. Our variable rate mortgage loans may be convertible into fixed rate loans upon payment of a fee, do not contain prepayment penalties and do not produce negative amortization. Initial interest rates offered on our variable rate mortgage loans may be below the fully indexed rate, although borrowers are generally qualified at the fully indexed rate.

We also offer fixed rate mortgage loans to owner occupants with maturities up to 30 years, which conform to secondary market standards. Interest rates charged on these fixed rate loans are priced on a daily basis according to market conditions. These loans generally do not include prepayment penalties. We currently sell in the secondary market, long-term, conforming fixed-rate loans with terms of 15 years or greater which we originated.

Generally we originate residential mortgage loans with loan-to-value ratios not to exceed 80%. For loans with loan-to-value ratios that equal or exceed 90% at origination, we require private mortgage insurance in an amount sufficient to reduce our exposure to 80% or less of the lower of the appraised value or purchase price of the underlying collateral. In underwriting one- to four-family residential real estate loans, we evaluate both the borrower's ability to make monthly payments and the value of the property securing the loan. Properties securing one- to four-family residential real estate loans that we made are appraised by independent fee appraisers. We require borrowers to obtain title insurance and fire, property and, if necessary, flood insurance.

***Multi-Family and Commercial Real Estate Loans.*** We originate permanent loans secured by multi-family and commercial real estate. Our permanent multi-family and commercial real estate loan portfolio includes loans secured by apartment buildings, condominiums, small office buildings, small business facilities, medical facilities and other non-residential building properties, substantially all of which are located within our primary market area.

Permanent multi-family and commercial real estate loans have a maximum maturity of 10 years with an amortization period of up to 20 years. Most of these loans, however, have maturities of 5 years or less with amortization periods of 15 and 20 years. Multi-family loans and commercial real estate loans are generally written in amounts of up to 80% of the lesser of the appraised value of the property or the purchase price, and borrowers are generally personally liable for all or part of the indebtedness.

Appraisals on properties securing multi-family and commercial real estate loans that we originate are primarily performed by independent appraisers who we designate at the time the loan is made. Management reviews all appraisals on multi-family and commercial real estate loans. In addition, our underwriting procedures generally require verification of the borrower's credit history, income and financial statements, banking relationships, references, and historical and projected cash flows for the property that indicate minimum debt service coverage ratios.

Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family and commercial real estate is typically dependent upon the successful operation of the related real estate project. If cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired. For example, if leases are not obtained or renewed, or a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations, cash flow from the project will be reduced.

***Construction and Development Loans.*** We make construction loans to individuals for the construction of their residences. Construction loans are also made to builders and developers for the construction of one- to four-family residences and the development of one- to four-family lots, residential subdivisions, condominium developments and other commercial developments.

Construction loans to individuals for their residences are structured to be converted to permanent loans at the end of the construction phase, which typically runs six to nine months. These construction loans have rates and terms which generally match one- to four-family loans then offered by us, except that during the construction phase, the borrower pays interest only. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential loans.

Construction loans to builders of one- to four-family residences generally require the payment of interest only for up to one year with adjustable rates. These loans may also provide for the payment of loan fees from loan proceeds. We also make loans to builders for the purpose of developing one- to four-family lots and residential condominium projects. These loans typically have terms of two years or less with maximum loan to value ratios of 80%. These loans may provide for the payment of loan fees from loan proceeds. Loan principal is typically paid down as lots or units are sold.

Construction and development loans are obtained principally through continued business from developers and builders who have previously borrowed from us, as well as referrals from existing customers. As part of the application process, the applicant must submit accurate plans, specifications and costs of the project to be constructed or developed to us. These items are used as a basis to determine the appraised value of the subject property. Loans are based on the lesser of current appraised value and/or the cost of construction (land plus building). Construction and development loans to borrowers other than owner-occupants involve many of the same risks discussed above regarding multi-family and commercial real estate loans and tend to be more sensitive to general economic conditions than many other types of loans. Further, because of the uncertainties inherent in estimating development and construction costs and the market for the project upon completion, it is relatively difficult to evaluate accurately the total loan funds required to complete a project, the related loan-to-value ratios and the likelihood of ultimate success of the project.

***Commercial Business Loans.*** Our commercial business lending portfolio contains loans with a variety of purposes and security, including loans to finance operations and equipment. Generally, our commercial business lending has been limited to borrowers headquartered, or doing business, in our primary market area.

Unlike residential mortgage loans, which generally are made on the basis of the borrower’s ability to make repayment from his or her employment and other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower’s ability to make repayment from the cash flow of the borrower’s business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

***Consumer Loans.*** We originate a variety of different types of consumer loans, including automobile loans, home equity lines of credit and installment loans, home improvement loans, deposit account loans and other loans for household and personal purposes. Our automobile loans typically are originated at fixed interest rates with terms up to 60 months for new and used vehicles. Loans secured by automobiles are generally originated for up to 80% of the National Automobile Dealers Association book value of the automobile securing the loan.

Our home equity installment loans are written so that the total commitment amount, when combined with the balance of the first mortgage lien, generally will not exceed the greater of 90% of the appraised value of the property or 90% of two times the Michigan real estate assessment value. These loans have a maximum maturity of 5 years with an amortization period of up to 15 years, and carry fixed rates of interest.

We also originate home equity lines of credit utilizing the same underwriting standards as for home equity installment loans. Home equity lines of credit are revolving line of credit loans. The majority of our existing home equity line of credit portfolio has adjustable rates, interest only payments and a maximum maturity of ten years.

The underwriting standards that we employ for consumer loans include a determination of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

***Securities.*** Our security portfolio is classified as either "available for sale" or "held to maturity." Securities classified as "available for sale" may be sold to meet our liquidity needs. The primary objective of our investing activities is to provide for the safety of the principal invested. Our secondary considerations include earnings, liquidity and decreased overall exposure to changes in interest rates. The following table reflects the composition of our securities portfolio as of the dates indicated.

| (Dollars in thousands) | Year Ended December 31 | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| U.S. Treasury and U.S. Government Agencies | $ 91,399 | $ 76,225 | $ 71,867 |
| State and municipal bonds | 48,402 | 33,448 | 18,303 |
| Total | $ 139,801 | $ 109,673 | $ 90,170 |

Excluding our investment portfolio holdings in U.S. Treasury and U.S. Government Agency Securities, we had no investments in securities of any one issuer which exceeded 10% of shareholders' equity.

***Schedule of Maturities of Investment Securities and Weighted Average Yields.*** The following is a schedule of investment security maturities and their weighted average yield by category at December 31, 2004.

| (dollars in thousands) | Due Within One Year | | One to Five Years | | Five to Ten Years | | After Ten Years | | Investments with No Contractual Maturity | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Amount** | **Average Yield** | **Amount** | **Average Yield** | **Amount** | **Average Yield** | **Amount** | **Average Yield** | **Amount** | **Average Yield** |
| U.S. Treasury and U.S. Government Agencies | $ 4,057 | 4.93% | $ 83,025 | 4.05% | $ 3,973 | 3.37% | $ 344 | 4.55% | -- | -- |
| Tax-exempt state and municipal bonds (1) | -- | | -- | | 11,757 | 6.94% | 36,645 | 6.40% | -- | -- |
| Total (1) | $ 4,057 | 4.93% | $ 83,025 | 4.05% | $ 15,730 | 6.00% | $ 36,989 | 6.39% | -- | -- |

(1) Yields on tax-exempt securities are computed on a fully taxable-equivalent basis.

***Trust Services***. We began offering trust services in January 1999, to further provide for the financial needs of our customers. With the acquisition of Grand Bank in April 2002 our trust assets increased by over $500 million and as of December 31, 2004, the Trust Department had assets of approximately $1.0 billion. Our types of service include both personal trust and employee benefit plans.

**Market Area**

Our market area of Ottawa, Kent and northern Allegan Counties are located in western Michigan. This area consists of two mid-sized cities, Grand Rapids and Holland, and rural areas. Grand Rapids is the second largest city in Michigan and Holland the largest city in Ottawa County. Both cities and surrounding areas have a solid and diverse economic base, which includes tourism, office furniture, automotive components and assemblies, pharmaceutical, transportation, equipment, food and construction supplies. Companies operating in the market area include Steelcase, Herman Miller, Alticor, Haworth, Johnson Controls, General Motors, Gerber, SPX, Magna Donnelly, and Meijer.

Much of our success as a retail and small to mid-sized business lender has been due to our market area's favorable population, housing and income demographics. Population within our three county market area grew by 20.6% from 1990 to 2002. Household income levels in our market area exceed state and national levels while unemployment levels are below state but above national levels.

**Competition**

Our primary market area includes Ottawa County, Kent County and northern Allegan County, all located in Western Michigan. There are many bank, thrift and credit union offices located within our market area. Most are branches of larger financial institutions. We also face competition from finance companies, insurance companies, mortgage companies, securities brokerage firms, money market funds and other providers of financial services. Many of our competitors have been in business a number of years, have established customer bases, are larger and have higher lending limits than we do. We compete for loans principally through our ability to communicate effectively with our customers and to understand and meet their needs. Our management believes that our personal service philosophy enhances our ability to compete favorably in attracting individuals and small businesses. We actively solicit customers and compete for deposits by offering our customers personal attention, professional service, and competitive interest rates.

**Environmental Matters**

We do not believe that existing environmental regulations will have any material effect upon our capital expenditures, our earnings or our competitive position.

**Employees**

As of December 31, 2004, we had 299 full-time and 108 part-time employees. We have assembled a staff of experienced, dedicated and highly qualified professionals whose goal is to provide outstanding service. The majority of our management team has at least 10 years of banking experience, and several key personnel have more than 20 years of banking experience. None of our employees is represented by collective bargaining agreements with us.

**Acquisition of Grand Bank**

On April 1, 2002, Grand Bank Financial Corporation was merged into Macatawa Bank Corporation. Macatawa Bank Corporation became the holding company for Grand Bank. Effective January 1, 2003, Grand Bank was merged into Macatawa Bank.

## SUPERVISION AND REGULATION

*The following is a summary of certain statutes and regulations affecting Macatawa Bank Corporation and Macatawa Bank. This summary is qualified in its entirety by such statutes and regulations. A change in applicable laws or regulations may have a material effect on us and our business.*

### General

Financial institutions and their holding companies are extensively regulated under federal and state law. Consequently, our growth and earnings performance can be affected not only by management decisions and general economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. Those authorities include, but are not limited to, the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), the FDIC, the Commissioner of the Michigan Office of Financial and Insurance Services ("Commissioner"), the Internal Revenue Service, and state taxing authorities. The effect of such statutes, regulations and policies can be significant, and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions and their holding companies regulate, among other things, the scope of business, investments, reserves against deposits, capital levels relative to operations, lending activities and practices, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to us and our bank establishes a comprehensive framework for our respective operations and is intended primarily for the protection of the FDIC's deposit insurance funds, our depositors, and the public, rather than our shareholders.

Federal law and regulations establish supervisory standards applicable to the lending activities of our bank, including internal controls, credit underwriting, loan documentation and loan-to-value ratios for loans secured by real property.

Macatawa Bank Mortgage Company, a subsidiary of Macatawa Bank, and Macatawa Investment Services, Inc., a subsidiary of Macatawa Bank Corporation, are subject to various state and federal regulations.

### Macatawa Bank Corporation

***General***. On January 9, 2002, Macatawa Bank Corporation became a financial holding company, within the meaning of the Gramm-Leach-Bliley Act of 1999 ("GLB Act"), and is registered with, and subject to regulation by, the Federal Reserve Board under the Bank Holding Company Act, as amended (the "BHCA"). Under the BHCA, we are subject to periodic examination by the Federal Reserve Board, and are required to file with the Federal Reserve Board periodic reports of our operations and such additional information as the Federal Reserve Board may require.

In accordance with Federal Reserve Board policy, we are expected to act as a source of financial strength to Macatawa Bank and to commit resources to support Macatawa Bank in circumstances where we might not do so absent such policy. In addition, if the Commissioner deems Macatawa Bank's capital to be impaired, the Commissioner may require Macatawa Bank to restore its capital by a special assessment upon us as the bank's sole shareholder. If we were to fail to pay any such assessment, the directors of Macatawa Bank would be required, under Michigan law, to sell the shares of the bank's stock owned by us to the highest bidder at either a public or private auction and use the proceeds of the sale to restore the bank's capital.

***Investments and Activities***. In general, any direct or indirect acquisition by us of any voting shares of any bank which would result in our direct or indirect ownership or control of more than 5% of any class of voting shares of such bank, and any merger or consolidation between us and another financial holding company or bank holding company, will require the prior written approval of the Federal Reserve Board under the BHCA. No Federal Reserve Board approval is required for us to acquire a company, other than a bank holding company or bank, engaged in activities that are financial in nature as determined by the Federal Reserve Board.

The merger or consolidation of an existing bank subsidiary of ours with another bank, or the acquisition by such a subsidiary of assets of another bank, or the assumption of liability by such a subsidiary to pay any deposits in another bank, will require the prior written approval of the responsible Federal depository institution regulatory agency under the Bank Merger Act. In addition, in certain such cases an application to, and the prior approval of, the Federal Reserve Board under the BHCA and/or the Commissioner under the Michigan Banking Code, may be required.

Financial holding companies, like us, may engage in various lending, advisory, insurance and insurance underwriting, securities underwriting, dealing and market making, and merchant banking activities (as well as those activities previously approved for bank holding companies by the Federal Reserve Board) together with such other activities as may be determined by the Federal Reserve Board (in coordination with other regulatory authorities) to be financial in nature, incidental to any such financial activity, or complimentary to any such financial activity, and which do not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. In order to maintain the benefits and flexibility of being a financial holding company, each of our subsidiary depository institutions must continue to be "well-capitalized" and "well-managed" under applicable regulatory standards and each subsidiary depository institution must maintain at least a satisfactory or above Community Reinvestment Act rating.

***Capital Requirements***. The Federal Reserve Board uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other items, be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve Board's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a leverage capital requirement expressed as a percentage of total average assets, and (ii) a risk-based requirement expressed as a percentage of total risk-weighted assets. The leverage capital requirement consists of a minimum ratio of Tier 1 capital (which consists principally of shareholders' equity) to total average assets of 3% for the most highly rated companies, with minimum requirements of 4% to 5% for all others. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, of which at least one-half must be Tier 1 capital.

***Dividends***. Macatawa Bank Corporation is a corporation separate and distinct from Macatawa Bank. Most of our revenues are dividends paid by our bank. Thus, our ability to pay dividends to our shareholders is indirectly limited by statutory restrictions on our bank's ability to pay dividends described below. Further, in a policy statement, the Federal Reserve Board has expressed its view that a bank holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income or which can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing. Additionally, the Federal Reserve Board possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. Similar enforcement powers over our bank are possessed by the FDIC. The "prompt corrective action" provisions of federal law and regulation authorizes the Federal Reserve Board to restrict the payment of dividends by us for an insured bank which fails to meet specified capital levels.

In addition to the restrictions on dividends imposed by the Federal Reserve Board, the Michigan Business Corporation Act provides that dividends may be legally declared or paid only if after the distribution a corporation, like us, can pay its debts as they come due in the usual course of business and its total assets equal or exceed the sum of its liabilities plus the amount that would be needed to satisfy the preferential rights upon dissolution of any holders of preferred stock whose preferential rights are superior to those receiving the distribution.

***Federal Securities Regulation.*** Our common stock is registered with the Securities and Exchange Commission ("SEC") under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. The Sarbanes-Oxley Act of 2002 provides for numerous changes to the reporting, accounting, corporate governance and business practices of companies as well as financial and other professionals who have involvement with the U.S. public markets. The SEC continues to issue new and proposed rules implementing various provisions of the Sarbanes-Oxley Act.

**Macatawa Bank**

***General***. Macatawa Bank is a Michigan banking corporation, and its deposit accounts are insured by the Bank Insurance Fund (the “BIF”) of the FDIC. As a BIF insured Michigan chartered bank, Macatawa Bank is subject to the examination, supervision, reporting and enforcement requirements of the Commissioner, as the chartering authority for Michigan banks, and the FDIC, as administrator of BIF. These agencies and the federal and state laws applicable to our bank and its operations, extensively regulate various aspects of the banking business including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and on deposits, the maintenance of non-interest bearing reserves on deposit accounts, and the safety and soundness of banking practices. Grand Bank was also subject to the same supervision and regulation until its merger into Macatawa Bank effective January 1, 2003.

***Deposit Insurance***. As an FDIC-insured institution, we are required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system under which all insured depository institutions are placed into one of nine categories and assessed insurance premiums, based upon their respective levels of capital and results of supervisory evaluation. Institutions classified as well-capitalized (as defined by the FDIC) and considered healthy pay the lowest premium while institutions that are less than adequately capitalized (as defined by the FDIC) and considered of substantial supervisory concern pay the highest premium. Risk classification of all insured institutions is made by the FDIC for each semi-annual assessment period.

The Federal Deposit Insurance Act (“FDIA”) requires the FDIC to establish assessment rates at levels which will maintain the Deposit Insurance Fund at a mandated reserve ratio of not less than 1.25% of estimated insured deposits. For several years, the BIF reserve ratio has been at or above the mandated ratio and assessments have ranged from 0% of deposits for institutions in the lowest risk category to .27% of deposits in the highest risk category.

***FICO Assessments.*** Our bank, as a member of the BIF, is subject to assessments to cover the payments on outstanding obligations of the Financing Corporation (“FICO”). FICO was created to finance the recapitalization of the Federal Savings and Loan Insurance Corporation, the predecessor to the FDIC’s Savings Association Insurance Fund (the “SAIF”) which insures the deposits of thrift institutions. From now until the maturity of the outstanding FICO obligations in 2019, BIF members and SAIF members will share the cost of the interest on the FICO bonds on a *pro rata* basis. It is estimated that FICO assessments during this period will be less than 0.025% of deposits.

***Commissioner Assessments.*** Michigan banks are required to pay supervisory fees to the Commissioner to fund the operations of the Commissioner. The amount of supervisory fees paid by a bank is based upon the bank’s total assets, as reported to the Commissioner.

***Capital Requirements***. The FDIC has established the following minimum capital standards for state-chartered, FDIC insured non-member banks, such as Macatawa Bank: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total average assets of 3% for the most highly-rated banks with minimum requirements of 4% to 5% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. Tier 1 capital consists principally of shareholders’ equity. These capital requirements are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions.

Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." Federal regulations define these capital categories as follows:

| | Total Risk-Based Capital Ratio | Tier 1 Risk-Based Capital Ratio | Leverage Ratio |
|---|---|---|---|
| Well capitalized | 10% or above | 6% or above | 5% or above |
| Adequately capitalized | 8% or above | 4% or above | 4% or above |
| Undercapitalized | Less than 8% | Less than 4% | Less than 4% |
| Significantly undercapitalized | Less than 6% | Less than 3% | Less than 3% |
| Critically undercapitalized | -- | -- | A ratio of tangible equity to total assets of 2% or less |

As of December 31, 2004, each of Macatawa Bank's ratios exceeded minimum requirements for the well capitalized category.

Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and ultimately, appointing a receiver for the institution.

In general, a depository institution may be reclassified to a lower category than is indicated by its capital levels if the appropriate federal depository institution regulatory agency determines the institution to be otherwise in an unsafe or unsound condition or to be engaged in an unsafe or unsound practice. This could include a failure by the institution, following receipt of a less-than-satisfactory rating on its most recent examination report, to correct the deficiency.

***Dividends***. Under Michigan law, our bank is restricted as to the maximum amount of dividends it may pay on its common stock. Our bank may not pay dividends except out of net income after deducting its losses and bad debts. A Michigan state bank may not declare or pay a dividend unless the bank will have surplus amounting to at least 20% of its capital after the payment of the dividend.

Federal law generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. The FDIC may prevent an insured bank from paying dividends if the bank is in default of payment of any assessment due to the FDIC. In addition, the FDIC may prohibit the payment of dividends by our bank, if such payment is determined, by reason of the financial condition of our bank, to be an unsafe and unsound banking practice.

***Insider Transactions***. Our bank is subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to us or our subsidiaries, on investments in the stock or other securities of our or our subsidiaries and the acceptance of the stock or other securities of us or our subsidiaries as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by our bank to its directors and officers, to our directors and officers, the directors and officers of our bank, to our principal shareholders and to "related interests" of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of our company or one of its subsidiaries or a principal shareholder in our company may obtain credit from banks with which our bank maintains a correspondent relationship.

***Safety and Soundness Standards***. The federal banking agencies have adopted guidelines to promote the safety and soundness of federally insured depository institutions. These guidelines establish standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

***Investments and Other Activities***. Under federal law and FDIC regulations, FDIC insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law, as implemented by FDIC regulations, also prohibits FDIC insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank or its subsidiary, respectively, unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the deposit insurance fund of which the bank is a member. Impermissible investments and activities must be divested or discontinued within certain time frames set by the FDIC in accordance with federal law. These restrictions are not currently expected to have a material impact on the operations of our bank.

***Consumer Protection Laws***. Our bank's business includes making a variety of types of loans to individuals. In making these loans, we are is subject to State usury and regulatory laws and to various federal statutes, including the privacy of consumer financial information provisions of the Gramm-Leach-Bliley Act and regulations promulgated thereunder, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, and the Home Mortgage Disclosure Act, and the regulations promulgated thereunder, which prohibit discrimination, specify disclosures to be made to borrowers regarding credit and settlement costs, and regulate the mortgage loan servicing activities of our bank, including the maintenance and operation of escrow accounts and the transfer of mortgage loan servicing. In receiving deposits, our bank is subject to extensive regulation under State and federal law and regulations, including the Truth in Savings Act, the Expedited Funds Availability Act, the Bank Secrecy Act, the Electronic Funds Transfer Act, and the Federal Deposit Insurance Act. Violation of these laws could result in the imposition of significant damages and fines upon our bank and its directors and officers.

***Branching Authority.*** Michigan banks have the authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals. Banks may establish interstate branch networks through acquisitions of other banks. The establishment of de novo interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is allowed only if specifically authorized by state law.

Michigan permits both U.S. and non-U.S. banks to establish branch offices in Michigan. The Michigan Banking Code permits, in appropriate circumstances and with the approval of the Michigan Office of Financial and Insurance Services, Division of Financial Institutions, (1) acquisition of Michigan banks by FDIC-insured banks, savings banks or savings and loan associations located in other states, (2) sale by a Michigan bank of branches to an FDIC-insured bank, savings bank or savings and loan association located in a state in which a Michigan bank could purchase branches of the purchasing entity, (3) consolidation of Michigan banks and FDIC-insured banks, savings banks or savings and loan associations located in other states having laws permitting such consolidation, (4) establishment of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting a Michigan bank to establish a branch in such jurisdiction, and (5) establishment by foreign banks of branches located in Michigan.

**ITEM 2: Properties.**

We own or lease facilities located in Ottawa County, Allegan County and Kent County, Michigan. Our administrative offices are located at 10753 Macatawa Drive, Holland, Michigan 49424. Our administrative offices are approximately 49,000 square feet and contain our administration, human resources, trust, loan underwriting and processing, and deposit operations.

Our facilities as of March 1, 2005, were as follows:

| Location of Facility | Use |
|---|---|
| 10753 Macatawa Drive, Holland | Main Branch, Administrative, and Loan Processing Offices |
| 51 E. Main Street, Zeeland* | Branch Office |
| 125 Ottawa Avenue N.W., Grand Rapids* | Trust and Mortgage Offices |
| 126 Ottawa Avenue N.W., Grand Rapids* | Branch Office |
| 139 E. 8th Street, Holland* | Branch Office |
| 489 Butternut Dr., Holland | Branch Office |
| 701 Maple Avenue, Holland | Branch Office |
| 699 E. 16th Street, Holland | Branch Office |
| 41 N. State Street, Zeeland | Branch Office |
| 2020 Baldwin Street, Jenison | Branch Office |
| 6299 Lake Michigan Dr., Allendale | Branch Office |
| 132 South Washington, Douglas | Branch Office |
| 4758 - 136th Street, Hamilton* | Branch Office |
| 3526 Chicago Drive, Hudsonville | Branch Office |
| 20 E. Lakewood Blvd., Holland | Branch Office |
| 3191 - 44th Street, S.W., Grandville | Branch Office |
| 8233 Byron Center Avenue S.W., Byron Center* | Branch Office |
| 5271 Clyde Park Avenue, S.W., Wyoming | Branch Office and Loan Center |
| 4590 Cascade Road, Grand Rapids | Branch Office |
| 3177 Knapp Street, N.E., Grand Rapids | Branch Office and Loan Center |
| 15135 Whittaker Way, Grand Haven | Branch Office and Loan Center |
| 12415 Riley Street, Holland | Branch Office |
| 2750 Walker N.W., Walker | Branch Office |
| 1575 - 68th Street S.W., Grand Rapids | Branch Office |

* Leased facility

We believe our facilities are well-maintained and adequately insured. Because of our growth, we are continually evaluating the need for additional space and branches.

**ITEM 3: Legal Proceedings.**

Please refer to the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, (Part II, Item 1 Legal Proceedings) for information concerning legal proceedings related to Trade Partners, Inc.

A lawsuit was filed in April 2003 by John and Kathryn Brand in Oklahoma state court against Grand Bank, the Company, Trade Partners and certain individuals and entities associated with Trade Partners. The complaint seeks damages for the asserted breach of certain escrow agreements for which Grand Bank served as custodian and escrow agent. The Company and Grand Bank have answered this complaint, denying the material allegations and raising certain affirmative defenses. No trial date has yet been set. The Company has also filed a motion to stay this action until Trade Partners can be joined as a party (all actions against Trade Partners have been stayed since April 2003 by order of the United States District Court for the Western District of Michigan). The Oklahoma state court has orally advised counsel that it has decided to grant the Company’s stay motion, though as of March 8, 2005 no official order had yet been entered.

In May 2003, a purported class action complaint was filed by Forrest W. Jenkins and Russell S. Vail against the Company and against LaSalle Bank Corporation in the United States District Court for the District of Western Michigan. The purported class included investors who invested in limited liability companies formed by Trade Partners. On November 6, 2003, the court permitted the plaintiffs to amend their complaint to expand the purported class to include all individuals who invested in Trade Partners viatical investments. The class has not been certified. The court stayed this action to avoid interference with the process of the receivership proceedings, though the stay was modified on July 19, 2004 to permit the Company and plaintiffs to engage in certain limited discovery directed to each other. The plaintiffs allege that Grand Bank breached certain escrow agreements, breached its fiduciary duties, acted negligently or grossly negligently with respect to the plaintiff’s investments and violated the Michigan Uniform Securities Act. The amended complaint seeks certification of the action as a class action, unspecified damages and other relief. The Company has answered this complaint denying the material allegations and raising certain affirmative defenses.

The Company believes it has meritorious defenses and intends to vigorously defend both cases.

On April 15, 2003, the United States District Court for the Western District of Michigan appointed a receiver for Trade Partners. In order to prevent or minimize any loss to investors in the viaticals sold by Trade Partners to investors, the court appointed receiver has been coordinating the payment of premiums on the approximately 1,000 outstanding viaticated insurance policies in the Trade Partners portfolio so that the policies do not lapse. The receiver informed the Company that nine policies with a total face value of approximately $1.4 million lapsed for failure to pay premiums prior to the receiver’s coordination efforts. In addition, about $700,000 is being contested as to lapses.

The receiver has received court permission to pool the death benefits of any of the Trade Partners viaticated policies that mature and use the benefits to pay premiums on other viaticated policies. As of January 15, 2005, the Receiver reported that he had received since the inception of the receivership cash payments for death benefit claims aggregating about $24.6 million, and had claims pending for an additional $7.4 million (though other parties assert claims to some of these proceeds). He reported at the same time that he had sufficient funds to pay premiums through June 30, 2005 as they accrue. As of January 15, 2004, the receiver reported cash on hand of approximately $12.3 million. As additional viaticated policies mature, death benefits from those policies could provide a source of funding for continued premium payments.

In addition, on July 1, 2003, the United States District Court for the Western District of Michigan authorized the receiver to borrow money from Macatawa Bank to pay premiums, if needed. Macatawa Bank agreed to extend a $4 million line of credit to the receiver, conditioned upon obtaining a security interest in the viaticals. No draws were made against the line, and the line expired during the fourth quarter of 2004.

The receiver in June 2004 proposed a plan of distribution of the assets of Trade Partners. No hearing has yet been set on the plan. The receiver has received authorization from the Court to pursue a sale of the entire portfolio, and on January 19, 2005 filed a motion seeking approval of a sale of the entire portfolio with a face value of approximately $170 million to Universal Settlements International, Inc., a Canadian company, for an amount equal to 26.58% of face value. The sale agreement allows for an auction to be held under the supervision of the Court in the event overbids meeting certain criteria are received before the hearing date on the motion for approval of the sale. A hearing on the sale motion was held before the Magistrate Judge on February 24 and 25, 2005, and is scheduled to resume on March 10, 2005. The receiver has indicated that, depending on the outcome of the motion to sell the portfolio, he may propose a new plan of distribution by the end of the first calendar quarter of 2005. The receiver reported as of January 18, 2005 that claims against the receivership estate totaling $81,750,316.64 have been approved, and that he estimates total claims will be approximately $174,061,528.92.

The Company has no information on the amount of distributions the receiver may propose to make to investors, or when such distributions might begin.

It is possible that one or more additional legal actions may be initiated involving the custodial and escrow agent services provided by Grand Bank in connection with Trade Partners. If any such legal actions are commenced, the Company intends to defend them vigorously. To the extent any pending or future claims allege errors or omissions on the part of Grand Bank or Macatawa Bank, Management believes that some or all liability, if any is proven or established, will be covered by errors and omissions insurance maintained by Grand Bank and Macatawa Bank. The Company has reported the Trade Partners matter to its two insurance carriers. One carrier has assumed the Company's defense and has advanced a portion of its defense costs pursuant to a reservation of rights letter asserting certain coverage defenses, and an Interim Funding Agreement. The other carrier has taken the position that the duty of defense rests solely with the first carrier, and reserves its rights with respect to indemnity pursuant to a reservation letter asserting certain coverage defenses.

As of the date hereof, except as disclosed above, there were no material pending legal proceedings, other than routine litigation incidental to the business of banking to which we or any of our subsidiaries are a party of or which any of our properties are the subject.

**ITEM 4: Submission of Matters to a Vote of Security Holders.**

No matters were submitted during the fourth quarter of 2004 to a vote of our shareholders.

**ADDITIONAL ITEM: Executive Officers of the Registrant.**

The list below identifies those persons designated as executive officers of Macatawa Bank Corporation and Macatawa Bank.

| Name | Age | Year Elected an Executive Officer | Positions Held |
|---|---|---|---|
| Benj. A. Smith, III | 61 | 1997 | Chairman of the Board and Chief Executive Officer of Macatawa Bank Corporation. |
| Philip J. Koning | 50 | 1997 | President and Chief Executive Officer of Macatawa Bank and Treasurer and Secretary of Macatawa Bank Corporation. |
| Jon W. Swets | 39 | 2002 | Senior Vice President and Chief Financial Officer of Macatawa Bank Corporation and Macatawa Bank. |
| Ray D. Tooker | 61 | 2000 | Senior Vice President Loan Administration of Macatawa Bank. |

## PART II

**ITEM 5: Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is quoted on the Nasdaq National Market. High and low sales prices (as reported on the Nasdaq National Market) for each quarter are included in the following table. The information in the following table has been retroactively adjusted to reflect the effect of all stock dividends paid.

| | 2004 | | | 2003 | | |
|---|---|---|---|---|---|---|
| **Quarter** | **High** | **Low** | **Dividends Declared** | **High** | **Low** | **Dividends Declared** |
| First Quarter | $ 28.00 | $ 24.19 | $ 0.11 | $ 20.47 | $ 17.69 | $ 0.09 |
| Second Quarter | $ 28.50 | $ 24.00 | $ 0.12 | $ 23.56 | $ 18.74 | $ 0.10 |
| Third Quarter | $ 28.75 | $ 24.88 | $ 0.12 | $ 24.38 | $ 21.19 | $ 0.10 |
| Fourth Quarter | $ 32.99 | $ 25.85 | $ 0.15 | $ 27.95 | $ 22.05 | $ 0.11 |

On February 24, 2005, there were approximately 743 owners of record and, in addition, approximately 5,213 beneficial owners of our common stock.

The Company declared its first cash dividend, amounting to $.06 per share, during the fourth quarter of 2000. Quarterly cash dividends totaling $.25 were paid during 2001, and a 3% stock dividend was declared during the second quarter of 2001. Quarterly cash dividends totaling $.31 were paid during 2002, and a 4% stock dividend was declared during the second quarter of 2002. Quarterly cash dividends totaling $.40 were paid during 2003, and a 5% stock dividend was declared during the second quarter of 2003. Quarterly cash dividends totaling $.50 were paid during 2004, and a 5% stock dividend was declared during the second quarter of 2004. All of these cash dividend amounts have been retroactively adjusted to reflect the effect of the stock dividends.

We intend to continue to declare quarterly cash dividends in the future. We may also consider declaring stock dividends on an annual basis. We expect to obtain the funds for the payment of future cash dividends from cash currently held and from the dividends we receive from Macatawa Bank out of its earnings. However, there can be no assurance that we will have the financial resources to continue to pay dividends in the future.

**ITEM 6: Selected Financial Data.**

The information set forth under the caption "Selected Consolidated Financial Data" in our Annual Report to Shareholders for the year ended December 31, 2004, is incorporated by reference and is filed as part of Exhibit 13 to this form 10-K Annual Report.

**ITEM 7: Management's Discussion and Analysis of Results of Operations and Financial Condition.**

The information set forth under the caption "Management's Discussion and Analysis of Results of Operations and Financial Condition," in our Annual Report to Shareholders for the year ended December 31, 2004, is hereby incorporated by reference and is filed as part of Exhibit 13 to this Form 10-K Annual Report.

**ITEM 7A: Quantitative and Qualitative Disclosures About Market Risk.**

The information set forth under the captions "Management's Discussion and Analysis of Results of Operations and Financial Condition – Sensitivity to Market Risk" in our Annual Report to Shareholders for the year ended December 31, 2004, is hereby incorporated by reference and is filed as part of Exhibit 13 to this Form 10-K Annual Report.

**ITEM 8: Financial Statements and Supplementary Data.**

The information set forth under the captions "Quarterly Financial Data," "Report of Independent Registered Public Accounting Firm on Financial Statements," "Consolidated Balance Sheets," "Consolidated Statements of Income," "Consolidated Statements of Changes in Shareholders' Equity," "Consolidated Statements of Cash Flows," and "Notes to Consolidated Financial Statements" in our Annual Report to Shareholders for the year ended December 31, 2004, is hereby incorporated by reference and is filed as part of Exhibit 13 to this Form 10-K Annual Report.

**ITEM 9: Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

There have been no disagreements with our independent public accountants.

**ITEM 9A: Controls and Procedures.**

(a) Evaluation of Disclosure Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Report, have concluded that as of the end of the period covered by this Report the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the company, particularly during the period in which this Form 10-K Annual Report was being prepared.

(b) Management's Report on Internal Control over Financial Reporting.

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Company management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment we believe that, as of December 31, 2004, the Company's internal control over financial reporting is effective based on those criteria.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2004, has been audited by Crowe Chizek and Company LLC, an independent registered certified public accounting firm, as stated in their report included in Exhibit 13 to this Annual Report on Form 10-K which is incorporated herein by reference.

(c) Changes in Internal Controls.

There were no significant changes in the Company's internal controls over financial reporting during the fourth quarter ended December 31, 2004, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**ITEM 9B: Other Information.**

None.

## PART III

**ITEM 10: Directors and Executive Officers of the Registrant.**

The information set forth on pages 4-5, under the caption "Information About Directors" and on page 13 under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in our definitive Proxy Statement dated March 10, 2005, relating to our 2005 Annual Meeting of Shareholders and the information within that section is incorporated by reference. Information relating to our Executive Officers is included in Part I hereof entitled "Executive Officers of the Registrant." There are no family relationships between or among the above-named executive officers. There are no arrangements or understandings between any of the above-named officers pursuant to which any of them was named an officer.

We have adopted a Senior Officer Code of Ethics. A copy of our Senior Officer Code of Ethics is available upon request by writing to the Chief Financial Officer, Macatawa Bank Corporation, 10753 Macatawa Drive, Holland, Michigan 49424.

**ITEM 11: Executive Compensation.**

Information relating to compensation of our executive officers and directors is contained under the captions "Compensation of Directors" and "Executive Compensation," in our definitive Proxy Statement dated March 10, 2005, relating to our 2005 Annual Meeting of Shareholders and the information within those sections is incorporated by reference.

**ITEM 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

Information relating to security ownership of certain beneficial owners and management is contained on Page 2 under the caption "Voting Securities and Principal Holders Thereof" and on page 11 under the caption "Security Ownership of Management" in our definitive Proxy Statement dated March 10, 2005, relating to our 2005 Annual Meeting of Shareholders and the information within that section is incorporated by reference.

## Equity Compensation Plan Information

We maintain certain equity compensation plans under which common stock is authorized for issuance to employees, consultants and directors in exchange for services, including our Stock Compensation Plan, 1998 Directors' Stock Option Plan, the Grand Bank Financial Corporation 1988 Stock Option Plan and the Grand Bank Financial Corporation Stock Option Plan of 1997.

The following table sets forth certain information regarding the above referenced equity compensation plans as of December 31, 2004. The following information has been adjusted to reflect the effect of all stock dividends.

**Equity Compensation Plan Information**

| Plan Category | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights (1) | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 508,846 | $19.13 | 172,403 |
| Equity compensation plans not approved by security holders | 0 | NA | 0 |
| Total | 508,846 | $19.13 | 172,403 |

(1) We had not granted warrants or rights applicable to this chart.

**ITEM 13: Certain Relationships and Related Transactions.**

Information relating to certain relationships and related transactions is contained on page 12, under the caption "Transactions Involving Management" in our definitive Proxy Statement dated March 10, 2005, relating to our 2005 Annual Meeting of Shareholders and the information within that section is incorporated by reference.

**ITEM 14: Principal Accountant Fees and Services.**

Information relating to principal accountant fees and services is contained on page 15, under the caption "Principal Accounting Firm Fees" in our definitive Proxy Statement dated March 10, 2005, relating to our 2005 Annual Meeting of Shareholders and the information within that section is incorporated by reference.

## PART IV

**ITEM 15: Exhibits, Financial Statement Schedules.**

(a) Financial Statements.

1. The following documents are filed as part of Item 8 of this report:

   Report of Independent Registered Public Accounting Firm on Financial Statements
   Consolidated Balance Sheets as of December 31, 2004 and 2003
   Consolidated Statements of Income for the years ended December 31, 2004, 2003 and 2002
   Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2004, 2003 and 2002
   Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003 and 2002
   Notes to Consolidated Financial Statements

2. Schedules to the consolidated financial statements required by Article 9 of Regulation S-X are not required under the related instructions or are inapplicable, and therefore have been omitted.

3. The following exhibits are filed as part of this report: Reference is made to the exhibit index which follows the signature page of this report.

   The Registrant will furnish a copy of any exhibits listed on the Exhibit Index to any shareholder of the Registrant without charge upon written request to Chief Financial Officer, Macatawa Bank Corporation, 10753 Macatawa Drive, Holland, Michigan 49424.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, dated March 4, 2005.

**MACATAWA BANK CORPORATION**

By: /s/ Benj. A. Smith, III

Benj. A. Smith, III
Chairman and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Jon W. Swets

Jon W. Swets
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 4, 2005, by the following persons on behalf of the Registrant and in the capacities indicated. Each director of the Registrant, whose signature appears below, hereby appoints Benj. A. Smith, III and Philip J. Koning, and each of them severally, as his attorney-in-fact, to sign in his name and on his behalf, as a director of the Registrant, and to file with the Commission any and all Amendments to this Report on Form 10-K.

| Signature | |
|---|---|
| /s/ Benj. A. Smith, III | March 4, 2005 |
| Benj. A. Smith, III, Principal Executive Officer and a Director | |
| /s/ Jon W. Swets | March 4, 2005 |
| Jon W. Swets, Principal Financial and Accounting Officer | |
| /s/ G. Thomas Boylan | March 4, 2005 |
| G. Thomas Boylan, Director | |
| /s/ Robert E. DenHerder | March 4, 2005 |
| Robert E. DenHerder, Director | |
| /s/ John F. Koetje | March 4, 2005 |
| John F. Koetje, Director | |
| /s/ Philip J. Koning | March 4, 2005 |
| Philip J. Koning, Director and President | |
| /s/ Arend D. Lubbers | March 4, 2005 |
| Arend D. Lubbers, Director | |

EXHIBIT INDEX

**Exhibit Number and Description**

| | |
|---|---|
| 2 | Consolidation Agreement dated December 10, 1997, incorporated by reference to Exhibit 2 to the Macatawa Bank Corporation Registration Statement on Form SB-2 (Registration No. 333-45755). |
| 3.1 | Articles of Incorporation of Macatawa Bank Corporation, as amended, incorporated by reference to Exhibit 3.1 to the Macatawa Bank Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2002. |
| 3.2 | Bylaws of Macatawa Bank Corporation, incorporated by reference to Exhibit 3.2 to the Macatawa Bank Corporation Registration Statement on Form SB-2 (Registration No. 333-45755). |
| 4 | Specimen stock certificate of Macatawa Bank Corporation, incorporated by reference to Exhibit 4 to the Macatawa Bank Corporation Registration Statement on Form SB-2 (Registration No. 333-45755). |
| 10.1 | Macatawa Bank Corporation Stock Compensation Plan, incorporated by reference to Exhibit 10.1 to the Registrant's Form SB-2 Registration Statement (No. 333-45755), as amended by the First Amendment included as Appendix B to the Macatawa Bank Corporation Proxy Statement dated March 5, 1999, for the Annual Meeting of Shareholders held April 15, 1999, as further amended by the Second Amendment included as Appendix A to the Macatawa Bank Corporation Proxy Statement dated March 7, 2002, for the Annual Meeting of Shareholders held April 18, 2002, both of which amendments are incorporated herein by reference. |
| 10.2 | Macatawa Bank Corporation 1998 Directors' Stock Option Plan incorporated by reference to Exhibit 10.2 to the Registrant's Form SB-2 Registration Statement (No. 333-45755), as amended by the First Amendment included as Appendix B to the Macatawa Bank Corporation Proxy Statement dated March 7, 2002, for the Macatawa Bank Corporation Annual Meeting of Shareholders held April 18, 2002, which is incorporated herein by reference. |
| 10.3 | Employment Agreement between Benj. A Smith III and Macatawa Bank Corporation dated August 25, 2004, incorporated by reference to Exhibit 10.1 to the Macatawa Bank Corporation Report on Form 8-K dated August 26, 2004. |
| 10.4 | Form of Indemnity Agreement between Macatawa Bank Corporation and each of its directors, incorporated by reference to Exhibit 10.2 to the Macatawa Bank Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2003. |
| 10.5 | Investment Management Agreement between Macatawa Bank and Smith & Associates Investment Management Services dated March 11, 2004, incorporated by reference to Exhibit 10.5 to the Macatawa Bank Corporation Annual Report on Form 10-K for the year ended December 31, 2003. |

| | |
|---|---|
| 10.6 | Form of Stock Option Agreement. |
| 13 | Annual Report to Shareholders for the year ended December 31, 2004. This exhibit, except for those portions expressly incorporated by reference in this filing, is furnished for the information of the Securities and Exchange Commission and is not deemed “filed” as part of this filing. This information was delivered to the Company’s shareholders in compliance with Rule 14a-3 of the Securities Exchange Act of 1934, as amended. |
| 21 | Subsidiaries of the Registrant 23 Consent of Crowe Chizek and Company LLC, independent public accountants |
| 24 | Power of Attorney (included on the signature page on page 23 of the Annual Report on Form 10-K) |
| 31.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certificate of the Chief Executive Officer and Chief Financial Officer of Macatawa Bank Corporation pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**Exhibit 10.6 – Form of Stock Option Agreement**

The standard Form of Agreement under the Stock Compensation Plan and the 1998 Directors' Stock Option Plan are listed below. There exists no authorized options for further issuance under the Stock Option Plans acquired as part of the acquisition of Grand Bank Financial Corporation.

**STOCK COMPENSATION PLAN**
**STOCK OPTION AGREEMENT**

This **STOCK OPTION AGREEMENT** is made this day of , 20__ between **MACATAWA BANK CORPORATION** (the "Company") and **__________**, an employee of the Company or one of its subsidiaries (the "Employee"), pursuant to the Macatawa Bank Corporation Stock Compensation Plan (the "Plan"). All capitalized defined terms in this Agreement shall have the meaning ascribed to such terms in the Plan, unless other wise defined in this Agreement.

**IT IS AGREED AS FOLLOWS**:

1. Grant of Option. Pursuant to the Plan, the Company hereby grants to the Employee the option to purchase of the Company's common stock, no par value, on the terms and conditions herein set forth (the "Option"). All of the shares covered by this Option shall be considered and hereby are designated as incentive stock options ("ISOs") qualifying under the provisions of Section 422 of the Internal Revenue Code of 1986, as amended.

2. Purchase Price. The purchase price of the shares covered by this Option shall be **$** per share. The "Committee" (provided for in Article 3 of the Plan) has determined that such price represents one hundred percent 100% of the fair market value of a share of the Company's common stock on this date.

3. Term of Option. The term of this Option shall be for a period of ten (10) years from the date hereof, subject in each case to earlier termination as provided in subsequent paragraphs of this Agreement.

4. Employee's Agreement. In consideration of the granting of the Option, the Employee agrees to remain in the employ of the Company for a period of at lease twelve (12) months from the date hereof (the "Minimum Employment Period"). Such employment, subject to the provisions of any written contract between the Company and the Employee, shall be at the pleasure of the Board of Directors, and this Option Agreement shall not impose on the Company any obligation to retain the Employee in its employ for any period. In the event of the termination of employment of the Employee for any reason during the Minimum Employment Period, this Option shall terminate, unless this Option becomes exersiable as provided in Paragraph 9.

5. Exercise of Option. Except as provided in paragraph 9, this Option shall not be exercisable prior to the expiration of the Minimum Employment Period. Thereafter, this Option may be exercised in whole or in part, at any time and from time to time. This Option may not be exercised as to less than 100 shares at any one time, unless the number purchased — is the total number at that time purchasable under this Option. This Option shall be exercised by written notice to the Company. The notice shall state the number of shares with respect to which the Option is being exercised, shall be signed by the person exercising this Option, and shall be accompanied by payment of the full purchase price of the shares in such form as the Committee may accept. This Option agreement shall be submitted to the Company with the notice for purposes of recording the shares being purchased, if exercised in part, or for purposes of cancellation if all shares men subject to this Option are being purchased. In the event the Option shall be exercised pursuant to paragraph 8(c) hereof by any person other than the Employee, such notice shall be accompanied by appropriate proof of the right of such person to exercise the Option. To the extent determined by the Committee in its sole discretion, payment of the purchase price shall be made by: (a) cash, check, bank draft, or money order, payable to the order of the Company; (b) the delivery by the Employee of unencumbered shares of common stock of the Company with a Fair Market Value on the last trading day preceding payment equal to the total purchase price of the shares to be purchased; (c) the reduction in the number of shares issuable upon exercise (based on the fair market value of the shares on the date of exercise); or (d) a combination of (a), (b), and (c). Upon exercise of all or a portion of this Option, the Company shall issue to the Employee a stock certificate representing the number of shares with respect to which this Option was exercised.

6. Tax Withholding. The exercise of this Option is subject to the satisfaction of withholding tax or other withholding liabilities, if any, under federal, state and local laws in connection with such exercise or the delivery or purchase of shares pursuant hereto. The exercise of this Option shall not be effective unless applicable withholding shall have been effected or obtained in the following manner or in any other manner acceptable to the Committee. Unless otherwise prohibited by the Committee, Optionee may satisfy any such withholding tax obligation by any of the following means or by a combination of such means: (a) tendering a cash payment; (b) authorizing the Company to withhold from the shares otherwise issuable to Optionee as a result of the exercise of this Option a number of shares having a fair market value as of the date that the amount of tax to be withheld is to be determined ('Tax Date"), which shall be the date of exercise of the Option, less than or equal to the amount of the withholding tax obligation; or (c) delivering to the Company unencumbered shares of the Company's common stock owned by Optionee having a fair market value, as of the Tax Date, less than or equal to the amount of the withholding tax obligation.

7. Nontransferability of Option. This Option shall not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated other than by will or by the laws of descent and distribution, and shall not be subject to execution, levy, attachment or similar process. Any attempted sale, transfer, assignment, pledge, hypothecation or other disposition of this Option contrary to the terms hereof, and any execution, levy, attachment or similar process upon the Option, shall be null and void and without effect. Following any transfer, this Option shall continue to be subject to the same terms and conditions immediately prior to transfer. The designation of a person entitled to exercise this Option after the Employee's death will not be deemed a transfer.

8. Termination of Employment.

(a) Termination of Employment for Reasons Other Than Retirement, Disability or Death. Upon Termination of Employment for any reason other than Retirement or on account of Disability or death, this Option shall, to the extent rights to purchase shares hereunder have accrued at the date of such Termination of Employment and shall not have been fully exercised, be exercisable, in whole or in part, at any time within a period of three (3) months following Termination of Employment, subject, however, to prior expiration of the term of this Option and any other limitations upon its exercise in effect at the date of exercise.

(b) Termination of Employment for Retirement or Disability. Upon Termination of Employment by reason of Retirement or Disability, this Option shall, to the extent rights to purchase shares hereunder have accrued at the date of such Retirement or Disability and have not been fully exercised, be exercisable, in whole: or in part, for a period of three (3) years following such Termination of Employment, subject to any other limitations imposed by the Plan. If the Employee dies after such Retirement or Disability, this Option shall be exercisable in accordance with paragraph 8(c) hereof.

(c) Termination of Employment for Death. Upon Termination of Employment due to death, this Option shall, to the extent rights to purchase shares hereunder have accrued at the date of death and shall not have been folly exercised, be exercisable, in whole or in part, by the personal representative of the Employee's estate, by any person or persons who shall have acquired this Option directly from the Employee by bequest or inheritance, by a person designated to exercise the Option after the Employee's death, or a Permitted Transferee only under the following circumstances and during the following periods: (i) if the Employee dies while employed by the Company or a subsidiary, at any time within three (3) years after his or her death, or (ii) if the Employee dies during the extended exercise period following termination of employment specified in paragraph 8(b), at any time within the longer of such extended period or one (1) year after his or her death, subject, in any case, to the earlier expiration of this Option.

(d) Termination of Option. If this Option is not exercised within whichever of the exercise periods specified in paragraph 8(a), 8(b) or 8(c) is applicable, this Option shall terminate upon expiration of such exercise period.

9. Changes in Capital Structure. The number of shares covered by this Option, and the price per share, shall be proportionately adjusted for any increase or decrease in the number of issued shares of common stock of the Company resulting from any combination of shares or the payment of a stock dividend on the Company's common stock or any other increase or decrease in the number of shares effected without receipt of consideration by the Company.

In the event of a "Change of Control" (as defined in Section 12.2 of the Plan) of the Company, this Option will be and become fully vested and exercisable irrespective the Minimum Employment Period and irrespective any vesting schedule set forth in this Agreement, unless in the case of a transaction described in clause (iii) or (Iv), of Section 12.2 of the Plan, provisions are made in connection with such transaction for the continuance of the Plan and the assumption of this Option or the substitution for this Option of a new option covering the stock of a successor employer corporation, or a parent or subsidiary thereof, covering the stock of a successor employer corporation, or a parent or subsidiary thereof, with appropriate adjustments as to the number and kind of shares and prices.

In the event of a change in the common stock of the Company as presently constituted, which is limited to a change of all its authorized shares into the same number of shares with a different par value or without par value, the shares resulting from any such change shall be deemed to be the shares subject to this Option.

Except as expressly provided in this paragraph 9, the Employee shall have no rights by reason of: (i) any subdivision or combination of shares of stock of any class, (ii) the payment of any stock dividend or any other increase or decrease in the number of shares of stock of any class; or (iii) any dissolution, liquidation, merger or consolidation or spinoff of assets or stock of another corporation. Except as provided in this paragraph 9, any issue by the company of shares of stock of any class, or securities convertible into shares of stock of any class, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares subject to this Option.

The grant of this Option shall not affect in anyway the right or power of the Company to make adjustments, reclassifications, reorganizations or changes of its capital or business structure or to merge or to consolidate or to dissolve, liquidate or sell, or transfer all or any part of its business or assets.

10. Rjghts as a Shareholder. Neither the Employee nor a transferee of this Option shall have any rights as a shareholder with respect to any shares covered hereby until the date he or she shall have become the holder of record of such shares. No adjustment shall be made for dividends, distributions or other rights for which the record date is prior to the date on which he or she shall have become the holder of record thereof, except as provided in paragraph 9 hereof.

11. Modification, Extention and Renewal. Subject to the terms and conditions and within the limitations of the Plan, the Committee, subject to approval of the Board of Directors, may modify or renew this Option, or accept its surrender (to. the extent not theretofore exercised) and authorize the granting of a new option or options in substitution therefore (to the extent not theretofore exercised). Notwithstanding the foregoing, no modification shall, without the consent of the Employee, alter or impair any rights or obligations hereunder.

12. Postponement of Delivery of Shares and Representations. The Company, in its discretion, may postpone the issuance and/or delivery of shares upon any exercise of this Option until completion of such stock exchange listing, or registration, or other qualification of such shares under any state and/or federal law, rule or regulation as me Company may consider appropriate, and may require any person exercising this Option to make such representations, including a representation that it is the Employee's intention to acquire shares for investment and not with a view to distribution thereof, and furnish such information as it may consider appropriate in connection with the issuance or delivery of shares in compliance with applicable laws, rules and regulations. In such event, no shares shall be issued to such holder unless and until the Company is satisfied with the accuracy of any such representations.

13. Subject to Plan. This Option is subject to the terms and provisions of the Macatawa Bank Corporation Stock Compensation Plan. If any inconsistency exists between the provisions of this Agreement and the Plan, the Plan shall govern.

14. ISO Stock Option. Any provision of this Option or the Plan to the contrary notwithstanding, neither the Company, the Company's Board of Directors nor the Committee shall have any authority to take any action or to do anything which would cause the shares designated herein as ISOs to fail to qualify as ISOs within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended.

In Witness Whereof, this Stock Option Agreement has been executed the date first above written.

**MACATAWA BANK CORPORATION**

**BY** ______________________________

**ITS** ______________________________

**EMPLOYEE**

__________________________________

**PRINT NAME**

**ADDRESS**

**SS#:**

**1998 DIRECTORS' STOCK OPTION PLAN**
**STOCK OPTION AGREEMENT**

STOCK OPTION AGREEMENT, made this _________ day of ___________ , 2004, between MACATAWA BANK CORPORATION (herein called the "Company") and _________, a director of the Company (me "Grantee"), pursuant to the Macatawa Bank Corporation 1998 Directors' Stock Option Plan (herein called the "Plan").

IT IS AGREED AS FOLLOWS:

1. Grant of Option

Pursuant to the Plan and the terms of this Agreement, the Company hereby grants to Grantee, an Eligible Director under the terms of the Plan, the option to purchase_______ shares of the Company's common stock, no par value per share.

2. Purchase Price

The purchase price of the shares covered by this option shall be $ 28.80 per share, which represents one hundred percent (100) of the Fair Market Value of the Company's common stock on this date ("Grant Date").

3. Additional Terms

(a) Exercise Period

The Option may be exercised and Option Shares may be purchased at any time and from time to time on or after Ac first anniversary of the date of this Agreement and prior to the tenth anniversary of the date of this Agreement ("Exercise Period"), subject to the following:

(1) If Grantee dies while serving as a director of the Company, this Option shall become immediately exercisable as of the date of death and shall remain exercisable until the earlier of (a) the last day of the 36th month after the month of Grantee's death, or (b) the tenth anniversary of the Grant Date; and

(2) This Option may not be exercised after (he earlier of (a) the last day of the 36th month following the month in which Grantee's service as a director terminates, or (b) the tenth anniversary of the Grant Date.

(b) Procedure for Exercise

Subject to conditions of this Agreement, the Option may be exercised at any time and from time to time during the Exercise Period by delivering written notice to the Company, signed by Grantee, a Permitted Transferee, or Post-Death Representative, specifying the number of Option Shares to be purchased and accompanied by this Agreement.

(c) Payment of Option Price

The Option Price shall be paid in full either (1) in cash or (2) through the delivery of unencumbered shares of the Company's common stock owned by the person exercising this Option having a Fair Market Value on the date of exercise equal to the total exercise price, or (3) by a combination of (1) and (2) above, except that (i) any portion of the exercise price representing a fraction of a Share shall be paid in cash, and (ii) no Shares of Stock which have been held for less than six months may be delivered in payment of the exercise price. If approved by the Committee, payment of the exercise price of this Option may be made by a reduction in the number of shares issuable upon exercise of this Option, based upon the Fair Market Value of the Stock on the last trading day preceding exercise of this Option.

4. Transferabilitv of Option

Except as otherwise provided in this paragraph, this Option shall not be sold, pledged, assigned or transferred in any way, nor be assignable by operation of law or subject to execution, levy, attachment or similar process. Except as provided in this paragraph, any attempted sale, pledge, assignment or other transfer of this Option contrary to the terms hereof, and any execution, levy, attachment or similar process upon the Option, shall be null and void and without any effect. Notwithstanding the foregoing, this Option shall, subject to the conditions set forth in this paragraph 4, be transferable by the original Grantee by gift, or other transfer that involves no payment of consideration lo the original Grantee, at any time after the grant of the Option to the Grantee's spouse and/or the Grantee's descendants or to a trust created primarily for the benefit of the Grantee, the Grantee's spouse and/or the Grantee's descendants ("Authorized Transferee"), Payment of any consideration by an Authorized Transferee to the original Grantee is prohibited and any attempted transfer for consideration shall be void. An Authorized Transferee shall have no right to transfer the Option. An Authorized Transferee shall succeed to all rights and benefits (except the right to further transfer the Option) and be subject to all obligations, conditions and limitations of the original Grantee, However, such rights and benefits (except the rights to further transfer the Option) and obligations, conditions and limitations shall be determined as if the original Grantee continued to hold the Option, whereby, the provisions of this Option Agreement dealing with termination of employment, retirement, disability and death of an Grantee continue to refer to the original Grantee regardless of whether the options are or are not transferred to an Authorized Transferee. In order to transfer this Option, the Grantee must first give prior written notice to the Company's president or chief financial officer stating the name address and tax identification or social security number of the proposed transferee and the relationship of the proposed transferee to the Grantee and certifying mat the transfer involves no payment of consideration. This Option may not be transferred if the transfer would constitute a violation of any applicable federal or state securities or other law or valid regulation. As a condition to the transfer of this Option, the Company may require the proposed transferee to make any representations and warranties to the Company as the Company may deem to be required by applicable law or regulation. In such event, the Option may not be transferred unless and until the Company is satisfied with the correctness of any such representation and warranty. Moreover, the Company, in its discretion, may postpone the transfer of this Option until completion of such stock exchange listing, or registration, or other qualification under any state and/or federal law, rule or regulation as the Company may consider appropriate.

5. Conformity with Plan

The Option is intended to conform in all respects with and is subject to all applicable provisions of the Plan which is incorporated herein by reference. Any inconsistencies between this Agreement and the Plan shall be resolved in accordance with the terms of the Plan. By executing and returning the enclosed copy of this Agreement, Grantee acknowledges receipt of the Plan and agrees to be bound by all of the terms of the Plan.

6. Service as a Director

Grantee acknowledges that nothing in this Agreement or in the Plan imposes upon the Company, its Board of Directors, or its shareholders any obligation to retain or elect the Grantee as director of the Company for any period.

7. Adjustments

The Company shall make appropriate and proportionate adjustments, to the number of Option Shares and me Option Price to reflect any stock dividend, stock split, or combination of shares, merger, consolidation, or other change in the capitalization of the Company, as provided in Section 10 of (he Plan. In the event of any such adjustment, all new, substituted, or additional securities or other property to which Grantee is entitled under the Option shall be included in the term "Option Shares."

8. Postponement of Delivery of Shares and Representations

The Company, in its discretion, may postpone the issuance or delivery of Shares upon any exercise of this Option until completion of the registration, or other qualification of such shares under any state and/or federal law, rule, or regulation as the Company may consider appropriate. The Company may require any person exercising this Option to make such representations, including a representation that it is their intention to acquire Shares for investment and not with a view to distribution thereof, and furnish such information as it may consider appropriate in connection with the issuance or delivery of the Shares in compliance with applicable laws, rules and regulations. No Shares shall be issued unless the Company is satisfied with the accuracy of any such representations.

9. Rights as a Shareholder

The Grantee shall have no rights as a shareholder with respect to any Option Shares until the Grantee becomes the holder of record of such shares.

10. Further Actions

The parties agree to execute such further instruments and to take such further actions as may reasonably be required to carry out the intent of this Agreement.

11. Notice

Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given upon personal delivery or upon deposit in the United States Post Office, by registered or certified mail with postage and fees prepaid, addressed to the other party hereto at the address set forth in this Agreement or at such other address as such party may designate by ten day's advance written notice to the other party.

12. Successors and Assigns

This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the Company and, subject to the restrictions on transfer set forth herein, be binding upon and inure to the benefit of Grantee's heirs, personal representatives, successors, and permitted assigns.

13. Governing Law

This Agreement and all documents contemplated hereby, and all remedies in connection therewith and all questions or transactions relating thereto, shall be construed in accordance with and governed by the laws of the state of Michigan.

14. Entire Agreement

This Agreement constitutes the entire understanding between the Grantee and the Company with respect to the Option Shares and supersedes all other agreements, whether written or oral, with respect to such Shares.

MACATAWA BANK CORPORATION

By: ____________________________

Its: ____________________________

The undersigned hereby acknowledges having read this Agreement, the Plan. and the other enclosures to this Agreement and hereby agrees to be bound by all provisions set forth herein and in the Plan.

GRANTEE

_____________________________

Signature

_____________________________

(Please Print Name)

Address:

**Exhibit 21 — Subsidiaries of Registrant**

Macatawa Bank - 100% owned
Incorporated as a Michigan Banking Corporation
10753 Macatawa Drive
Holland, Michigan 49424

Macatawa Investment Services, Inc. - 100% owned
Incorporated as a Michigan corporation
10753 Macatawa Drive
Holland, Michigan 49424

Macatawa Statutory Trust I - 100% owned
Statutory Trust under the laws of the State of Connecticut
10753 Macatawa Drive
Holland, Michigan 49424

Macatawa Statutory Trust II - 100% owned
Statutory Trust under the laws of the State of Delaware
10753 Macatawa Drive
Holland, Michigan 49424

Macatawa Bank Mortgage Company
100% owned by Macatawa Bank
Incorporated as a Michigan corporation
10753 Macatawa Drive
Holland, Michigan 49424

**Exhibit 23**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the registration statements on Form S-8 (File No. 333-53593, File No. 333-53595, File No. 333-94207, File No. 333-85288, File No. 333-88572 and File No. 333-88574) of our reports dated February 21, 2005 with respect to the 2004 consolidated financial statements of Macatawa Bank Corporation, Macatawa management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which reports are included in this Annual Report on Form 10-K for the year ended December 31, 2004.

/s/Crowe Chizek and Company LLC
Crowe Chizek and Company LLC

Grand Rapids, Michigan
March 9, 2005

**EXHIBIT 31.1**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Benj. A Smith, III, certify that:

1. I have reviewed this annual report on Form 10-K of Macatawa Bank Corporation;

2. Based on my knowledge, this annual report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant’s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) for the registrant and we have:

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

   (b) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably liked to materially affect, the registrant’s internal control over financial reporting.

5. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

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

Date: March 10, 2005

/s/ Benj. A. Smith, III

Benj. A. Smith, III
Chief Executive Officer

**EXHIBIT 31.2**

**Certification Pursuant to Section 302**
**of the Sarbanes-Oxley Act of 2002**

I, Jon W. Swets, certify that:

1. I have reviewed this annual report on Form 10-K of Macatawa Bank Corporation;

2. Based on my knowledge, this annual report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

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

   (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably liked to materially affect, the registrant's internal control over financial reporting.

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

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

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

Date: March 10, 2005

/s/ Jon W. Swets

Jon W. Swets
Senior Vice President and
Chief Financial Officer

**EXHIBIT 32-1**

Benj. A. Smith III, Chief Executive Officer of Macatawa Bank Corporation, and Jon W. Swets, Senior Vice President and Chief Financial Officer of Macatawa Bank Corporation, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Annual Report on Form 10-K for the year ended December 31, 2004 which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and

(2) the information contained in the Annual Report on Form 10-K for the year ended December 31, 2004 fairly presents, in all material respects, the financial condition and results of operations of Macatawa Bank Corporation.

Dated: March 10, 2005

/s/ Benj. A. Smith, III

Benj. A. Smith, III
Chief Executive Officer

/s/ Jon W. Swets

Jon W. Swets
Senior Vice President and Chief Financial Officer

**Selected Consolidated Financial Data**

The following selected consolidated financial and other data are derived from the Company's Financial Statements and should be read with the Consolidated Financial Statements and Notes thereto, and Management's Discussion and Analysis of Results of Operations and Financial Condition. The Consolidated Balance Sheets as of December 31, 2004 and 2003, and the Consolidated Statements of Income for the years ended December 31, 2004, 2003, and 2002, are included elsewhere in this Annual Report.

| (Dollars in thousands, except share and per share data) | **As of and For the Year Ended December 31** | | | | |
|---|---|---|---|---|---|
| | **2004** | **2003** | **2002** | **2001** | **2000** |
| Financial Condition | | | | | |
| Total assets | $ 1,672,606 | $ 1,401,111 | $ 1,176,583 | $ 670,203 | $ 499,813 |
| Securities | 139,801 | 109,673 | 90,170 | 64,316 | 48,669 |
| Loans | 1,396,387 | 1,157,107 | 961,038 | 545,693 | 410,676 |
| Deposits | 1,351,516 | 1,109,399 | 920,873 | 526,192 | 398,617 |
| FHLB Advances | 123,985 | 145,680 | 106,897 | 75,638 | 51,000 |
| Shareholders' equity | 129,074 | 121,900 | 113,974 | 66,502 | 38,128 |
| Share Information* | | | | | |
| Basic earnings per common share | $ 1.45 | $ 1.34 | $ 1.17 | $ .98 | .79 |
| Diluted earnings per common share | 1.42 | 1.32 | 1.16 | .97 | .79 |
| Book value per common share | 14.63 | 13.87 | 13.10 | 10.93 | 9.00 |
| Dividends per common share | .50 | .40 | .31 | .25 | .06 |
| Weighted average dilutive shares outstanding | 8,973,053 | 8,912,741 | 8,230,449 | 5,287,582 | 4,255,091 |
| Shares outstanding at end of period | 8,823,902 | 8,788,577 | 8,700,381 | 6,085,236 | 4,238,739 |
| Operations | | | | | |
| Interest income | $ 78,329 | $ 64,435 | $ 57,252 | $ 42,685 | $ 34,338 |
| Interest expense | 26,309 | 22,341 | 22,902 | 20,927 | 17,739 |
| Net interest income | 52,020 | 42,094 | 34,350 | 21,758 | 16,599 |
| Provision for loan losses | 7,890 | 4,105 | 3,321 | 2,285 | 1,931 |
| Net interest income after provision for loan losses | 44,130 | 37,989 | 31,029 | 19,473 | 14,668 |
| Total noninterest income | 10,042 | 10,154 | 7,877 | 3,683 | 2,052 |
| Total noninterest expense | 35,400 | 30,575 | 24,741 | 15,543 | 12,672 |
| Income before tax | 18,772 | 17,568 | 14,165 | 7,613 | 4,048 |
| Federal income tax | 5,996 | 5,788 | 4,652 | 2,497 | 699 |
| Net income | $ 12,776 | $ 11,780 | $ 9,513 | $ 5,116 | $ 3,349 |
| Performance Ratios | | | | | |
| Return on average equity | 10.15% | 9.91% | 9.46% | 9.58% | 9.31% |
| Return on average assets | .83% | .94% | .95% | .88% | .80% |
| Yield on average interest-earning assets | 5.47% | 5.55% | 6.16% | 7.82% | 8.85% |
| Cost on average interest-bearing liabilities | 2.07% | 2.19% | 2.82% | 4.39% | 5.20% |
| Average net interest spread | 3.40% | 3.36% | 3.34% | 3.43% | 3.65% |
| Average net interest margin | 3.64% | 3.63% | 3.69% | 3.98% | 4.18% |
| Efficiency ratio | 57.04% | 58.52% | 58.59% | 61.09% | 67.95% |
| Capital Ratios | | | | | |
| Equity to assets | 7.72% | 8.70% | 9.69% | 9.92% | 7.63% |
| Total risk-based capital ratio | 11.02% | 10.92% | 9.89% | 12.85% | 10.36% |
| Credit Quality Ratios | | | | | |
| Allowance for loan losses to total loans | 1.38% | 1.39% | 1.40% | 1.41% | 1.43% |
| Nonperforming assets to total assets | .35% | .32% | .28% | .36% | .04% |
| Net charge-offs to average loans | .37% | .14% | .12% | .09% | .02% |

*Retroactively adjusted to reflect the effect of all stock dividends.

**Quarterly Financial Data (unaudited)**

A summary of selected quarterly results of operations for the years ended December 31, 2004 and 2003 follows:

| (Dollars in thousands, except share and per share data) | Three Months Ended | | | |
|---|---|---|---|---|
| | **March 31** | **June 30** | **September 30** | **December 31** |
| 2004 | | | | |
| Interest income | $ 17,305 | $ 18,636 | $ 20,345 | $ 22,043 |
| Net Interest income | 11,392 | 12,570 | 13,619 | 14,439 |
| Provision for loan losses | 1,225 | 1,440 | 3,900 | 1,325 |
| Income before income tax expense | 4,208 | 4,948 | 3,047 | 6,569 |
| Net income | 2,866 | 3,346 | 2,116 | 4,448 |
| Net income per share | | | | |
| Basic | 0.33 | 0.38 | 0.24 | 0.50 |
| Diluted | 0.32 | 0.37 | 0.24 | 0.49 |
| 2003 | | | | |
| Interest income | $ 15,408 | $ 15,885 | $ 16,373 | $ 16,768 |
| Net Interest income | 9,608 | 10,287 | 10,936 | 11,263 |
| Provision for loan losses | 995 | 870 | 1,040 | 1,200 |
| Income before income tax expense | 4,238 | 4,395 | 4,572 | 4,363 |
| Net income | 2,810 | 2,932 | 3,063 | 2,975 |
| Net income per share | | | | |
| Basic | .32 | .33 | .35 | .34 |
| Diluted | .32 | .33 | .34 | .33 |

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

**MANAGEMENT’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company’s internal control system was designed to provide reasonable assurance to the company’s management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Company management assessed the effectiveness of the company’s internal control over financial reporting as of December 31, 2004. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment we believe that, as of December 31, 2004, the Company’s internal control over financial reporting is effective based on those criteria.

The Company’s independent auditors have issued an audit report on our assessment of the Company’s internal control over financial reporting.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Macatawa Bank Corporation maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Macatawa Bank Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Macatawa Bank Corporation maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Macatawa Bank Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Macatawa Bank Corporation as of December 31, 2004 and 2003 and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004 and our report dated February 21, 2005 expressed an unqualified opinion on those consolidated financial statements.

Crowe Chizek and Company LLC

Grand Rapids, Michigan
February 21, 2005

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Macatawa Bank Corporation
Holland, Michigan

We have audited the accompanying consolidated balance sheets of Macatawa Bank Corporation as of December 31, 2004 and 2003, and the related statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Macatawa Bank Corporation at December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Macatawa Bank Corporation's internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 21, 2005 expressed an unqualified opinion thereon.

Crowe Chizek and Company LLC

Grand Rapids, Michigan
February 21, 2005

MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2004 and 2003
(Dollars in thousands)

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 31,711 | $ 41,633 |
| Federal funds sold | 0 | 18,414 |
| Total cash and cash equivalents | 31,711 | 60,047 |
| Securities available for sale, at fair value | 137,249 | 107,049 |
| Securities held to maturity (fair value 2004 - $2,662, 2003 - $2,701) | 2,552 | 2,624 |
| Federal Home Loan Bank (FHLB) stock | 12,239 | 8,793 |
| Loans held for sale | 3,150 | 4,054 |
| Total loans | 1,396,387 | 1,157,107 |
| Allowance for loan losses | (19,251) | (16,093) |
| | 1,377,136 | 1,141,014 |
| Premises and equipment - net | 45,784 | 38,713 |
| Accrued interest receivable | 6,395 | 5,095 |
| Goodwill | 23,915 | 23,915 |
| Acquisition intangibles | 2,347 | 2,787 |
| Bank-owned life insurance | 20,157 | 0 |
| Other assets | 9,971 | 7,020 |
| Total assets | $ 1,672,606 | $ 1,401,111 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Deposits | | |
| Noninterest-bearing | $ 149,104 | $ 139,557 |
| Interest-bearing | 1,202,412 | 969,842 |
| Total | 1,351,516 | 1,109,399 |
| Federal funds purchased | 22,131 | 0 |
| FHLB advances | 123,985 | 145,680 |
| Long-term debt | 41,238 | 19,655 |
| Accrued expenses and other liabilities | 4,662 | 4,477 |
| Total liabilities | 1,543,532 | 1,279,211 |
| Shareholders' equity | | |
| Preferred stock, no par value, 500,000 shares authorized; no shares issued and outstanding | | |
| Common stock, no par value, 20,000,000 shares authorized; 8,823,902 and 8,370,073 shares issued and outstanding at December 31, 2004 and 2003, respectively | 124,389 | 114,568 |
| Retained earnings | 4,277 | 5,300 |
| Accumulated other comprehensive income | 408 | 2,032 |
| Total shareholders' equity | 129,074 | 121,900 |
| Total liabilities and shareholders' equity | $ 1,672,606 | $ 1,401,111 |

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2004, 2003 and 2002
(Dollars in thousands)

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Interest income | | | |
| Loans, including fees | $ 72,583 | $ 59,775 | $ 52,687 |
| Securities | | | |
| Taxable | 3,528 | 3,237 | 3,476 |
| Tax-exempt | 1,727 | 1,067 | 620 |
| FHLB stock | 430 | 338 | 289 |
| Federal funds sold and other short-term investments | 61 | 18 | 180 |
| Total interest income | 78,329 | 64,435 | 57,252 |
| Interest expense | | | |
| Deposits | 19,071 | 16,970 | 18,273 |
| FHLB advances | 5,223 | 4,676 | 4,407 |
| Long-term debt | 1,659 | 507 | 120 |
| Federal funds purchased and other borrowings | 356 | 188 | 102 |
| Total interest expense | 26,309 | 22,341 | 22,902 |
| **Net interest income** | 52,020 | 42,094 | 34,350 |
| Provision for loan losses | 7,890 | 4,105 | 3,321 |
| **Net interest income after provision for loan losses** | 44,130 | 37,989 | 31,029 |
| Noninterest income | | | |
| Service charges and fees | 2,962 | 2,564 | 2,247 |
| Gain on sales of loans | 2,207 | 3,746 | 2,382 |
| Trust fees | 2,945 | 2,480 | 2,118 |
| Other | 1,928 | 1,364 | 1,130 |
| Total noninterest income | 10,042 | 10,154 | 7,877 |
| Noninterest expense | | | |
| Salaries and benefits | 19,206 | 16,371 | 12,838 |
| Occupancy of premises | 2,653 | 2,342 | 1,861 |
| Furniture and equipment | 2,768 | 2,588 | 2,161 |
| Legal and professional fees | 679 | 763 | 617 |
| Marketing and promotion | 1,210 | 946 | 722 |
| Supplies | 551 | 595 | 486 |
| Data processing fees | 1,074 | 799 | 829 |
| Other | 7,259 | 6,171 | 5,227 |
| Total noninterest expenses | 35,400 | 30,575 | 24,741 |
| **Income before income tax expense** | 18,772 | 17,568 | 14,165 |
| Income tax expense | 5,996 | 5,788 | 4,652 |
| **Net income** | $ 12,776 | $ 11,780 | $ 9,513 |
| Basic earnings per share | $ 1.45 | $ 1.34 | $ 1.17 |
| Diluted earnings per share | $ 1.42 | $ 1.32 | $ 1.16 |
| Cash dividends per share | $ .50 | $ .40 | $ .31 |

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2004, 2003 and 2002
(Dollars in thousands)

| | Common Stock | Retained Earnings | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|---|---|---|---|---|
| **Balance, January 1, 2002** | $ 62,334 | $ 3,180 | $ 988 | $ 66,502 |
| Net income | | 9,513 | | 9,513 |
| Other comprehensive income (loss): | | | | |
| Net change in unrealized gain (loss) on derivative instruments, net of tax of $338 | | | 656 | 656 |
| Net change in unrealized gain (loss) on securities available for sale, net of tax of $617 | | | 1,198 | 1,198 |
| Comprehensive income | | | | 11,367 |
| Issued 2,472,015 shares for acquisition of GBFC, adjusted for stock dividend | 39,817 | | | 39,817 |
| Conversion of GBFC stock options | 987 | | | 987 |
| Repurchase of 115,000 shares | (2,300) | | | (2,300) |
| Issued 212,355 shares in payment of 4% stock dividend | 4,270 | (4,277) | | (7) |
| Issued 14,931 shares for stock option exercises | 93 | | | 93 |
| Cash dividends at $.31 per share | | (2,485) | | (2,485) |
| **Balance, December 31, 2002** | 105,201 | 5,931 | 2,842 | 113,974 |
| Net income | | 11,780 | | 11,780 |
| Other comprehensive income (loss): | | | | |
| Net change in unrealized gain (loss) on derivative instruments, net of tax of ($13) | | | (25) | (25) |
| Net change in unrealized gain (loss) on securities available for sale, net of tax of ($423) | | | (785) | (785) |
| Comprehensive income | | | | 10,970 |
| Issued 397,664 shares in payment of 5% stock dividend | 8,926 | (8,940) | | (14) |
| Issued 80,907 shares for stock option exercises | 441 | | | 441 |
| Cash dividends at $.40 per share | | (3,471) | | (3,471) |
| **Balance, December 31, 2003** | 114,568 | 5,300 | 2,032 | 121,900 |

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (continued)
Years ended December 31, 2004, 2003 and 2002
(Dollars in thousands)

| | Common Stock | Retained Earnings | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|---|---|---|---|---|
| Net income | | 12,776 | | 12,776 |
| Other comprehensive income (loss): | | | | |
| Net change in unrealized gain (loss) on derivative instruments, net of tax of ($366) | | | (679) | (679) |
| Net change in unrealized gain (loss) on securities available for sale, net of tax of ($509) | | | (945) | (945) |
| Comprehensive income | | | | 11,152 |
| Issued 418,263 shares in payment of 5% stock dividend | 9,330 | (9,355) | | (25) |
| Issued 35,566 shares for stock option exercises (net of 5,249 shares exchanged and $97 of tax benefit) | 491 | | | 491 |
| Cash dividends at $.50 per share | | (4,444) | | (4,444) |
| **Balance, December 31, 2004** | $ 124,389 | $ 4,277 | $ 408 | $ 129,074 |

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2004, 2003 and 2002
(Dollars in thousands)

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net income | $ 12,776 | $ 11,780 | $ 9,513 |
| Adjustments to reconcile net income to net cash from operating activities | | | |
| Depreciation and amortization | 2,971 | 2,703 | 2,368 |
| Provision for loan losses | 7,890 | 4,105 | 3,321 |
| Origination of loans for sale | (141,661) | (305,612) | (240,819) |
| Proceeds from sales of loans originated for sale | 144,772 | 324,030 | 229,047 |
| Gain on sales of loans | (2,207) | (3,746) | (2,382) |
| Net change in | | | |
| Accrued interest receivable and other assets | (3,446) | 1,780 | 1,708 |
| Bank-owned life insurance | (157) | 0 | 0 |
| Accrued expenses and other liabilities | 1,157 | (5,057) | 2,086 |
| Net cash from operating activities | 22,095 | 29,983 | 4,842 |
| **Cash flows from investing activities** | | | |
| Loan originations and payments, net | (245,862) | (197,553) | (166,549) |
| Purchase of FHLB stock | (3,446) | (3,402) | (815) |
| Purchases of securities available for sale | (68,554) | (42,687) | (29,083) |
| Maturities and calls of securities available for sale | 36,574 | 19,273 | 13,584 |
| Principal paydowns on securities | 413 | 2,839 | 2,469 |
| Cash received from acquisition of GBFC | 0 | 0 | 21,390 |
| Purchase of bank-owned life insurance | (20,000) | 0 | 0 |
| Additions to premises and equipment | (9,617) | (15,264) | (12,109) |
| Net cash from investing activities | (310,492) | (236,794) | (171,113) |
| **Cash flows from financing activities** | | | |
| Net increase in deposits | 242,117 | 188,526 | 148,621 |
| Net increase (decrease) in short-term borrowings | 22,131 | (20,000) | 20,000 |
| Proceeds from long-term debt and other borrowings | 21,583 | 19,655 | 4,936 |
| Repayments on other borrowings | 0 | (4,500) | 0 |
| Proceeds from FHLB advances | 339,000 | 128,500 | 29,328 |
| Repayments on FHLB advances | (360,695) | (90,153) | (18,239) |
| Fractional shares purchased | (25) | (14) | (7) |
| Cash dividends paid | (4,444) | (3,471) | (2,485) |
| Shares repurchased | 0 | 0 | (2,300) |
| Proceeds from exercises of stock options | 394 | 441 | 93 |
| Net cash from financing activities | 260,061 | 218,984 | 179,947 |
| Net change in cash and cash equivalents | (28,336) | 12,173 | 13,676 |
| Beginning cash and cash equivalents | 60,047 | 47,874 | 34,198 |
| Ending cash and cash equivalents | $ 31,711 | $ 60,047 | $ 47,874 |
| Supplemental cash flow information: | | | |
| Interest paid | $ 25,816 | $ 22,915 | $ 22,525 |
| Income taxes paid | 6,525 | 6,400 | 5,450 |

See accompanying notes to consolidated financial statements.

MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
Years ended December 31, 2004, 2003 and 2002
(Dollars in thousands)

| | **2004** | **2003** | **2002** |
|---|---|---|---|
| Supplemental noncash disclosures: | | | |
| Transfers from loans to other real estate | 1,850 | 753 | 388 |
| GBFC acquisition: | | | |
| Securities acquired (including FHLB stock) | | | 11,864 |
| Loans acquired | | | 246,344 |
| Premises and equipment acquired | | | 656 |
| Acquisition intangibles recorded | | | 27,578 |
| Other assets acquired | | | 4,142 |
| Deposits assumed | | | (246,060) |
| Borrowings assumed | | | (20,170) |
| Other liabilities assumed | | | (4,940) |
| Value of common stock issued and converted stock options | | | (40,804) |

See accompanying notes to consolidated financial statements.

**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Macatawa Bank, and its wholly-owned subsidiary, Macatawa Bank Mortgage Company; and Macatawa Investment Services, Inc. Upon the completion of the acquisition of Grand Bank Financial Corporation (GBFC), Grand Bank became a wholly owned subsidiary effective April 1, 2002, and its results are included in the consolidated statements of income since this effective date. Effective January 1, 2003 Grand Bank was merged into Macatawa Bank with the combined bank named Macatawa Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company also owns all of the common stock of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and, as discussed in a separate note, were previously consolidated with the Company and now reported separately.

Nature of Operations: Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The bank operates 22 full service branch offices providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan. Macatawa Bank Mortgage Company originates and sells residential mortgage loans into the secondary market on a servicing released basis. Macatawa Investment Services was formed in October 2001 and gained approval in June 2002 from the NASD to commence operations as a broker/dealer. Macatawa Investment Services provides various brokerage services including discount brokerage, personal financial planning and consultation regarding individual stocks and mutual funds. Macatawa Statutory Trust I and Macatawa Statutory Trust II are grantor trusts that were established on July 15, 2003 and March 18, 2004 through which trust preferred securities were issued.

The Company elected to become a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act, effective January 9, 2002. At the present time, the Company has no plans to engage in any of the expanded activities permitted under the new regulations.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, the fair value of intangible assets, the status of contingencies and the fair values of financial instruments are particularly subject to change.

Concentration of Credit Risk: Loans are granted to, and deposits are obtained from, customers primarily in the western Michigan area as described above. Substantially all loans are secured by specific items of collateral, including residential real estate, commercial real estate, commercial assets and consumer assets. Other financial instruments, which potentially subject the Company to concentrations of credit risk, include deposit accounts in other financial institutions.

Cash Flow Reporting: Cash and cash equivalents include cash on hand, demand deposits with other financial institutions and short-term securities (securities with maturities of equal to or less than 90 days and federal funds sold). Cash flows are reported net for customer loan and deposit transactions, interest-bearing time deposits with other financial institutions and short-term borrowings with maturities of 90 days or less.

(Continued)

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities available for sale consist of those securities which might be sold prior to maturity due to changes in interest rates, prepayment risks, yield and availability of alternative investments, liquidity needs or other factors. Securities classified as available for sale are reported at their fair value and the related unrealized holding gain or loss is reported in other comprehensive income. Federal Home Loan Bank stock is carried at cost.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level yield method without anticipating prepayments. Gains and losses on sales are based on the amortized cost of the security sold. Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Loans: Loans are reported at the principal balance outstanding, net of the allowance for loan losses, and charge-offs. Loans held for sale are reported at the lower of cost or market, on an aggregate basis. Loans are sold servicing released, therefore no mortgage servicing right assets are established.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term using the level yield method without anticipating prepayments. Interest income is not reported when full loan repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days (180 days for residential mortgages). Consumer loans are typically charged-off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and recoveries, and decreased by charge-offs, less recoveries. Management estimates the allowance balance required based on known and inherent risks in the portfolio, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

Loan impairment is reported when full payment under the loan terms is not expected. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Loans are evaluated for impairment when payments are delayed, typically 90 days or more, or when the internal grading system indicates a doubtful classification. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed. The Company held $1,850,000 in foreclosed assets at December 31, 2004 and $464,000 in foreclosed assets at December 31, 2003.

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 5 years. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable.

Bank-Owned Life Insurance: The Bank has purchased life insurance policies on certain officers. Bank-owned life insurance is recorded at its cash surrender value. Changes in cash surrender value are recorded in other income.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed separately. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on- and off-balance sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments.

Earnings Per Share: Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock options. Earnings and dividends per share are restated for all stock splits and dividends through the date of issue of the financial statements.

Stock Compensation: Employee compensation expense under stock option plans is reported using the intrinsic value method. No compensation cost related to stock options was recognized during 2004, 2003 or 2002, as all options granted had an exercise price equal to or greater than the market price of the underlying common stock at date of grant. Had compensation cost for stock options been measured using the fair value method, net income and basic and diluted earnings per share would have been the pro forma amounts indicated below (dollars in thousands except per share data). The pro forma effect may increase in the future if more options are granted.

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Net income as reported | $ 12,776 | $ 11,780 | $ 9,513 |
| Deduct: Stock-based compensation expense using fair value method | (243) | (211) | (214) |
| Pro forma net income | $ 12,533 | $ 11,569 | $ 9,299 |
| Basic earnings per share as reported | $ 1.45 | $ 1.34 | $ 1.17 |
| Pro forma basic earnings per share | 1.42 | 1.32 | 1.15 |
| Diluted earnings per share as reported | 1.42 | 1.32 | 1.16 |
| Pro forma diluted earnings per share | 1.40 | 1.30 | 1.13 |
| Weighted-average fair value of options granted during the period | 3.55 | 3.47 | 3.31 |

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

The pro forma effects are computed using option pricing models, using the following weighted-average assumptions as of grant date.

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Risk-free interest rate | 3.89% | 4.16% | 4.83% |
| Expected option life | 7 years | 7 years | 7 years |
| Expected stock price volatility | 23.38% | 24.08% | 25.25% |
| Dividend yield | 2.08% | 1.83% | 1.78% |

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and unrealized gains and losses on cash flow hedges which are also recognized as separate components of equity.

Segment Reporting: The Company, through the branch network of the Bank, provides a broad range of financial services to individuals and companies in western Michigan. These services include demand, time and savings deposits; lending; ATM processing; cash management; and trust services. While the Company's management team monitors the revenue streams of the various Company products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the Company's banking operations are considered by management to be aggregated in one reportable operating segment.

Off Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Derivative instruments and hedging activities: All derivative instruments are recorded at their fair values. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedge and the hedged item are included in current earnings. Fair value adjustments related to cash flow hedges are recorded in other comprehensive income and reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of hedges are reflected in income currently.

Goodwill: Goodwill results from prior business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified.

Acquisition Intangibles: Acquisition intangibles consist of core deposit and acquired customer relationship intangible assets arising from acquisitions. They are initially measured at fair value and then are amortized on an accelerated method with estimated useful lives of ten years. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable.

(Continued)

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Recently-Issued Standards Not Yet Adopted:

FAS 123, Revised, requires all public companies to record compensation cost for stock options provided to employees in return for employee service. The cost is measured at the fair value of the options when granted, and this cost is expensed over the employee service period, which is normally the vesting period of the options. This will apply to awards granted or modified after the first quarter or year beginning after June 15, 2005. Compensation cost will also be recorded for prior option grants that vest after the date of adoption. The effect on results of operations will depend on the level of future option grants and the calculation of the fair value of the options granted at such future date, as well as the vesting periods provided, and so cannot currently be predicted. Existing options that will vest after adoption date are expected to result in additional compensation expense of approximately $86,000 during the balance of 2005. There will be no significant effect on financial position as total equity will not change.

SOP 03-3 requires that a valuation allowance for loans acquired in a transfer, including in a business combination, reflect only losses incurred after acquisition and should not be recorded at acquisition. It applies to any loan acquired in a transfer that showed evidence of credit quality deterioration since it was made. The effect of this standard on the Company's financial position and results of operations is not expected to be material upon and after adoption.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

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

**NOTE 2 – CASH AND DUE FROM BANKS**

The Company was required to have $2,670,000 and $1,469,000 of cash on hand or on deposit with the Federal Reserve Bank to meet regulatory reserve and clearing requirements at year-end 2004 and 2003. These balances do not earn interest.

**NOTE 3 — SECURITIES**

The amortized cost and fair values of securities at year-end were as follows (dollars in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Values |
|---|---|---|---|---|
| Available for Sale 2004 | | | | |
| U.S. Treasury and federal agency securities | $ 91,394 | $ 447 | $ (442) | $ 91,399 |
| State and municipal bonds | 45,152 | 907 | (209) | 45,850 |
| | $ 136,546 | $ 1,354 | $ (651) | $ 137,249 |
| Held to Maturity 2004 | | | | |
| State and municipal bonds | $ 2,552 | $ 110 | $ 0 | $ 2,662 |
| | $ 2,552 | $ 110 | $ 0 | $ 2,662 |
| Available for Sale 2003 | | | | |
| U.S. Treasury and federal agency securities | $ 74,804 | $ 1,535 | $ (114) | $ 76,225 |
| State and municipal bonds | 30,088 | 945 | (209) | 30,824 |
| | $ 104,892 | $ 2,480 | $ (323) | $ 107,049 |
| Held to Maturity 2003 | | | | |
| State and municipal bonds | $ 2,624 | $ 77 | $ 0 | $ 2,701 |
| | $ 2,624 | $ 77 | $ 0 | $ 2,701 |

Securities with unrealized losses at year-end 2004 and 2003, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| **Description of Securities** | **Fair Value** | **Unrealized Loss** | **Fair Value** | **Unrealized Loss** | **Fair Value** | **Unrealized Loss** |
| December 31, 2004 | | | | | | |
| U.S. Treasury and federal agency securities | $ 32,610 | $ (389) | $ 1,947 | $ (53) | $ 34,557 | $ (442) |
| State and municipal bonds | 10,870 | (209) | 0 | 0 | 10,870 | (209) |
| Total temporarily impaired | $ 43,480 | $ (598) | $ 1,947 | $ (53) | $ 45,427 | $ (651) |

**NOTE 3 – SECURITIES** (Continued)

| Description of Securities | Less than 12 Months Fair Value | Less than 12 Months Unrealized Loss | 12 Months or More Fair Value | 12 Months or More Unrealized Loss | Total Fair Value | Total Unrealized Loss |
|---|---|---|---|---|---|---|
| December 31, 2003 | | | | | | |
| U.S. Treasury and federal agency securities | $ 7,886 | $ (114) | $ 0 | $ 0 | $ 7,886 | $ (114) |
| State and municipal bonds | 8,160 | (209) | 0 | 0 | 8,160 | (209) |
| Total temporarily impaired | $ 16,046 | $ (323) | $ 0 | $ 0 | $ 16,046 | $ (323) |

For unrealized losses on available for sale securities, no loss has been recognized into income because management has the intent and ability to hold these securities for the foreseeable future and the declines are largely due to differences in market interest rates as compared to those of the underlying securities. The declines in fair value are considered temporary and are expected to recover as the bonds approach their maturity date.

Contractual maturities of debt securities at December 31, 2004 were as follows (dollars in thousands):

| | Held-to-Maturity Securities Amortized Cost | Held-to-Maturity Securities Fair Value | Available-for-Sale Securities Amortized Cost | Available-for-Sale Securities Fair Value |
|---|---|---|---|---|
| Due in one year or less | $ 0 | $ 0 | $ 4,017 | $ 4,057 |
| Due from one to five years | 0 | 0 | 83,037 | 83,025 |
| Due from five to ten years | 517 | 519 | 14,687 | 15,213 |
| Due after ten years | 2,035 | 2,143 | 34,805 | 34,954 |
| | $ 2,552 | $ 2,662 | $ 136,546 | $ 137,249 |

There were no sales of securities for the years ended December 31, 2004, 2003 and 2002.

At December 31, 2004 and 2003, securities with a carrying value of approximately $1,000,000 were pledged as security for public deposits and for other purposes required or permitted by law. In addition, securities totaling $90,392,000 and $75,192,000 at December 31, 2004 and 2003 were used as collateral for advances from the Federal Home Loan Bank.

**NOTE 4 — LOANS**

Year-end loans were as follows (dollars in thousands):

| | 2004 | 2003 |
|---|---|---|
| Commercial | $ 338,398 | $ 312,131 |
| Commercial mortgage | 676,637 | 536,884 |
| Residential mortgage | 218,999 | 172,647 |
| Consumer | 162,353 | 135,445 |
| | $ 1,396,387 | $ 1,157,107 |

**NOTE 4 – LOANS** (Continued)

Activity in the allowance for loan losses was as follows (dollars in thousands):

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Beginning balance | $ 16,093 | $ 13,472 | $ 7,699 |
| Balances from GBFC acquisition | 0 | 0 | 3,464 |
| Provision for loan losses | 7,890 | 4,105 | 3,321 |
| Loans charged-off | (4,945) | (1,545) | (1,271) |
| Recoveries | 213 | 61 | 259 |
| Ending balance | $ 19,251 | $ 16,093 | $ 13,472 |

In 2004, loans charged-off included $2,800,000 related to one borrower whose loans with the Bank totaled approximately $5,900,000. These loans became impaired due to fraud perpetrated by the borrower. After this charge-off, approximately $3,100,000 of the loan balances remained outstanding. Subsequent to the charge-off, proceeds from the liquidation of certain collateral and payments on outstanding receivables have brought the balance to approximately $2,300,000 at December 31, 2004. This remaining loan balance is included in impaired loans at December 31, 2004.

Impaired loans were as follows (dollars in thousands):

| | 2004 | 2003 |
|---|---|---|
| Loans with no allocated allowance for loan losses | 0 | 807 |
| Loans with allocated allowance for loan losses | 3,215 | 2,533 |
| | $ 3,215 | $ 3,340 |
| Amount of the allowance for loan losses allocated | $ 923 | $ 792 |

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Average of impaired loans during the period | $ 3,329 | $ 2,583 | $ 2,594 |
| Interest income recognized during impairment | 0 | 154 | 144 |
| Cash-basis interest income recognized | 0 | 117 | 162 |

Nonperforming loans were as follows at year-end:

| | 2004 | 2003 |
|---|---|---|
| Loans past due over 90 days still on accrual | $ 772 | $ 2,308 |
| Nonaccrual loans | 3,249 | 1,717 |
| | $ 4,021 | $ 4,025 |

Nonperforming loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

**NOTE 5 — PREMISES AND EQUIPMENT — NET**

Year-end premises and equipment were as follows (dollars in thousands):

| | 2004 | 2003 |
|---|---|---|
| Land | $ 9,265 | $ 8,302 |
| Building | 27,703 | 21,785 |
| Leasehold improvements | 1,431 | 1,801 |
| Furniture and equipment | 13,320 | 12,863 |
| Construction in progress | 3,424 | 2,551 |
| | 55,143 | 47,302 |
| Less accumulated depreciation | (9,359) | (8,589) |
| | $ 45,784 | $ 38,713 |

Depreciation expense was $2,546,000, $2,301,000 and $1,872,000 for each of the years ending December 31, 2004, 2003 and 2002.

The Bank leases certain office and branch premises and equipment under operating lease agreements. Total rental expense for all operating leases aggregated $452,000, $586,000 and $648,000 for each of the years ending December 31, 2004, 2003 and 2002. Future minimum rental expense under noncancelable operating leases as of December 31, 2004 is as follows (dollars in thousands):

| | |
|---|---|
| 2005 | $ 335 |
| 2006 | 151 |
| 2007 | 33 |
| 2008 | 6 |
| 2009 | 3 |
| | $ 528 |

**NOTE 6 – ACQUISITION INTANGIBLES**

Intangible assets recorded for the April 1, 2002 acquisition of Grand Bank Financial Corporation that are subject to amortization were as follows in thousands of dollars as of December 31, 2004:

| | Gross Amount | Accumulated Amortization |
|---|---|---|
| Core deposits | $ 3,185 | $ 1,020 |
| Trust relationships | 478 | 296 |

Both the core deposits and trust relationships intangibles are being amortized on an accelerated basis over a period of ten years. Amortization expense for the years ended December 31, 2004, 2003 and 2002 was $440,000, $484,000 and $392,000. Estimated amortization expense for the next five years is as follows (dollars in thousands):

| | |
|---|---|
| 2005 | $ 406 |
| 2006 | 378 |
| 2007 | 340 |
| 2008 | 315 |
| 2009 | 297 |

**NOTE 7 — DEPOSITS**

Deposits at year-end were as follows (dollars in thousands):

| | 2004 | 2003 |
|---|---|---|
| Noninterest-bearing demand | $ 149,104 | $ 139,557 |
| Money market | 514,415 | 355,271 |
| NOW and Super NOW | 169,179 | 148,682 |
| Savings | 38,494 | 37,004 |
| Certificates of deposit | 480,324 | 428,885 |
| | $ 1,351,516 | $ 1,109,399 |

The following table depicts the maturity distribution of certificates of deposits at December 31, 2004 (dollars in thousands):

| | |
|---|---|
| 2005 | $ 340,778 |
| 2006 | 59,820 |
| 2007 | 33,988 |
| 2008 | 41,487 |
| 2009 | 4,251 |
| Thereafter | 0 |
| | $ 480,324 |

Approximately $331,677,000 and $272,492,000 in time certificates of deposit were in denominations of $100,000 or more at December 31, 2004 and 2003.

Brokered deposits totaled approximately $151,789,000 and $112,624,000 at December 31, 2004 and 2003. At December 31, 2004 and 2003, brokered deposits had interest rates ranging from 1.50% to 5.25% and 1.35% to 5.25%, respectively, and maturities ranging from one month to forty-six months.

**NOTE 8 — FEDERAL HOME LOAN BANK ADVANCES**

At year-end, advances from the Federal Home Loan Bank were as follows (dollars in thousands):

| Principal Terms | Advance Amount | Range of Maturities | Weighted Average Interest Rate |
|---|---|---|---|
| December 31, 2004 | | | |
| Single maturity fixed rate advances | $ 72,100 | January 2005 to October 2007 | 3.03% |
| Putable advances | 41,000 | January 2005 to December 2010 | 5.98% |
| Amortizable mortgage advances | 10,885 | February 2008 to July 2018 | 3.93% |
| | $ 123,985 | | |
| December 31, 2003 | | | |
| Single maturity fixed rate advances | $ 67,173 | January 2004 to January 2006 | 2.85% |
| Putable advances | 41,000 | January 2005 to December 2010 | 5.98% |
| Short-term variable | 25,000 | May 2004 to July 2004 | 1.11% |
| Amortizable mortgage advances | 12,507 | February 2008 to July 2018 | 3.98% |
| | $ 145,680 | | |

Each advance is payable at its maturity date and contains a prepayment penalty. Putable advances are fixed rate advances that can be changed to a variable rate at the option of the FHLB. If the FHLB exercises that option, these advances may be repaid without penalty. These advances were collateralized by securities totaling $90,392,000 and $75,192,000 at December 31, 2004 and 2003, and residential and commercial real estate loans totaling $757,502,000 and $598,214,000 under a blanket lien arrangement at December 31, 2004 and 2003.

Maturities as of December 31, 2004 were as follows (in thousands):

| | |
|---|---|
| 2005 | $ 22,900 |
| 2006 | 32,200 |
| 2007 | 27,000 |
| 2008 | 1,019 |
| 2009 | 5,533 |
| Thereafter | 35,333 |
| | $ 123,985 |

**NOTE 9 – OTHER BORROWINGS**

The Company has a $10,000,000 credit facility to provide liquidity for the parent company and additional capital for the bank as necessary. There were no advances outstanding on this credit facility as of December 31, 2004 and 2003.

**NOTE 10 – LONG-TERM DEBT**

The Company has issued $40.0 million of pooled trust preferred securities ("Preferred Securities") through its wholly-owned subsidiary grantor trusts. Macatawa Statutory Trust I issued $619,000 of common securities to the Company and $20.0 million of Preferred Securities on July 15, 2003 at a floating interest rate of the three-month LIBOR plus 3.05%, with an initial interest rate of 4.16%. Macatawa Statutory Trust II issued $619,000 of common securities and $20.0 million of Preferred Securities on March 18, 2004 at a floating interest rate of the three-month LIBOR plus 2.75%, with an initial interest rate of 3.86%.

The Company issued subordinated debentures ("Debentures") to each trust in exchange for the proceeds of the offerings, which Debentures represent the sole asset of each trust. The Preferred Securities represent an interest in our Company's subordinated debentures, which have terms that are similar to the Preferred Securities. As provided in each trust's indenture, the Preferred Securities accrue and pay distributions quarterly at a specified rate and are subject to mandatory redemption upon the maturity of the Debentures, 30 years from the date of issuance, or upon earlier redemption. The Company has the right to redeem the Debentures in whole or in part beginning five years from the date of issuance at a redemption price specified in each trust's indenture.

At December 31, 2003, the Debentures were eliminated in consolidation, and the Preferred Securities were reported in liabilities with a carrying value of $19,655,000, net of unamortized debt issuance costs. Beginning in 2004, under FASB Interpretation No. 46, the trusts are no longer consolidated. At December 31, 2004, the Debentures totaling $41,238,000 are now reported in liabilities as Long-term debt, and the common securities of $1,238,000 and unamortized debt issuance costs are included in other assets.

At December 31, 2003, the entire $20 million of Preferred Securities issued qualified as Tier 1 capital for regulatory capital purposes. At December 31, 2004, approximately $32.0 million of the $40.0 million of Preferred Securities issued qualified as Tier 1 capital for regulatory capital purposes.

**NOTE 11 — RELATED PARTY TRANSACTIONS**

Loans to principal officers, directors, and their affiliates were as follows (dollars in thousands).

| | 2004 | 2003 |
|---|---|---|
| Beginning balance | $ 12,375 | $ 20,659 |
| New loans and renewals | 17,353 | 9,155 |
| Repayments and renewals | (14,950) | (8,996) |
| Effect of changes in related parties | 0 | (8,443) |
| Ending balance | $ 14,778 | $ 12,375 |

The primary cause for the change in related parties during 2003 was the merger of Grand Bank into Macatawa Bank on January 1, 2003 and the corresponding elimination of its board of directors. Deposits from principal officers, directors, and their affiliates at December 31, 2004 and 2003 were $9,487,203 and $5,451,239.

**NOTE 12 — STOCK OPTIONS**

Options to buy stock are granted to officers and employees under the Employee Stock Option Plan (the Employees' Plan), which provides for issue of up to 573,300 options. Options are also granted to directors under the Directors' Stock Option Plan (the Directors' Plan), which provides for issuance of up to 161,900 options. In conjunction with the acquisition of Grand Bank Financial Corporation during the first quarter 2002, an additional 94,835 in options were authorized to exchange existing GBFC options outstanding. The exercise price is the market price at the date of grant for all plans. The maximum option term is ten years with options vesting over a one-year period for both the Employees' Plan and the Directors' Plan. The amount of options available for future grants is 172,403. A summary of the activity in the plans is as follows.

| | Options Outstanding | Weighted Average Exercise Price |
|---|---|---|
| Balance at January 1, 2002 | 220,310 | $ 11.60 |
| Granted | 115,527 | 17.51 |
| GBFC Options exchanged | 94,835 | 3.93 |
| Exercised | (16,808) | 5.50 |
| Forfeited | (6,303) | 17.85 |
| Balance at December 31, 2002 | 407,561 | 11.65 |
| Granted | 139,039 | 23.31 |
| Exercised | (88,861) | 4.96 |
| Forfeited | (3,300) | 17.52 |
| Balance at December 31, 2003 | 454,439 | 16.49 |
| Granted | 99,050 | 28.75 |
| Exercised | (41,768) | 12.95 |
| Forfeited | (2,875) | 23.94 |
| Balance at December 31, 2004 | 508,846 | $ 19.13 |

Options outstanding at year-end 2004 were as follows.

| | Outstanding | | | Exerciseable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number | Weighted Average Remaining Contractual Life in Years | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| $2.50-$5.00 | 401 | 2.5 | $ 3.57 | 401 | $ 3.57 |
| $5.01-$10.00 | 60,110 | 3.4 | 8.35 | 60,110 | 8.35 |
| $10.01-$15.00 | 100,229 | 4.4 | 12.85 | 100,229 | 12.85 |
| $15.01-$20.00 | 156,896 | 7.6 | 17.74 | 156,896 | 17.74 |
| $20.01-$25.00 | 1,575 | 8.6 | 23.56 | 1,575 | 23.56 |
| $25.01-$30.00 | 189,635 | 9.4 | 27.02 | 90,585 | 25.14 |
| Outstanding at year end | 508,846 | 7.2 | $ 19.13 | 409,796 | $ 16.81 |

**NOTE 13 – EMPLOYEE BENEFITS**

The Company sponsors a 401(k) plan which covers substantially all employees. Employees may elect to contribute to the plan from 1% to 15% of their salary subject to statutory limitations. The Company makes matching contributions equal to 100% of the first 3% of employee contributions. Effective July 1, 2002, the plan was amended to establish additional Company matching contributions equal to 50% of employee contributions in excess of 3% and up to 6%. The Company's contribution for the years ended December 31, 2004, 2003 and 2002 were approximately $560,000, $450,000 and $294,000.

The Company sponsors an employee stock purchase plan which allows employees to defer after-tax payroll dollars and purchase Company stock on a quarterly basis. The Company has reserved 25,000 shares of common stock to be issued and purchased under the plan, however, the plan allows for shares to be purchased directly from the Company or on the open market.

Grand Bank had a defined benefit pension plan covering substantially all of its employees. This plan was curtailed in conjunction with the acquisition of Grand Bank effective April 1, 2002. Financial information regarding the plan was as follows, as of December 31, 2004 and 2003.

| | **2004** | **2003** |
|---|---|---|
| Benefit obligation at year-end | $ (503,558) | $ (640,223) |
| Fair value of plan assets at year-end | 473,999 | 534,648 |
| Funded status | $ (29,559) | $ (105,575) |
| Net benefit cost | $ 9,292 | $ 9,790 |
| Employer contributions | 66,000 | 184,621 |
| Benefits paid | 132,825 | 408,768 |

The weighted average discount rate used in determining the actuarial present value of the benefit obligation was 6.0% for 2004 and 2003, and the weighted average expected return on plan assets was 6.0% for 2004 and 2003.

**NOTE 14– EARNINGS PER SHARE**

A reconciliation of the numerators and denominators of basic and diluted earnings per share are as follows (dollars in thousands except per share data):

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Basic earnings per share | | | |
| Net income | $ 12,776 | $ 11,780 | $ 9,513 |
| Weighted average common shares outstanding | 8,805,852 | 8,771,893 | 8,106,320 |
| Basic earnings per share | $ 1.45 | $ 1.34 | $ 1.17 |
| Diluted earnings per share | | | |
| Net income | $ 12,776 | $ 11,780 | $ 9,513 |
| Weighted average common shares outstanding | 8,805,852 | 8,771,893 | 8,106,320 |
| Add: Dilutive effects of assumed exercises of stock options | 167,201 | 140,848 | 124,129 |
| Weighted average common and dilutive potential common shares outstanding | 8,973,053 | 8,912,741 | 8,230,449 |
| Diluted earnings per share | $ 1.42 | $ 1.32 | $ 1.16 |

Stock options for 97,050, 96,600, and 42,998 shares of common stock were not considered in computing diluted earnings per share for December 31, 2004, 2003 and 2002 because they were antidilutive.

**NOTE 15 — FEDERAL INCOME TAXES**

The consolidated provision for income taxes was as follows (dollars in thousands):

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Current | $ 5,919 | $ 6,363 | $ 5,348 |
| Deferred (benefit) expense | 77 | (575) | (696) |
| | $ 5,996 | $ 5,788 | $ 4,652 |

The difference between the financial statement tax expense and amount computed by applying the statutory federal tax rate to pretax income was reconciled as follows (dollars in thousands):

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Statutory rate | 35% | 35% | 34% |
| Statutory rate applied to income before taxes | $ 6,570 | $ 6,149 | $ 4,816 |
| Add (deduct) | | | |
| Tax-exempt interest income | (554) | (337) | (187) |
| Bank-owned life insurance | (55) | 0 | 0 |
| Other, net | 35 | (24) | 23 |
| | $ 5,996 | $ 5,788 | $ 4,652 |

The net deferred tax asset recorded included the following amounts of deferred tax assets and liabilities (dollars in thousands):

| | 2004 | 2003 |
|---|---|---|
| Deferred tax asset | | |
| Allowance for loan losses | $ 6,690 | $ 5,483 |
| Accrued expenses | 114 | 186 |
| Nonaccrual loan interest | 56 | 31 |
| Unrealized loss on derivative instruments | 26 | 0 |
| Other | 134 | 33 |
| | 7,020 | 5,733 |
| Deferred tax liabilities | | |
| Depreciation | (1,779) | (473) |
| Purchase accounting adjustments | (886) | (1,236) |
| Unrealized gain on securities available for sale | (246) | (755) |
| Unrealized gain on derivative instruments | 0 | (339) |
| FHLB dividends | (268) | (117) |
| Accretion | (23) | (17) |
| Other | (273) | (48) |
| | (3,475) | (2,985) |
| Net deferred tax asset | $ 3,545 | $ 2,748 |

A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Based on the levels of taxable income in the current and prior years which would be available to absorb the benefit, management has determined that no valuation allowance was required at December 31, 2004 or 2003.

**NOTE 16 — COMMITMENTS AND OFF-BALANCE-SHEET RISK**

Some financial instruments are used to meet customer financing needs and to reduce exposure to interest rate changes. These financial instruments include commitments to extend credit and standby letters of credit. These involve, to varying degrees, credit and interest-rate risk in excess of the amount reported in the financial statements.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment, and generally have fixed expiration dates. Standby letters of credit are conditional commitments to guarantee a customer's performance to a third party. Exposure to credit loss if the other party does not perform is represented by the contractual amount for commitments to extend credit and standby letters of credit. Collateral or other security is normally not obtained for these financial instruments prior to their use, and many of the commitments are expected to expire without being used.

A summary of the notional or contractual amounts of financial instruments with off-balance-sheet risk was as follows (dollars in thousands):

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Commitments to make loans | $ 25,682 | $ 96,608 |
| Letters of credit | 20,716 | 13,270 |
| Unused lines of credit | 409,519 | 340,917 |

Approximately 42% of the Bank's commitments to make loans were at fixed rates, offered at current market rates. The majority of the variable rate commitments noted above were tied to prime and expire within 30 days. The majority of the unused lines of credit were at variable rates tied to prime.

The Bank conducts substantially all of its business operations in western Michigan.

**NOTE 17 – CONTINGENCIES**

The Company and its subsidiaries periodically become defendants in certain claims and legal actions arising in the ordinary course of business.

On July 8, 2003, the Company filed a Form 8-K (dated July 1, 2003) with the Securities and Exchange Commission reporting events related to a former trust customer, Trade Partners, Inc. ("Trade Partners"), of the former Grand Bank. Trade Partners was involved in purchasing and selling interests in viaticals which are interests in life insurance policies of the terminally ill or elderly. Beginning in 1996, Grand Bank served as a custodian and escrow agent with respect to viaticals purchased by Trade Partners and sold to investors. Two lawsuits were filed, one in December 2002 and another in March 2003, against Trade Partners, Grand Bank and the Company alleging that Grand Bank breached certain escrow agreements related to viatical settlement contracts. Both of these lawsuits have been dismissed although the plaintiffs reserved the right to pursue the claims in the future. A third lawsuit was filed in April 2003 by two individual investors against Grand Bank, the Company, Trade Partners and certain individuals and entities associated with Trade Partners. The complaint seeks damages for the asserted breach of certain escrow agreements for which Grand Bank served as custodian and escrow agent. In addition, in May 2003 a purported class action complaint was filed against the Company alleging that Grand Bank breached escrow agreements and its fiduciary duties and violated the Michigan Uniform Securities Act with respect to the investments secured by the purported class in viaticals or in interests in limited partnerships which made loans to Trade Partners secured by viaticals. The Company has answered the complaint denying the material allegations and raising certain affirmative defenses. Management believes the Company has strong defenses and will vigorously defend the cases.

**NOTE 17 – CONTINGENCIES (Continued)**

Trade Partners is now in receivership. The supervising court authorized the receiver to borrow money from Macatawa Bank to pay premiums, if needed. Macatawa Bank extended a $4 million line of credit to the receiver, conditioned upon obtaining a security interest in the viaticals. No draws were made against the line, and the line expired during the fourth quarter of 2004.

It is possible that one or more additional legal actions may be initiated involving the custodial and escrow agent services provided by Grand Bank in connection with Trade Partners. If any such legal actions are commenced, the Company intends to defend them vigorously. To the extent any pending or future claims allege errors or omissions on the part of Grand Bank or Macatawa Bank, Management believes that some or all liability, if any is proven or established, will be covered by errors and omissions insurance maintained by Grand Bank and Macatawa Bank. The Company has reported the Trade Partners matter to its two insurance carriers. One carrier has assumed the Company's defense and has advanced a portion of its defense costs pursuant to a reservation of rights letter asserting certain coverage defenses, and an Interim Funding Agreement. The other carrier has taken the position that the duty of defense rests solely with the first carrier, and reserves its rights with respect to indemnity.

The legal actions involving Trade Partners have not progressed to trial and the outcome of such actions is uncertain. While we are therefore unable to determine at this time whether or to what extent these actions may impact the Company, the Company believes it has strong defenses and fully intends to defend any and all such actions vigorously.

**NOTE 18 – HEDGING ACTIVITIES**

The Company has asset/liability management policies that include guidelines for measuring and monitoring interest rate risk. Within these guidelines, parameters have been established for maximum fluctuations in net interest income. Possible fluctuations are measured and monitored using simulation modeling. The policies provide for the use of derivative instruments and hedging activities to aid in managing interest rate risk to within the policy parameters.

The Company's assets are comprised of a large portion of loans on which the interest rates are variable. As such, the Company may periodically enter into derivative financial instruments to mitigate exposure to fluctuations in cash flows resulting from changes in interest rates. Interest rate swap arrangements may be utilized to hedge against these fluctuations in cash flows.

The Company has entered into interest rate swap arrangements, all of which are classified as cash flow hedges, that convert the variable rate cash inflows on certain of its loans to fixed rates of interest. These interest rate swaps pay interest to the Company at a fixed rate and require interest payments from the Company at a variable rate. All of these swaps were fully effective during 2004 and 2003. It is anticipated that approximately $5,633 net of tax, of unrealized losses on these cash flow hedges will be reclassified to earnings over the next twelve months.

Summary information about interest rate swaps at year-end follows (dollars in thousands).

| | December 31 2004 | December 31 2003 |
|---|---|---|
| Notional amounts | $ 100,000 | $ 60,000 |
| Weighted average pay rates | 5.25% | 4.00% |
| Weighted average receive rates | 6.54% | 6.64% |
| Weighted average maturity | 3.2 years | 3.9 years |
| Unrealized gain (loss) related to interest rate swaps | $ (75) | $ 970 |

**NOTE 19 — REGULATORY MATTERS**

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

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If the Bank is only adequately capitalized, regulatory approval is required to accept brokered deposits; and if the Bank is undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

At December 31, 2004 and 2003, actual capital levels (dollars in thousands) and minimum required levels were:

| | Actual | | Minimum Required For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Regulations | |
|---|---|---|---|---|---|---|
| | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| December 31, 2004 | | | | | | |
| Total capital (to risk weighted assets) | | | | | | |
| Consolidated | $ 161,367 | 11.1% | $ 116,104 | 8.0% | $ 145,130 | 10.0% |
| Bank | 147,500 | 10.2 | 115,945 | 8.0 | 144,931 | 10.0 |
| Tier 1 capital (to risk weighted assets) | | | | | | |
| Consolidated | 135,226 | 9.3 | 58,052 | 4.0 | 87,078 | 6.0 |
| Bank | 129,384 | 8.9 | 57,972 | 4.0 | 86,959 | 6.0 |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | 135,226 | 8.3 | 65,060 | 4.0 | 81,325 | 5.0 |
| Bank | 129,384 | 8.0 | 64,904 | 4.0 | 81,130 | 5.0 |
| December 31, 2003 | | | | | | |
| Total capital (to risk weighted assets) | | | | | | |
| Consolidated | $ 128,900 | 10.9% | $ 94,454 | 8.0% | $ 118,067 | 10.0% |
| Bank | 118,301 | 10.0 | 94,404 | 8.0 | 118,005 | 10.0 |
| Tier 1 capital (to risk weighted assets) | | | | | | |
| Consolidated | 114,142 | 9.7 | 47,227 | 4.0 | 70,840 | 6.0 |
| Bank | 103,550 | 8.8 | 47,202 | 4.0 | 70,803 | 6.0 |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | 114,142 | 8.8 | 52,144 | 4.0 | 65,180 | 5.0 |
| Bank | 103,550 | 8.0 | 52,040 | 4.0 | 65,049 | 5.0 |

The Company and Bank were categorized as well capitalized at December 31, 2004 and 2003. There are no conditions or events since that notification that management believes have changed either institution’s category.

Banking regulations limit capital distributions. Generally, capital distributions are limited to undistributed net income for the current and prior two years. At December 31, 2004 and 2003, approximately $35,516,000 and $23,536,000 was available to pay dividends to the holding company.

**NOTE 20 — FAIR VALUES OF FINANCIAL INSTRUMENTS**

Carrying amount and estimated fair values of financial instruments were as follows at year-end (dollars in thousands).

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets | | | | |
| Cash and cash equivalents | $ 31,711 | $ 31,711 | $ 60,047 | $ 60,047 |
| Securities available for sale | 137,249 | 137,249 | 107,049 | 107,049 |
| Securities held to maturity | 2,552 | 2,662 | 2,624 | 2,701 |
| Federal Home Loan Bank stock | 12,239 | 12,239 | 8,793 | 8,793 |
| Loans held for sale | 3,150 | 3,150 | 4,054 | 4,055 |
| Loans, net | 1,377,136 | 1,374,836 | 1,141,014 | 1,142,287 |
| Interest rate swaps | 0 | 0 | 970 | 970 |
| Accrued interest receivable | 6,395 | 6,395 | 5,095 | 5,095 |
| Bank-owned life insurance | 20,157 | 20,157 | 0 | 0 |
| Financial liabilities | | | | |
| Deposits | (1,351,516) | (1,352,905) | (1,109,399) | (1,121,532) |
| Other borrowings | (41,238) | (42,122) | (19,655) | (19,655) |
| Federal funds purchased | (22,131) | (22,131) | 0 | 0 |
| Federal Home Loan Bank advances | (123,985) | (127,415) | (145,680) | (158,440) |
| Interest rate swaps | (75) | (75) | 0 | 0 |
| Accrued interest payable | (2,776) | (2,776) | (2,283) | (2,283) |
| Off-balance sheet credit-related items | | | | |
| Loan commitments | 0 | 0 | 0 | 0 |

The methods and assumptions used to estimate fair value are described as follows.

Carrying amount is the estimated fair value for cash and cash equivalents, short-term borrowings, Federal Home Loan Bank stock, accrued interest receivable and payable, bank-owned life insurance, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. Security fair values are based on market prices or dealer quotes, and if no such information is available, on the rate and term of the security and information about the issuer. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values. Fair value of loans held for sale is based on market quotes. Fair value of debt is based on current rates for similar financing. The fair value of interest rate swaps is based on market prices or dealer quotes. The fair value of off-balance sheet credit-related items is not significant.

(Continued)

**NOTE 21 – CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)**

Following are condensed parent company only financial statements (dollars in thousands):

CONDENSED BALANCE SHEETS

| | 2004 | 2003 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents | $ 13,351 | $ 9,633 |
| Investment in Bank subsidiary | 155,232 | 131,308 |
| Investment in other subsidiaries | 2,082 | 1,460 |
| Other assets | 32 | 151 |
| Total assets | $ 170,697 | $ 142,552 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Long-term debt | $ 41,238 | $ 20,619 |
| Other liabilities | 385 | 33 |
| Total liabilities | 41,623 | 20,652 |
| Shareholders' equity | | |
| Common stock | 124,389 | 114,568 |
| Retained earnings | 4,277 | 5,300 |
| Accumulated other comprehensive income | 408 | 2,032 |
| Total shareholders' equity | 129,074 | 121,900 |
| Total liabilities and shareholders' equity | $ 170,697 | $ 142,552 |

(Continued)

**NOTE 21 – CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)** (Continued)

CONDENSED STATEMENTS OF INCOME

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Income | | | |
| Interest income | $ 0 | $ 76 | $ 121 |
| Dividends from subsidiaries | 0 | 0 | 1,000 |
| Total income | 0 | 76 | 1,121 |
| Expense | | | |
| Interest expense | 1,659 | 514 | 120 |
| Other expense | 567 | 434 | 435 |
| Total expense | 2,226 | 948 | 555 |
| Income (loss) before income tax and equity in undistributed net income of subsidiaries | (2,226) | (872) | 566 |
| Equity in undistributed net income of subsidiaries | 14,222 | 12,350 | 8,799 |
| Income before income tax | 11,996 | 11,478 | 9,365 |
| Federal income tax expense (benefit) | (780) | (302) | (148) |
| Net income | $ 12,776 | $ 11,780 | $ 9,513 |

NOTE 21 – CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY) (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Cash flows from operating activities | | | |
| Net income | $ 12,776 | $ 11,780 | $ 9,513 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Equity in undistributed earnings of subsidiaries | (14,222) | (12,350) | (8,799) |
| (Increase) decrease in other assets | 119 | (45) | 91 |
| Increase (decrease) in other liabilities | 352 | (5) | 36 |
| Net cash from operating activities | (975) | (620) | 841 |
| Cash flows from investing activities | | | |
| Loan originations and payments | 0 | 4,500 | (4,500) |
| Investment in subsidiaries | (11,851) | (8,232) | (9,243) |
| Net cash from investing activities | (11,851) | (3,732) | (13,743) |
| Cash flows from financing activities | | | |
| Other borrowings | 0 | (4,500) | 4,500 |
| Proceeds from issuance of long-term debt | 20,619 | 20,619 | 0 |
| Proceeds from exercises of stock options | 394 | 441 | 93 |
| Fractional shares purchased | (25) | (14) | (7) |
| Shares repurchased | 0 | 0 | (2,300) |
| Cash dividends paid | (4,444) | (3,471) | (2,485) |
| Net cash from financing activities | 16,544 | 13,075 | (199) |
| Net change in cash and cash equivalents | 3,718 | 8,723 | (13,101) |
| Cash and cash equivalents at beginning of year | 9,633 | 910 | 14,011 |
| Cash and cash equivalents at end of year | $ 13,351 | $ 9,633 | $ 910 |

**NOTE 22 — QUARTERLY FINANCIAL DATA (Unaudited)**

| | Interest Income | Net Interest Income | Net Income | Earnings Per Share Basic | Earnings Per Share Fully Diluted |
|---|---|---|---|---|---|
| | (Dollars in thousands except per share data) | | | | |
| 2004 | | | | | |
| First quarter | $ 17,305 | $ 11,392 | $ 2,866 | $ 0.33 | $ 0.32 |
| Second quarter | 18,636 | 12,570 | 3,346 | 0.38 | 0.37 |
| Third quarter | 20,345 | 13,619 | 2,116 | 0.24 | 0.24 |
| Fourth quarter | 22,043 | 14,439 | 4,448 | 0.50 | 0.49 |
| 2003 | | | | | |
| First quarter | $ 15,408 | $ 9,608 | $ 2,810 | $ 0.32 | $ 0.32 |
| Second quarter | 15,885 | 10,287 | 2,932 | 0.33 | 0.33 |
| Third quarter | 16,373 | 10,936 | 3,063 | 0.35 | 0.34 |
| Fourth quarter | 16,768 | 11,263 | 2,975 | 0.34 | 0.33 |

Net income for the third quarter of 2004 includes the impact of a $2.3 million ($1.5 million after-tax, or $0.17 per share) charge against earnings related to the one borrower that became impaired as previously described in Note 4.

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

Management's discussion and analysis of results of operations and financial condition contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those projected in such forward-looking statements.

The following section presents additional information to assess the financial condition and results of operations of the Company. This section should be read in conjunction with the consolidated financial statements and the supplemental financial data contained elsewhere in this Annual Report.

**Overview**

Macatawa Bank Corporation is a Michigan corporation and is the holding company for two wholly owned subsidiaries, Macatawa Bank and Macatawa Investment Services, Inc. and for two trusts, Macatawa Statutory Trust I and Macatawa Statutory Trust II. Effective January 9, 2002, Macatawa Bank Corporation elected to become a financial holding company pursuant to Title I of the Gramm-Leach-Bliley Act. Macatawa Bank commenced operations on November 25, 1997. On April 1, 2002, Macatawa Bank Corporation acquired Grand Bank Financial Corporation ("GBFC") and its wholly owned banking subsidiary, Grand Bank. Its results are included in the consolidated statements of income since this effective date. Grand Bank was merged into Macatawa Bank effective January 1, 2003 with the combined bank named Macatawa Bank. Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The bank operates twenty-two branch offices and a lending and operational service facility, providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan. Macatawa Investment Services was formed in October 2001 and gained approval in June 2002 from NASD to commence operations as a broker/dealer. Macatawa Investment Services provides various services including discount brokerage, personal financial planning, and consultation regarding mutual funds and annuities. Macatawa Statutory Trusts I and II are grantor trusts and issued $20.0 million each of pooled trust preferred securities. These trusts are not consolidated in the Corporation's financial statements. For further information regarding consolidation, see the Notes to the Consolidated Financial Statements included herein. Macatawa Bank Mortgage Company, a subsidiary of Macatawa Bank, originates and sells residential mortgage loans into the secondary market on a servicing released basis.

While maintaining asset quality and improving profitability, we have experienced rapid and substantial growth since opening Macatawa Bank in November of 1997. We first became profitable in 1999 and have increased earnings each year since then with 2004 net income reaching $12.8 million. Since our inception in 1997, we have raised approximately $100.6 million in capital through private and public common stock offerings and trust preferred offerings to facilitate our growth and progress over these years. When we acquired GBFC we issued 2,472,000 shares of common stock in exchange for all of the outstanding stock of GBFC.

We believe that growth in core deposits is key to our long-term success and is our primary funding source for asset growth. Establishing a branching network in our markets has been of high importance in order to facilitate this core deposit growth. We have gained community awareness and acceptance in our markets through this expanding branch network and our high service quality standards. Since our inception in 1997, core deposits have increased at an annual rate exceeding 20% each year.

The West Michigan markets within which we operate continue to provide significant expansion opportunities for us. We opened our ninth branch in the Kent County market on the south side of the greater Grand Rapids area during the third quarter of 2004. Because of the significance of the greater Grand Rapids market and as it represents the greatest opportunity for market share growth, we anticipate additional branch openings in this market within the next year. We also continue to enjoy success in building new and existing relationships in the Holland/Zeeland area, and our entrance into the Grand Haven market during the third quarter of 2003 has produced excellent growth results. We anticipate that we will continue to experience growth in our balance sheet and in our earnings due to these expansion opportunities.

**RESULTS OF OPERATIONS**

**Summary:** Net income totaled $12.8 million, or $1.42 per diluted share for 2004 as compared to $11.8 million, or $1.32 per diluted share for 2003, and $9.5 million, or $1.16 per diluted share for 2002. The results for 2004 include a charge against earnings of $2.3 million ($1.5 million after tax), or approximately $0.17 per share, for a loss associated with the impaired commercial loan relationship described under Loan Portfolio and Asset Quality.

The increase in net income principally reflects strong growth in our net interest income due to our continuing growth in interest earning assets, offset by increases in the provision for loan losses and noninterest expense.

The effective date of the GBFC acquisition was April 1, 2002 and therefore the results of operations for the first quarter of 2002 did not include the effect of GBFC and Grand Bank.

**Net Interest Income:** Net interest income totaled $52.0 million during 2004 compared to $42.1 million during 2003 and $34.5 million during 2002. The 24% growth in net interest income during 2004 compared to 2003 was driven by significant growth in average interest earning assets which increased by $273.0 million, or 24%, to $1.43 billion for 2004. The net interest margin remained relatively flat, increasing one basis point to 3.64% for 2004. The ratio of interest earning assets to interest-bearing funds declined slightly from 113.37% to 113.36%.

The yield on earning assets declined eight basis points to 5.47% for 2004 from 5.55% for 2003. Declining rates occurred through the first half of 2003 and remained at historically low rates through the first half of 2004. The amortization and prepayment of higher yielding loans and the addition of new loans and securities at generally lower rates during this period was the primary reason for the decline in asset yield. The increases in short-term interest rates that occurred in the last half of 2004 caused an increase in the yield on our variable rate loan portfolio which helped to offset some of the general decline in our loan yields from the prior year. The decline in the yield on earning assets was more than offset by a 12 basis point decline in our overall cost of funds. This decline was primarily attributable to a 17 basis point decline in our cost of deposits as we continued to experience a shift to lower costing transaction accounts, primarily money market accounts, discussed under the section on Deposits.

The 23% growth in net interest income during 2003 compared to 2002 was also largely driven by significant growth in average interest earning assets which increased by $224.4 million, or 24%, to $1.15 billion for 2003. Despite an increase of two basis points in the net interest spread to 3.36% for 2003, a decline in net interest margin of six basis points to 3.63% for 2003 slightly offset the increase in net interest income. This was the result of a slightly greater reliance on interest-bearing funds. Accordingly, the ratio of interest earning assets to interest bearing liabilities declined to 113.37% for 2003 from 114.45% for 2002.

During a continued period of declining interest rates from 2002 to 2003, the decline in the yield on earning assets was offset by a corresponding decline in the overall cost of funds. The decline in net interest margin during 2003 was mitigated by 34% growth in noninterest bearing deposits, a slight shift in the mix of the interest bearing deposit portfolio to lower costing demand and money market accounts, and continued downward repricing of the time deposit portfolio.

During the period when short-term interest rates remained at historic lows throughout 2003 and into 2004, we continued our use of derivative instruments, as discussed in the Notes to the Consolidated Financial Statements, to help mitigate some of the decline in net interest margin associated with our significant variable rate loan portfolio.

Anticipated growth in earning assets is expected to continue to increase levels of net interest income. In addition, we would expect a continued rise in short-term interest rates to have a favorable impact on our net interest margin considering our asset sensitivity as discussed under Sensitivity to Market Risk.

The following table shows an analysis of net interest margin for the years ended December 31, 2004, 2003 and 2002.

| | For the years ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2004 | | | 2003 | | | 2002 | | |
| **(Dollars in Thousands)** | **Average Balance** | **Interest Earned or Paid** | **Average Yield or Cost** | **Average Balance** | **Interest Earned or Paid** | **Average Yield or Cost** | **Average Balance** | **Interest Earned or Paid** | **Average Yield or Cost** |
| **Assets:** | | | | | | | | | |
| Taxable securities | $ 84,151 | $ 3,528 | 4.19% | $ 70,723 | $ 3,237 | 4.76% | $ 65,829 | $ 3,476 | 5.28% |
| Tax-exempt securities (1) | 40,491 | 1,727 | 6.62% | 24,843 | 1,067 | 6.82% | 13,315 | 620 | 7.21% |
| Loans (2) | 1,295,887 | 72,583 | 5.54% | 1,046,723 | 59,775 | 5.58% | 831,709 | 52,687 | 6.27% |
| Federal Home Loan Bank stock | 9,857 | 430 | 4.29% | 6,629 | 338 | 5.03% | 4,775 | 289 | 5.98% |
| Federal funds sold and other short-term investments | 4,787 | 61 | 1.25% | 1,856 | 18 | 0.98% | 10,757 | 180 | 1.67% |
| Total interest earning assets (1) | $1,435,173 | 78,329 | 5.47% | $1,150,774 | $64,435 | 5.55% | $ 926,385 | $57,252 | 6.16% |
| Noninterest earning assets: | | | | | | | | | |
| Cash and due from banks | 33,792 | | | 30,367 | | | 32,770 | | |
| Other | 68,478 | | | 69,422 | | | 42,074 | | |
| Total assets | $1,537,443 | | | $1,250,563 | | | $1,001,229 | | |
| **Liabilities and Shareholders' Equity:** | | | | | | | | | |
| Deposits: | | | | | | | | | |
| NOW and money market accounts | $ 587,834 | $ 6,916 | 1.18% | $ 395,697 | $ 3,662 | 0.93% | $ 334,510 | $ 5,159 | 1.14% |
| Savings | 38,266 | 86 | 0.23% | 35,172 | 127 | 0.36% | 24,800 | 272 | 1.10% |
| IRAs | 27,170 | 884 | 3.26% | 25,618 | 936 | 3.66% | 19,490 | 876 | 4.49% |
| Time deposits | 407,835 | 11,185 | 2.74% | 406,613 | 12,245 | 3.01% | 328,715 | 11,966 | 3.64% |
| Borrowings: | | | | | | | | | |
| Federal Home Loan Bank advances | 145,346 | 5,223 | 3.59% | 124,825 | 4,676 | 3.75% | 89,757 | 4,407 | 4.91% |
| Long-term debt | 36,742 | 1,659 | 4.52% | 12,850 | 507 | 3.95% | 6,781 | 120 | 1.74% |
| Federal funds borrowed and other borrowed funds | 22,837 | 356 | 1.54% | 14,317 | 188 | 1.30% | 5,392 | 102 | 1.87% |
| Total interest bearing liabilities | 1,266,030 | 26,309 | 2.07% | 1,015,092 | 22,341 | 2.19% | 809,445 | 22,902 | 2.82% |
| Noninterest bearing liabilities: | | | | | | | | | |
| Noninterest bearing demand accounts | 139,510 | | | 110,670 | | | 82,757 | | |
| Other noninterest bearing liabilities | 5,973 | | | 5,966 | | | 8,503 | | |
| Shareholders' equity | 125,930 | | | 118,835 | | | 100,524 | | |
| Total liabilities and Shareholders' equity | $1,537,443 | | | $1,250,563 | | | $1,001,229 | | |
| Net interest income | | $52,020 | | | $42,094 | | | $34,350 | |
| Net interest spread (1) | | | 3.40% | | | 3.36% | | | 3.34% |
| Net interest margin (1) | | | 3.64% | | | 3.63% | | | 3.69% |
| Ratio of average interest earning assets to average interest bearing liabilities | 113.36% | | | 113.37% | | | 114.45% | | |

(1) Yields are adjusted for tax-exempt interest.
(2) Loan fees included in interest income are not material. Nonaccrual loans are included in average loans outstanding.

The following table presents the dollar amount of changes in net interest income due to changes in volume and rate.

| (Dollars in thousands) | Year Ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2004 vs 2003 | | | 2003 vs 2002 | | |
| | Increase (Decrease) Due to | | | Increase (Decrease) Due to | | |
| | Volume | Rate | Total | Volume | Rate | Total |
| Interest income | | | | | | |
| Taxable securities | $ 709 | $ (418) | $ 291 | $ 111 | $ (350) | $ (239) |
| Tax-exempt securities | 727 | (67) | 660 | 483 | (36) | 447 |
| Loans | 13,147 | (339) | 12,808 | 13,276 | (6,188) | 7,088 |
| FHLB stock | 146 | (54) | 92 | 100 | (51) | 49 |
| Fed funds sold and other short-term investments | 36 | 7 | 43 | (109) | (53) | (162) |
| Total interest income | $ 14,765 | $ (871) | $ 13,894 | $ 13,861 | $ (6,678) | $ 7,183 |
| Interest expense | | | | | | |
| NOWs and MMDAs | $ 2,506 | $ 748 | $ 3,254 | $ 825 | $ (2,322) | $ (1,497) |
| Savings | 40 | (81) | (41) | 84 | (229) | (145) |
| IRAs | 162 | (214) | (52) | 243 | (183) | 60 |
| Time deposits | 111 | (1,171) | (1,060) | 2,552 | (2,273) | 279 |
| FHLB advances | 856 | (309) | 547 | 1,468 | (1,199) | 269 |
| Long-term debt | 1,069 | 83 | 1,152 | 202 | 185 | 387 |
| Fed funds purchased and other borrowings | 127 | 41 | 168 | 126 | (40) | 86 |
| Total interest expense | 4,871 | (903) | 3,968 | 5,500 | (6,061) | (561) |
| Net interest income | $ 9,894 | $ 32 | $ 9,926 | $ 8,361 | $ (617) | $ 7,744 |

**Provision for Loan Losses:** The provision for loan losses for 2004 was $7.9 million as compared to $4.1 million for 2003 and $3.3 million for 2002. The increase in 2004 is largely related to the $2.3 million additional provision for the one commercial borrower described under Portfolio Loans and Asset Quality. The amount of the loan loss provision in all periods is a byproduct of establishing our allowance for loan losses at levels deemed necessary in our methodology for determining the adequacy of the allowance. For more information about our allowance for loan losses and our methodology for establishing its level, see the discussion under the section Allowance for Loan Losses.

**Noninterest Income:** Noninterest income totaled $10.0 million during 2004, as compared to $10.2 during 2003 and $7.9 million in 2002. Increases in deposit service charges, trust fees and other income were offset by a decline in gain on sales of loans during 2004. All noninterest income components contributed to the increase in 2003 over 2002.

The increase in deposit service charges of $398,000 or 16% during 2004 and $317,000 or 14% during 2003 reflects the continued expansion of our deposit customer account base as we have grown.

Revenues from trust services grew to $2.9 million for 2004 compared to $2.5 million for 2003 and $2.1 million for 2002. Trust fees are, to a great extent, based on the underlying values of trust assets managed. The upward trend in the market valuation of securities in both the latter half of 2004 and 2003 contributed to the increase in trust fees in each year, in addition to increased fees due to gaining new trust customers during each year.

Other income increased $564,000 in 2004 and $234,000 in 2003. The increase in other income for both years included increases in miscellaneous fee categories associated with volume increases as we have grown. These fee categories include debit card and ATM processing income, revenues from mutual fund and annuity sales, and income from title insurance sales. The increase in 2004 also included $157,000 of income earned on bank-owned life insurance purchased during the fourth quarter of 2004. The impact of the income on bank-owned life insurance to non-interest income will increase as it is expected to remain fully outstanding in future periods.

Gain on sales of loans primarily includes gains on the sale of real estate mortgage loans, and to a lesser extent, gains on the sale of the SBA guaranteed portion of certain commercial loans. We sell the majority of the fixed-rate mortgage loans we originate. We do not retain the servicing rights for the loans we sell. A summary of gain on sales of loans and related volume is as follows:

| **(Dollars in thousands)** | **Year Ended December 31** | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| Gain on the sale of SBA guaranteed loans | $ 122 | $ 109 | $ -- |
| Net gain on the sale of real estate mortgage loans | 2,085 | 3,637 | 2,382 |
| Gain on sales of loans | $ 2,207 | $ 3,746 | $ 2,382 |
| Real estate mortgage loans originated for sale | 141,661 | 305,612 | 240,819 |
| Real estate mortgage loans sold | 144,772 | 324,030 | 229,047 |
| Net gain on the sale of real estate mortgage loans as a percent of real estate mortgage loans sold ("Loan sales margin") | 1.44% | 1.12% | 1.04% |

Gain on sales of loans declined $1.5 million in 2004 compared to 2003, while 2003 increased $1.4 million compared to 2002. The generally higher levels of longer-term interest rates in 2004 resulted in significantly lower levels of residential refinancing and loan originations than at the end of 2002 and into 2003 when longer-term interest rates reached historic lows and related refinancing activity was at record highs. An improvement in the loan sales margin received on residential loans sold during 2004 slightly offset the significant decline in volume. The general improvement in our loan sales margin since 2002 reflects an improvement in our competitive position with our secondary market investors and greater discipline in our pricing practices. Since mortgage interest rate levels have generally increased from their historic lows, we expect the volume of originations from refinancing activity to continue to slow. We do, however, believe the decline in refinancing volume will be somewhat offset by an increase in new home purchase originations as additional opportunities arise from our continued market expansion.

**Noninterest Expense:** Noninterest expense totaled $35.4 million for 2004 as compared to $30.6 million for 2003 and $24.7 million for 2002. Salaries and benefits increased $2.8 million in 2004 over 2003 and $3.5 million in 2003 over 2002, comprising the majority of the increase in both years.

The increase in salaries and benefits for 2004 primarily reflects an increase in staffing for the five new full-service branches that were opened since the fourth quarter of 2003, and for the lending, trust and investment service departments that has occurred in the past twelve months to enhance our service in these areas. For 2003, approximately 30% of this increase related to the addition of the Grand Bank workforce effective with the GBFC acquisition on April 1, 2002. In addition, our growth in 2003 also required additional staff in various areas including new branches, lending departments, and operations which were all necessary to support increased customer activity. The consistent increase in salaries and benefits reflects our attention to properly managing and supporting our growth and our interest in creating a platform for strong future growth.

The increase in occupancy expense of $311,000 in 2004 and $481,000 in 2003 and the increase in furniture and equipment expense of $180,000 in 2004 and $427,000 in 2003 are consistent with our branch and facilities expansion during these periods. The increases in 2003 were also partially due to the GBFC acquisition. Consistent with the recent trend, we would expect the level of increase in these expense categories to decline as we focus on growing into our current branch capacity.

The increase in marketing and promotion expense of $264,000 in 2004 and $224,000 in 2003 is consistent with the growth in our company, and our interest in creating a more significant presence in the markets we serve.

Data processing fees were up $275,000 in 2004 consistent with the growth in our company. The slight decline in data processing fees in 2003 compared to 2002 reflects operational efficiencies achieved with the integration of the systems and operations of Grand Bank into ours during the second quarter of 2002 and the merger of Grand Bank into ours effective January 1, 2003.

Other expense increased $1.1 million in 2004 and $944,000 in 2003. The increase in both periods includes increases in various expense categories consistent with the growth of our company. These categories include expenses associated with debit card and ATM processing, customer and internal courier, community donations, loan related fees and state taxes. The increase for 2004 also includes expenses associated with the implementation of Section 404 of the Sarbanes-Oxley Act and additional holding costs associated with other real estate owned.

**Federal Income Tax Expense:** Our federal income tax expense has increased generally commensurate with our increase in pre-tax earnings. Our actual federal income tax expense is lower than the amount computed by applying our statutory federal income tax rate to our pre-tax earnings primarily due to tax-exempt interest income. Our effective tax rate was 31.9%, 32.9% and 32.8% in 2004, 2003 and 2002, respectively. The decrease in 2004 from prior years is principally attributed to an increase in tax-exempt interest income and income from bank owned life insurance.

**FINANCIAL CONDITION**

**Summary:** Our total assets were $1.67 billion at December 31, 2004, an increase of $271.5 million from $1.40 billion in total assets at December 31, 2003. We believe the continued strong asset growth reflects the acceptance of our full-service community banking philosophy in the growing communities we serve. Our asset growth consists primarily of growth in our loan portfolio as we continue to attract new loan customers and deepen relationships with existing customers despite the strong competition from other locally based community banks and larger regional banks. Total portfolio loans increased $239.3 million or 21% during 2004. The growth in total assets also included growth in our investment securities portfolio, premises and equipment and other assets.

The increase in total assets was principally funded by strong deposit growth. Deposits grew by $242.1 million during 2004, a 22% growth rate. We attribute the strong deposit growth to our quality customer service, the desire of our customers to bank with a locally run bank, and convenient accessibility through the expansion of our branch network.

**Cash and Cash Equivalents**: Our cash and cash equivalents, which include federal funds sold and short-term investments, were $31.7 million at December 31, 2004, as compared to $60.0 million at December 31, 2003. The high balance at the end of 2003 included federal funds sold reflecting a large inflow of customer deposits that occurred right at the end of the year.

**Securities:** Securities increased $30.1 million or 27% to $139.8 million at December 31, 2004 from $109.7 million at December 31, 2003. We maintain our security portfolio at a level to provide diversity in the nature of our assets, to support our liquidity needs and to balance our interest rate risk. Our portfolio consists primarily of high quality U.S government agency and state and local municipal bonds classified as available for sale. These securities are generally purchased at fixed rates to help offset the interest sensitivity of our variable rate loan portfolio. We expect continued growth of our securities portfolio generally consistent with the growth of our company to maintain the diversity of our assets and support our liquidity and interest rate risk management.

**Loan Portfolio and Asset Quality:** Our total loan portfolio increased to $1.40 billion at December 31, 2004 from $1.16 billion at December 31, 2003. The $239.3 million increase in portfolio loans continues our consistent pattern of growth. Each of our loan portfolios, including commercial and commercial real estate, residential real estate and consumer loans, grew by 20% or more during 2004. We believe the continued strong loan growth we have experienced in each of our loan portfolios is a result our focus on providing high quality customer service and reflects the acceptance of our full-service community banking philosophy in the growing communities we serve.

The majority of loans that we retain in our portfolio are to small and mid-sized businesses in the form of commercial and commercial real estate loans. Our combined commercial loan portfolios accounted for approximately 73% of our total portfolio loans at both December 31, 2004 and 2003. The $1.02 million in commercial and commercial real estate loans at December 31, 2004 represents an increase of 20% over the $849.0 million at December 31, 2003. We feel the consistent growth in commercial loans that we have been able to achieve reflects the acceptance of our lending approach by our customers and the ability of our lending team to respond to their needs effectively. Our commercial loan department is built around a well-seasoned officer team and our lending approach involves an efficient loan approval process focused around local decision-making.

The residential real estate portfolio increased 27% to $219.0 million at December 31, 2004. Our residential real estate loan portfolio, which also includes residential construction loans made to individual homeowners, comprised approximately 16% of portfolio loans at the end of 2004. Our residential real estate portfolio only represents a small portion of our residential origination loan volume, as we sell the majority of our fixed-rate obligations on the secondary market with servicing released to reduce our exposure to interest rate risk. We originated for sale $141.7 million in residential mortgages in 2004, $305.6 million in 2003, and $240.8 million in 2002. Loans held for sale were $3.2 million at December 31, 2004 as compared to $4.1 million at December 31, 2003. The generally higher levels of longer-term interest rates in 2004 resulted in significantly lower levels of residential refinancing and loan originations as compared to the end of 2002 and into 2003 when longer-term interest rates were at historic lows and related refinancing activity was at record highs.

Our consumer loan portfolio includes both loans secured by personal property, as well as home equity fixed term and line of credit loans. Our consumer loan portfolio increased 20% to $162.4 million at December 31, 2004. Consumer loans comprised approximately 12% of our portfolio loans at the end of 2004.

As we continue to leverage our expansive branch network and strengthen our presence in the markets we serve, we anticipate further growth in each of our loan portfolios consistent with our historical growth patterns.

Nonperforming assets are comprised of nonperforming loans, foreclosed assets and repossessed assets. Our nonperforming loans include loans on non-accrual status, restructured loans and loans delinquent more than 90 days but still accruing. Nonperforming loans as of December 31, 2004 totaled $4.0 million or 0.29% of total portfolio loans compared to $4.0 million or 0.35% of total portfolio loans at December 31, 2003.

The majority of nonperforming loans at the end of 2004 relates to one commercial borrower. The loans associated with this borrower became impaired due to fraud perpetrated by the borrower. The borrower has since ceased operations. The loans are secured by liens on commercial real estate, equipment, accounts receivable, and inventory and were written down to a balance deemed collectible based upon a valuation of the collateral. Of the original $5.9 million in loans to this borrower, $2.8 million was charged-off, resulting in a balance of $3.1 million. Subsequent to the charge-off, proceeds from the liquidation of certain collateral and payments on outstanding receivables have brought the balance to approximately $2.3 million at December 31, 2004. For the remaining portion of our nonperforming loans we are well-collateralized or we have written the loan down to a level commensurate with the estimated value of the underlying collateral.

Our loan portfolio is reviewed regularly by an external loan review team, our own loan officers, and our senior management. When reasonable doubt exists concerning collectibility of interest or principal of one of our loans, that loan is placed in non-accrual status. Any interest previously accrued but not collected is reversed and charged against current earnings.

Foreclosed assets include assets acquired in settlement of loans. As of December 31, 2004 foreclosed assets totaled $1.9 million compared to $464,000 as of December 31, 2003. The balance at the end of 2004 relates to one piece of commercial real estate for which no loss is expected upon disposition.

Total nonperforming assets amounted to $5.9 million or 0.35% of total assets as of December 31, 2004 compared to $4.5 million or 0.32% of total assets as of December 31, 2003. The following table shows the composition and amount of our nonperforming assets.

| **(Dollars in thousands)** | **As of December 31** | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| Nonaccrual loans | $ 3,249 | $ 1,717 | $ 2,539 |
| Loans 90 days or more delinquent and still accruing | 772 | 2,308 | 259 |
| Restructured loans | -- | -- | -- |
| Total nonperforming loans | $ 4,021 | $ 4,025 | $ 2,798 |
| Foreclosed assets | 1,850 | 464 | 388 |
| Repossessed assets | -- | 4 | 58 |
| Total nonperforming assets | $ 5,871 | $ 4,493 | $ 3,244 |
| Nonperforming loans to total loans | .29% | .35% | .29% |
| Nonperforming assets to total assets | .35% | .32% | .28% |

**Allowance for Loan Losses:** Our allowance for loan losses as of December 31, 2004 was $19.3 million, representing approximately 1.38% of total portfolio loans outstanding, compared to $16.1 million or 1.39% of total loans at December 31, 2003.

Our allowance for loan losses is maintained at a level considered appropriate based upon our regular, quarterly assessments of the probable estimated losses inherent in the loan portfolio. Our methodology for measuring the appropriate level of allowance relies on several key elements, which include specific allowances for loans considered impaired, formula allowance for graded loans, and general allocations based on historical trends for pools of similar loan types.

Specific allowances are established in cases where senior credit management has identified significant conditions or circumstances related to an individually impaired credit that we believe indicates the probability that a loss has been incurred. This amount is determined by methods prescribed by SFAS No. 114, “Accounting by Creditors for Impairment of a Loan”. The specific allowance for impaired loans was $923,000 at December 31, 2004 and $792,000 at December 31, 2003. The relative levels of specific allowance on impaired loans to the balance of impaired loans at December 31, 2004 and 2003 remained relatively stable.

The formula allowance is calculated by applying loss factors to outstanding loans based on the internal risk grade of such loans. We use a loan rating method based upon an eight point system. Loans are assigned a loss allocation factor for each loan classification category. The lower the grading assigned to a loan category, the greater the allocation percentage that is applied. Changes in risk grade of both performing and nonperforming loans affect the amount of the formula allowance. Because of the relatively unseasoned nature of our loan portfolio and the rapid loan growth we have experienced since inception, our actual historical loan loss experience remains limited. Accordingly, our loss factors are primarily based upon our analysis of the banking industry’s historical loan loss experience, including the historical loan loss experience within the current markets we operate. These factors are monitored against our loss experience as our portfolios’ age, and may be adjusted for significant factors that, in management’s judgment, affect the collectibility of the portfolio as of the analysis date. The formula allowance was $16.4 million at December 31, 2004 and $13.4 million at December 31, 2003. The increase of $3.2 million in the allowance for loan losses during 2004 was primarily related to this $3.0 million increase in the formula allowance. The increase in the formula allowance is primarily associated with the continuing growth in the commercial loan portfolio.

Groups of homogeneous loans, such as residential real estate, open- and closed-end consumer loans, etc., receive general allowance allocations based on loss trends. In lieu of an established loan loss trend for Macatawa Bank, we use historical loss trends based on industry experience and peers in determining an adequate allowance for probable losses associated with these pools of loans. General economic and business conditions, credit quality trends, collateral values, seasoning of the portfolios and recent loss experience are conditions considered in connection with allocation factors for these similar pools of loans. The general allowance was $1.7 million at December 31, 2004 and $1.6 million at December 31, 2003.

The continued increase in the allowance was deemed necessary given the significant growth in loans, the unseasoned nature of our portfolio and the still soft, although improving, economic conditions both on a national basis and locally. Based upon our internal analysis, in our judgment, we have provided adequate allowances for loan losses, although there can be no assurance that the allowance for losses on loans will be adequate to cover all losses.

The following table shows the allocation of the allowance for loan loss at the dates indicated to the extent specific allocations have been determined relative to particular loans.

| (Dollars in thousands) | As of December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2002 | |
| | Allowance Amount | % of Each Category to Total Loans | Allowance Amount | % of Each Category to Total Loans | Allowance Amount | % of Each Category to Total Loans |
| Commercial and commercial real estate | $ 17,324 | 78.7% | $ 14,371 | 78.3% | $ 11,207 | 72.6% |
| Residential real estate | 476 | 9.7% | 360 | 10.0% | 326 | 13.9% |
| Consumer | 1,243 | 11.6% | 1,074 | 11.7% | 950 | 13.5% |
| Unallocated | 208 | -- | 288 | -- | 989 | -- |
| Total | $ 19,251 | 100.0% | $ 16,093 | 100.0% | $ 13,472 | 100.0% |

The above allocations are not intended to imply limitations on usage of the allowance. The entire allowance is available for any loan losses without regard to loan type. The allocated portion of the allowance amounted to $19.0 million at December 31, 2004. Of this total, 5% related to specific allocations on impaired loans, 86% related to formula allocations and 9% related to general allocations.

Net charge-offs totaled $4.7 million, or 0.37% of average loans for 2004 compared to $1.5 million, or 0.14% of average loans for 2003. As previously noted under the section Loan Portfolio and Asset Quality, the increase for 2004 relates primarily to the $2.8 million charge-off associated with the impaired loans to one commercial borrower. The following is a summary of our loan balances, changes in the allowance for loan losses and related ratios.

| (Dollars in thousands) | December 31 | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| Loans: | | | |
| Average daily balance of loans for the year | $ 1,295,887 | $ 1,046,723 | $ 831,709 |
| Amount of loans outstanding at end of period | 1,396,387 | 1,157,107 | 961,038 |
| Allowance for loan losses: | | | |
| Balance at beginning of year | $ 16,093 | $ 13,472 | $ 7,699 |
| Balance from GBFC acquisition | -- | -- | 3,464 |
| Addition to allowance charged to operations | 7,890 | 4,105 | 3,321 |
| Loans charged-off: | | | |
| Commercial | (4,833) | (1,308) | (1,143) |
| Residential real estate | (21) | (50) | (0) |
| Consumer | (91) | (187) | (128) |
| Recoveries: | | | |
| Commercial | 180 | 26 | 249 |
| Residential real estate | 11 | 17 | 0 |
| Consumer | 22 | 18 | 10 |
| Balance at end of year | $ 19,251 | $ 16,093 | $ 13,472 |
| Ratios: | | | |
| Net charge-offs to average loans outstanding | .37% | .14% | .12% |
| Allowance for loan losses to loans outstanding at year end | 1.38% | 1.39% | 1.40% |

**Premises and Equipment:** Premises and equipment totaled $45.8 million at December 31, 2004, an increase of $7.1 million from December 31, 2003. The increase included costs incurred to complete our new regional banking facility in Grand Haven and two new full-service branch locations that opened during 2004. The new Grand Haven facility allowed us to replace a leased branch site with a full service facility in a more favorable location. The remaining branch sites allowed us to establish a presence both on the northwest side of Grand Rapids in Walker and on south side of Grand Rapids in Gaines Township. We also purchased property in downtown Grand Rapids which we expect to develop in the future to further strengthen our presence in the heart of Kent County.

**Deposits:** Total deposits increased $242.1 million to $1.35 billion at December 31, 2004, as compared to $1.11 billion at December 31, 2003. The majority of growth during the year was in lower costing transaction accounts, primarily money markets, although each category of deposits experienced growth during the year. Money market accounts increased $159.1 million primarily related to growth in business accounts and success in attracting large depositors. Although the balances for these large depositors may vary from period to period, we expect these relationships to be a long-term source of funding. With our continued focus on quality customer service, the desire of customers to deal with a local bank, and the convenience of our expanding and maturing branch network, we expect this trend of growth in transaction account deposits to continue.

The mix of our deposit portfolio remained relatively consistent. Noninterest bearing demand accounts comprised approximately 11% of total deposits at December 31, 2004, as compared to approximately 13% of total deposits at the end of 2003. Interest bearing demand, including money markets, and savings accounts comprised approximately 53% of total deposits at December 31, 2004, as compared to 49% at the end of last year. Time accounts as a percentage of total deposits were approximately 36% at December 31, 2004, and were approximately 38% at December 31, 2003.

**Borrowed Funds:** Borrowed funds consist of advances from the Federal Home Loan Bank, long-term debt associated with the issuance of trust preferred securities and federal funds purchased provided by our correspondent banks. Additionally, we have a $10.0 million credit facility available for general corporate needs including contributing capital to our subsidiary bank to enable it to maintain regulatory capital at well-capitalized levels. This credit facility was unused during all of 2004.

Borrowed funds totaled $187.4 million at December 31, 2004, including $124.0 million of Federal Home Loan Bank advances, $41.2 million in long-term debt associated with trust preferred securities and $22.1 million in federal funds purchased. Borrowed funds totaled $165.3 million at December 31, 2003 including $145.7 million of Federal Home Loan Bank advances and $19.6 million in long-term debt comprised of a trust preferred security offering issued in July 2003.

The repayment of Federal Home Loan Bank advances during 2004 was offset by a corresponding increase in federal funds purchased due to the relatively lower cost of these funds compared to alternative borrowings. In addition, our holdings of long-term debt increased as a result of our second trust preferred security issuance. These borrowings qualify as capital for regulatory purposes and are discussed further below.

## CAPITAL RESOURCES AND LIQUIDITY

**Capital Resources:** Total shareholders' equity was $129.1 million at December 31, 2004 compared to $121.9 million at December 31, 2003. The increase of $7.9 million was primarily the result of retained net income (net of cash dividends paid) that was slightly offset by a reduction in accumulated other comprehensive income. Net income generated during 2004 of $12.8 million was partially offset by cash dividends of $4.4 million, or $.50 per share. We began paying cash dividends at the end of 2000 and have increased the amount of the dividend each year since. It is anticipated that we will continue to pay quarterly cash dividends in the future. We have also paid a stock dividend each year beginning in 2001. A 5% stock dividend was paid in May 2004, resulting in a transfer of $9.4 million from retained earnings to common stock.

The change in accumulated other comprehensive income was due to a decrease in both the market value of securities available for sale and the derivative instruments associated with the Company's interest rate swap arrangements due principally to the general rise in longer-term interest rates during 2004. For more information regarding our interest rate swap arrangements, see the Notes to the Consolidated Financial Statements.

The Corporation was categorized as "well capitalized" for regulatory capital purposes at December 31, 2004 and 2003. The following table shows the Company's various capital ratios for 2004 and 2003.

| **As of and for the year ended December 31,** | **2004** | **2003** |
|---|---|---|
| Average equity to average assets | 8.2% | 9.5% |
| Total risk-based capital | 11.0% | 10.9% |
| Tier 1 risk-based capital | 9.2% | 9.7% |
| Tier 1 capital to average assets | 8.3% | 8.8% |

At December 31, 2004, our total capital to risk-weighted assets was 11.0% compared to 10.9% at December 31, 2003. Our Tier 1 Capital as a percent of average assets was 8.3% at December 31, 2004 and 8.8% at December 31, 2003. An increase in both our Tier 1 and total risk-based capital associated with our issuance of trust preferred securities in the first quarter of 2004 has been largely offset by significant growth in our assets. On March 18, 2004, we raised additional regulatory capital by participating in a pooled trust preferred security issuance in the amount of $20.0 million. Of the $40.0 million of trust preferred securities outstanding at December 31, 2004, approximately $32.0 million qualified as Tier 1 capital with the remaining qualifying as Tier 2 capital. For more information regarding the trust preferred securities, please refer to the Notes to the Consolidated Financial Statements.

We believe the additional regulatory capital provide by the trust preferred security issuances in the past two years, as supplemented by our improvement in earnings, will support our growth plans in the near future. Additional capital may be necessary within the next two years if our growth continues at its current pace. Capital sources include additional common stock offerings, trust preferred securities offerings and subordinated debt.

**Liquidity:** The liquidity of a financial institution reflects its ability to measure and monitor 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 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. Our sources of liquidity include our borrowing capacity with the Federal Home Loan Bank and federal funds purchased lines with our correspondent banks, loan payments by our borrowers, maturity and sales of our securities available for sale, growth of our deposits and deposit equivalents, federal funds sold, and the various capital resources discussed above. Liquidity management involves the ability to meet the cash flow requirements of our customers. Our customers may be either borrowers with credit needs or depositors wanting to withdraw funds. We feel our liquidity position is sufficient to meet these needs.

**SENSITIVITY TO MARKET RISK**

Our primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of our transactions are denominated in U.S. dollars with no specific foreign exchange exposure. Macatawa Bank has only limited agricultural-related loan assets, and therefore has no significant exposure to changes in commodity prices. Our market risk exposure is mainly comprised of our sensitivity to interest rate risk. Our balance sheet has sensitivity, in various categories of assets and liabilities, to changes in prevailing rates in the U.S. for prime rate, mortgage rates, U.S. Treasury rates and various money market indexes. Our asset/liability management process aids us in providing liquidity while maintaining a balance between interest earning assets and interest bearing liabilities.

We use two interest rate risk measurement techniques in our interest rate risk management. We first use a static gap analysis. This measures the difference between the dollar amounts of interest sensitive assets and liabilities that may be refinanced or repriced during a given time period. A significant repricing gap could result in a negative impact to our net interest margin during periods of changing market interest rates. The following table illustrates our interest rate repricing gaps for selected maturity periods at December 31, 2004.

| **Static Gap Analysis (dollars in thousands)** | **0 to 3 months** | **4 to 12 months** | **1 to 5 years** | **Over 5 Years** | **Total** |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Loans-fixed | $ 36,210 | $ 51,176 | $ 289,231 | $ 52,297 | $ 428,914 |
| Loans-variable | 906,626 | 5,650 | 51,867 | 3,330 | 967,473 |
| Taxable securities | 2,004 | 2,113 | 83,309 | 3,973 | 91,399 |
| Tax exempt securities | -- | -- | -- | 48,402 | 48,402 |
| Other securities | 12,239 | -- | -- | -- | 12,239 |
| Other assets, net | -- | -- | -- | -- | 124,179 |
| Total assets | $ 957,079 | $ 58,939 | $ 424,407 | $ 108,002 | $ 1,672,606 |
| Liabilities: | | | | | |
| Time deposits | $ 108,308 | $ 232,471 | $ 139,545 | $ -- | $ 480,324 |
| Savings | 38,494 | -- | -- | -- | 38,494 |
| Other interest bearing deposits | 683,594 | -- | -- | -- | 683,594 |
| Other borrowings | 79,569 | 6,700 | 65,752 | 35,333 | 187,354 |
| Noninterest bearing deposits | -- | -- | -- | -- | 149,104 |
| Other liabilities & equity | -- | -- | -- | -- | 133,736 |
| Total liabilities & equity | $ 909,965 | $ 239,171 | $ 205,297 | $ 35,333 | $ 1,672,606 |
| Period gap | $ 47,114 | $ (180,232) | $ 219,110 | $ 72,669 | |
| Cumulative gap | $ 47,114 | $ (133,118) | $ 85,992 | $ 158,661 | |
| Cumulative gap/total assets | 2.82% | (7.96)% | 5.14% | 9.49% | |

The above table shows that total assets maturing or repricing within three months exceeded liabilities maturing within the same time period by $47.1 million indicating that we are asset sensitive in this time horizon. The above gap analysis is limited, however, in that cash flows and repricing characteristics for various categories of assets and liabilities are subject to competitive pressures, consumer sentiments and other influences that are beyond our control and are not reflected in this static analysis. As a result, various assets and liabilities indicated as maturing or repricing within a stated period may reprice at different levels and mature or reprice in other periods or at different volumes.

The analysis also does not consider the extent of repricing for certain assets or liabilities shown as re-priceable within twelve months or reflect the magnitude of interest rate changes on net interest income, or consider certain interest rate swaps utilized to mitigate some of our interest rate risk.

Accordingly, we also utilize a simulation model to assess the direction and magnitude of variations in net interest income and the economic value of equity (“EVE”) resulting from potential changes in market interest rates. Key assumptions in the model include contractual cash flows and maturities of interest-sensitive assets and interest-sensitive liabilities, prepayment speeds on certain assets, and changes in market conditions impacting loan and deposit pricing. We also assume certain levels of rate sensitivity of our non-maturing transaction deposits based upon our historical sensitivity under previous interest rate cycles, and we include pricing floors on discretionary priced liability products which limit how low various checking and savings products could go under declining interest rates. These assumptions reflect our pricing philosophy in response to changing interest rates.

The simulation analysis also considers the interest rate swaps we have entered into which have the effect of converting $100.0 million in variable rate loans repricing immediately into fixed rate loans repricing in one to five years. The interest rate swaps are not reflected in the table above and are more fully discussed in the Notes to the Consolidated Financial Statements.

We forecast the next twelve months of net interest income under an assumed environment of gradual changes in market interest rates under various scenarios. The resulting change in net interest income is an indication of the sensitivity of our earnings to directional changes in market interest rates. The simulation also measures the change in EVE, or the net present value of our assets and liabilities, under the same shifts in interest rates, as calculated by discounting the estimated future cash flows using a market-based discount rate.

The following table shows the impact of changes in interest rates on net interest income over the next twelve months and EVE based on our balance sheet as of December 31, 2004 (dollars in thousands).

| **Interest Rate Scenario** | **Economic Value of Equity** | **Percent Change** | **Net Interest Income** | **Percent Change** |
|---|---|---|---|---|
| **Change in Interest Rates** | | | | |
| 200 basis point rise | $ 146,833 | (8.6)% | $ 62,417 | 5.1% |
| 100 basis point rise | 155,136 | (3.4) | 60,902 | 2.6 |
| Base-rate scenario | 160,669 | - | 59,368 | - |
| 100 basis point decline | 166,536 | 3.7 | 57,691 | (2.8) |
| 200 basis point decline | 175,190 | 9.0 | 54,982 | (7.4) |

If interest rates were to increase, this analysis suggests that we are well-positioned for improvements in net interest income over the next twelve months. Further, our balanced sensitivity in time horizons beyond one year results in little fluctuation in EVE under the various rate shock scenarios.

We also forecast the impact of immediate and parallel interest rate shocks on net interest income under various scenarios to measure the sensitivity of our earnings under extreme conditions.

The quarterly simulation analysis is monitored against acceptable interest rate risk parameters by the Asset/Liability Committee and reported to the Board of Directors.

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

**Forward-Looking Statements:** This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and are including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies, and expectations are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, may or similar expressions. The presentation and discussion of the provision and allowance for loan losses, statements concerning future profitability or future growth or increases, and statements about the adequacy of our capital resources are examples of inherently forward-looking statements in that they involve judgements and statements of belief as to the outcome of future events. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on our operations and future prospects include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in our market area and accounting principles, policies, and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning us and our business, including additional factors that could materially affect our financial results, is included in our filings with the Securities and Exchange Commission.

**Quarterly Stock Price Information:** The Company's common stock is quoted on the Nasdaq National Market under the symbol MCBC. High and low sales prices (as reported on the Nasdaq National Market) for each quarter for the years ended December 31, 2004 and 2003 are set forth in the table below. This information has been restated for the 5% stock dividends paid in May 2004 and May 2003.

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | **High** | **Low** | **High** | **Low** |
| Quarter | | | | |
| First Quarter | $ 28.00 | $ 24.19 | $ 20.47 | $ 17.69 |
| Second Quarter | $ 28.50 | $ 24.00 | $ 23.56 | $ 18.74 |
| Third Quarter | $ 28.75 | $ 24.88 | $ 24.38 | $ 21.19 |
| Fourth Quarter | $ 32.99 | $ 25.85 | $ 27.95 | $ 22.05 |

Quarterly cash dividends totaling $.31 were paid during 2002, and a 4% stock dividend was declared during the second quarter of 2002. Quarterly cash dividends totaling $.40 were paid during 2003, and a 5% stock dividend was declared during the second quarter of 2003. Quarterly cash dividends totaling $.50 were paid during 2004, and a 5% stock dividend was declared during the second quarter of 2004.