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U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

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

For the transition period from to .

Commission File No. 000-26719

MERCANTILE BANK CORPORATION

(Exact name of registrant as specified in its charter)

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

310 Leonard Street, NW, Grand Rapids, MI 49504

(Address of principal executive offices) (Zip Code)

(616) 406-3000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨	Smaller reporting company ¨

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

At May 9, 2013, there were 8,705,412 shares of common stock outstanding.

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MERCANTILE BANK CORPORATION

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2013 (Unaudited)	December 31, 2012 (Audited)
ASSETS		
Cash and due from banks	$ 14,382,000	$ 20,302,000
Interest-bearing deposit balances	10,801,000	10,822,000
Federal funds sold	89,594,000	104,879,000
Total cash and cash equivalents	114,777,000	136,003,000
Securities available for sale	140,013,000	138,314,000
Federal Home Loan Bank stock	11,961,000	11,961,000
Loans	1,022,956,000	1,041,189,000
Allowance for loan losses	(26,035,000)	(28,677,000)
Loans, net	996,921,000	1,012,512,000
Premises and equipment, net	25,665,000	25,919,000
Bank owned life insurance	50,386,000	50,048,000
Accrued interest receivable	3,899,000	3,874,000
Other real estate owned and repossessed assets	6,506,000	6,970,000
Net deferred tax asset	20,482,000	22,015,000
Other assets	14,745,000	15,310,000
Total assets	$ 1,385,355,000	$ 1,422,926,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest-bearing	$ 189,477,000	$ 190,241,000
Interest-bearing	903,313,000	944,963,000
Total deposits	1,092,790,000	1,135,204,000
Securities sold under agreements to repurchase	68,744,000	64,765,000
Federal Home Loan Bank advances	35,000,000	35,000,000
Subordinated debentures	32,990,000	32,990,000
Accrued interest and other liabilities	6,139,000	8,377,000
Total liabilities	1,235,663,000	1,276,336,000
Shareholders equity		

Preferred stock, no par value; 1,000,000 shares authorized; none issued	0	0
Common stock, no par value; 20,000,000 shares authorized; 8,705,412 shares outstanding at March 31, 2013 and 8,706,251 shares outstanding at December 31, 2012	165,353,000	166,074,000
Retained earnings (deficit)	(16,734,000)	(21,134,000)
Accumulated other comprehensive income	1,073,000	1,650,000
Total shareholders equity	149,692,000	146,590,000
Total liabilities and shareholders equity	$ 1,385,355,000	$ 1,422,926,000

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Interest income		
Loans, including fees	$ 12,846,000	$ 13,813,000
Securities, taxable	1,007,000	1,280,000
Securities, tax-exempt	295,000	422,000
Federal funds sold	54,000	32,000
Interest-bearing deposit balances	7,000	6,000
Total interest income	14,209,000	15,553,000
Interest expense		
Deposits	2,320,000	3,008,000
Short-term borrowings	20,000	49,000
Federal Home Loan Bank advances	118,000	389,000
Other borrowings	297,000	238,000
Total interest expense	2,755,000	3,684,000
Net interest income	11,454,000	11,869,000
Provision for loan losses	(1,500,000)	0
Net interest income after provision for loan losses	12,954,000	11,869,000
Noninterest income		
Service charges on accounts	374,000	386,000
Earnings on bank owned life insurance	338,000	407,000
Mortgage banking activities	252,000	299,000
Rental income from other real estate owned	199,000	212,000
Other income	664,000	630,000
Total noninterest income	1,827,000	1,934,000
Noninterest expense		
Salaries and benefits	4,857,000	4,691,000
Occupancy	658,000	678,000
Furniture and equipment depreciation, rent and maintenance	256,000	308,000
Nonperforming asset costs	131,000	1,275,000
FDIC insurance costs	245,000	304,000
Other expense	2,437,000	2,398,000

Total noninterest expenses	8,584,000	9,654,000
Income before federal income tax expense	6,197,000	4,149,000
Federal income tax expense	1,797,000	1,269,000
Net income	4,400,000	2,880,000
Preferred stock dividends and accretion	0	328,000
Net income attributable to common shares	$ 4,400,000	$ 2,552,000
Basic earnings per share	$ 0.51	$ 0.30
Diluted earnings per share	$ 0.50	$ 0.28
Cash dividends per share	$ 0.10	$ 0.00
Average basic shares outstanding	8,705,677	8,605,484
Average diluted shares outstanding	8,718,601	8,991,422

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net income	$ 4,400,000	$ 2,880,000
Other comprehensive income, net of tax effect:		
Change in net unrealized gain on securities available for sale	(651,000)	(657,000)
Change in fair value of interest rate swap	74,000	94,000
Other comprehensive income, net of tax effect	(577,000)	(563,000)
Comprehensive income	$ 3,823,000	$ 2,317,000

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF

CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

($ in thousands)	Preferred Stock	Common Stock	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total Shareholders Equity
Balances, January 1, 2013	$ 0	$ 166,074	$ (21,134)	$ 1,650	$ 146,590
Employee stock purchase plan (532 shares)		9			9
Dividend reinvestment plan (929 shares)		16			16
Stock-based compensation expense		118			118
Cash dividends ($0.10 per common share)		(864)			(864)
Net income for the three months ended March 31, 2013			4,400		4,400
Change in net unrealized gain on securities available for sale, net of tax effect				(651)	(651)
Change in fair value of interest rate swap, net of tax effect				74	74
Balances, March 31, 2013	$ 0	$ 165,353	$ (16,734)	$ 1,073	$ 149,692

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF

CHANGES IN SHAREHOLDERS EQUITY (Continued)

(Unaudited)

($ in thousands)	Preferred Stock	Common Stock	Common Stock Warrant	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total Shareholders Equity
Balances, January 1, 2012	$ 20,331	$ 172,841	$ 1,138	$ (32,639)	$ 3,328	$ 164,999
Employee stock purchase plan (637 shares)		9				9
Stock option exercises (2,900 shares)		18				18
Stock-based compensation expense		4				4
Preferred stock dividends				(263)		(263)
Accretion of preferred stock	65			(65)		0
Net income for the three months ended March 31, 2012				2,880		2,880
Change in net unrealized gain on securities available for sale, net of tax effect					(657)	(657)
Change in fair value of interest rate swap, net of tax effect					94	94
Balances, March 31, 2012	$ 20,396	$ 172,872	$ 1,138	$ (30,087)	$ 2,765	$ 167,084

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Cash flows from operating activities		
Net income	$ 4,400,000	$ 2,880,000
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	553,000	510,000
Provision for loan losses	(1,500,000)	0
Stock-based compensation expense	118,000	4,000
Proceeds from sales of mortgage loans held for sale	16,260,000	16,431,000
Origination of mortgage loans held for sale	(15,393,000)	(17,066,000)
Net gain from sales of mortgage loans held for sale	(202,000)	(253,000)
Net (gain) loss from sale and valuation write-down of foreclosed assets	(528,000)	158,000
Earnings on bank owned life insurance	(338,000)	(407,000)
Net change in:		
Accrued interest receivable	(25,000)	(24,000)
Other assets	2,159,000	629,000
Accrued expenses and other liabilities	(2,205,000)	72,000
Net cash from operating activities	3,299,000	2,934,000
Cash flows from investing activities		
Loan originations and payments, net	14,779,000	7,951,000
Purchases of securities available for sale	(14,984,000)	(17,985,000)
Proceeds from maturities, calls and repayments of securities available for sale	12,314,000	40,118,000
Proceeds from sales of foreclosed assets	2,639,000	9,714,000
Purchases of premises and equipment	(80,000)	(70,000)
Net cash from investing activities	14,668,000	39,728,000
Cash flows from financing activities		
Net decrease in time deposits	(43,116,000)	(24,108,000)
Net increase in all other deposits	702,000	5,467,000
Net increase (decrease) in securities sold under agreements to repurchase	3,979,000	(15,129,000)
Proceeds from Federal Home Loan Bank advances	0	10,000,000
Maturities of Federal Home Loan Bank advances	0	(10,000,000)
Net increase (decrease) in other borrowed money	81,000	(20,000)
Proceeds from stock option exercises	0	18,000
Employee stock purchase plan	9,000	9,000
Dividend reinvestment plan	16,000	0
Payment of cash dividends on preferred stock	0	(263,000)
Payment of cash dividends to common shareholders	(864,000)	0

Net cash for financing activities	(39,193,000)	(34,026,000)

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net change in cash and cash equivalents	(21,226,000)	8,636,000
Cash and cash equivalents at beginning of period	136,003,000	76,372,000
Cash and cash equivalents at end of period	$ 114,777,000	$ 85,008,000
Supplemental disclosures of cash flows information		
Cash paid during the period for:		
Interest	$ 3,339,000	$ 4,420,000
Federal income tax	0	0
Noncash financing and investing activities:		
Transfers from loans to foreclosed assets	1,647,000	8,096,000
Preferred stock cash dividend accrued	0	134,000

See accompanying notes to condensed consolidated financial statements.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: The unaudited financial statements for the three months ended March 31, 2013 include the consolidated results of operations of Mercantile Bank Corporation and its consolidated subsidiaries. These subsidiaries include Mercantile Bank of Michigan (our bank) and our bank s two subsidiaries, Mercantile Bank Real Estate Co., LLC (our real estate company) and Mercantile Insurance Center, Inc. (our insurance center). These consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and Item 303(b) of Regulation S-K and do not include all disclosures required by accounting principles generally accepted in the United States of America for a complete presentation of our financial condition and results of operations. In the opinion of management, the information reflects all adjustments (consisting only of normal recurring adjustments) which are necessary in order to make the financial statements not misleading and for a fair presentation of the results of operations for such periods. The results for the period ended March 31, 2013 should not be considered as indicative of results for a full year. For further information, refer to the consolidated financial statements and footnotes included in our annual report on Form 10-K for the year ended December 31, 2012.

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

Earnings Per Share: Basic earnings per share is based on the weighted average number of common shares and participating securities outstanding during the period. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under our stock-based compensation plans and our common stock warrant granted to the U.S. Department of Treasury that we repurchased on July 3, 2012, and are determined using the treasury stock method. Our unvested restricted shares, which contain non-forfeitable rights to dividends whether paid or accrued (i.e., participating securities), are included in the number of shares outstanding for both basic and diluted earnings per share calculations. In the event of a net loss, our unvested restricted shares are excluded from the calculation of both basic and diluted earnings per share.

Approximately 65,000 unvested restricted shares were included in determining both basic and diluted earnings per share for the three months ended March 31, 2013. In addition, stock options for approximately 21,000 shares of common stock were included in determining diluted earnings per share for the three months ended March 31, 2013. Stock options for approximately 132,000 shares of common stock were antidilutive and not included in determining diluted earnings per share for the three months ended March 31, 2013.

Approximately 38,000 unvested restricted shares were included in determining both basic and diluted earnings per share for the three months ended March 31, 2012. In addition, stock options and a stock warrant for approximately 45,000 and 616,000 shares of common stock, respectively, were included in determining diluted earnings per share for the three months ended March 31, 2012. Stock options for approximately 167,000 shares of common stock were antidilutive and not included in determining diluted earnings per share for the three months ended March 31, 2012.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans: Loans that we have the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on commercial loans and mortgage loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer and credit card loans are typically charged off no later than when they are 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 and 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 (allowance) is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when we believe the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. We estimate the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in our judgment, should be charged-off.

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

(Continued)

MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled Debt Restructurings: A loan is accounted for as a troubled debt restructuring if we, for economic or legal reasons, grant a concession to a borrower considered to be experiencing financial difficulties that we would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan, or a modification of terms such as a reduction of the stated interest rate or balance of the loan, a reduction of accrued interest, an extension of the maturity date or renewal of the loan at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings can be in either accrual or nonaccrual status. Nonaccrual troubled debt restructurings are included in nonperforming loans. Accruing troubled debt restructurings are generally excluded from nonperforming loans as it is considered probable that all contractual principal and interest due under the restructured terms will be collected.

In accordance with current accounting guidance, loans modified as troubled debt restructurings are, by definition, considered to be impaired loans. Impairment for these loans is measured on a loan-by-loan basis similar to other impaired loans as described above under Allowance for Loan Losses. Certain loans modified as troubled debt restructurings may have been previously measured for impairment under a general allowance methodology (i.e., pooling), thus at the time the loan is modified as a troubled debt restructuring the allowance will be impacted by the difference between the results of these two measurement methodologies. Loans modified as troubled debt restructurings that subsequently default are factored into the determination of the allowance in the same manner as other defaulted loans.

Derivatives: Derivative financial instruments are recognized as assets or liabilities at fair value. The accounting for changes in the fair value of derivatives depends on the use of the derivatives and whether the derivatives qualify for hedge accounting. Used as part of our asset and liability management to help manage interest rate risk, our derivatives have historically consisted of interest rate swap agreements that qualified for hedge accounting. In February 2012, we entered into an interest rate swap agreement that qualifies for hedge accounting. However, in June 2011, we simultaneously purchased and sold an interest rate cap, a structure commonly referred to as a cap corridor , which does not qualify for hedge accounting. The current outstanding interest rate swap and cap corridor are discussed in more detail in Note 9. We do not use derivatives for trading purposes.

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

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Adoption of New Accounting Standards: In February 2013, the FASB issued ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which is intended to improve the reporting of reclassifications out of accumulated other comprehensive income. The ASU requires an entity to report, either on the face of the income statement or in the notes to the financial statements, the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the income statement. We adopted this ASU in the first quarter of 2013.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2013				
U.S. Government agency debt obligations	$ 83,936,000	$ 766,000	$ (690,000)	$ 84,012,000
Mortgage-backed securities	17,567,000	1,555,000	0	19,122,000
Michigan Strategic Fund bonds	11,070,000	0	0	11,070,000
Municipal general obligation bonds	21,702,000	906,000	0	22,608,000
Municipal revenue bonds	1,728,000	70,000	0	1,798,000
Mutual funds	1,361,000	42,000	0	1,403,000
	$ 137,364,000	$ 3,339,000	$ (690,000)	$ 140,013,000
December 31, 2012				
U.S. Government agency debt obligations	$ 78,447,000	$ 1,039,000	$ (388,000)	$ 79,098,000
Mortgage-backed securities	20,182,000	1,814,000	0	21,996,000
Michigan Strategic Fund bonds	11,255,000	0	0	11,255,000
Municipal general obligation bonds	21,700,000	1,043,000	0	22,743,000
Municipal revenue bonds	1,726,000	91,000	0	1,817,000
Mutual funds	1,354,000	51,000	0	1,405,000
	$ 134,664,000	$ 4,038,000	$ (388,000)	$ 138,314,000

(Continued)

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. SECURITIES (Continued)

Securities with unrealized losses at March 31, 2013 and December 31, 2012, aggregated by investment category and length of time that individual securities have been in a continuous loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
March 31, 2013						
U.S. Government agency debt obligations	$ 47,229,000	$ (690,000)	$ 0	$ 0	$ 47,229,000	$ (690,000)
Mortgage-backed securities	0	0	0	0	0	0
Michigan Strategic Fund bonds	0	0	0	0	0	0
Municipal general obligation bonds	0	0	0	0	0	0
Municipal revenue bonds	0	0	0	0	0	0
Mutual funds	0	0	0	0	0	0
	$ 47,229,000	$ (690,000)	$ 0	$ 0	$ 47,229,000	$ (690,000)
December 31, 2012						
U.S. Government agency debt obligations	$ 33,555,000	$ (388,000)	$ 0	$ 0	$ 33,555,000	$ (388,000)
Mortgage-backed securities	0	0	0	0	0	0
Michigan Strategic Fund bonds	0	0	0	0	0	0
Municipal general obligation bonds	0	0	0	0	0	0
Municipal revenue bonds	0	0	0	0	0	0
Mutual funds	0	0	0	0	0	0
	$ 33,555,000	$ (388,000)	$ 0	$ 0	$ 33,555,000	$ (388,000)

(Continued)

MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. SECURITIES (Continued)

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

At March 31, 2013, 33 debt securities with a fair value totaling $47.2 million have unrealized losses aggregating $0.7 million. After we considered whether the securities were issued by the federal government or its agencies and whether downgrades by bond rating agencies had occurred, we determined that unrealized losses were due to changing interest rate environments. As we do not intend to sell our debt securities before recovery of their cost basis and we believe it is more likely than not that we will not be required to sell our debt securities before recovery of the cost basis, no unrealized losses are deemed to be other-than-temporary.

The amortized cost and fair values of debt securities at March 31, 2013, by maturity, are shown in the following table. The contractual maturity is utilized for U.S. Government agency debt obligations and municipal bonds. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately. Weighted average yields are also reflected, with yields for municipal securities shown at their tax equivalent yield.

	Weighted Average Yield	Amortized Cost	Fair Value
Due in 2013	5.93%	$ 4,244,000	$ 4,269,000
Due in 2014 through 2018	4.99	4,649,000	4,819,000
Due in 2019 through 2023	3.35	29,434,000	29,725,000
Due in 2024 and beyond	3.80	69,039,000	69,605,000
Mortgage-backed securities	5.18	17,567,000	19,122,000
Michigan Strategic Fund bonds	1.73	11,070,000	11,070,000
Mutual funds	2.04	1,361,000	1,403,000
	3.82%	$ 137,364,000	$ 140,013,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. SECURITIES (Continued)

The amortized cost of securities issued by the State of Michigan and all its political subdivisions totaled $23.4 million at March 31, 2013 and December 31, 2012, with estimated market values of $24.4 million and $24.6 million, respectively. Total securities of any other specific issuer, other than the U.S. Government and its agencies, did not exceed 10% of shareholders equity.

The carrying value of U.S. Government agency debt obligations and mortgage-backed securities that are pledged to secure repurchase agreements was $85.4 million and $83.8 million at March 31, 2013 and December 31, 2012, respectively. In addition, substantially all of our municipal bonds have been pledged to the Discount Window of the Federal Reserve Bank of Chicago. Investments in Federal Home Loan Bank stock are restricted and may only be resold or redeemed by the issuer.

3. LOANS AND ALLOWANCE FOR LOAN LOSSES

Our total loans at March 31, 2013 were $1.02 billion compared to $1.04 billion at December 31, 2012, a decrease of $18.2 million, or 1.8%. The components of our loan portfolio disaggregated by class of loan within the loan portfolio segments at March 31, 2013 and December 31, 2012, and the percentage change in loans from the end of 2012 to the end of the first quarter of 2013, are as follows:

	March 31, 2013		December 31, 2012		Percent Increase
	Balance	%	Balance	%	(Decrease)
Commercial:					
Commercial and industrial	$ 272,890,000	26.7%	$ 285,322,000	27.4%	(4.4%)
Vacant land, land development, and residential construction	45,174,000	4.4	48,099,000	4.6	(6.1)
Real estate owner occupied	253,089,000	24.7	259,277,000	24.9	(2.4)
Real estate non-owner occupied	327,776,000	32.1	324,886,000	31.2	0.9
Real estate multi-family and residential rental	50,035,000	4.9	50,922,000	4.9	(1.7)
Total commercial	948,964,000	92.8	968,506,000	93.0	(2.0)
Retail:					
Home equity and other	38,257,000	3.7	38,917,000	3.7	(1.7)
1-4 family mortgages	35,735,000	3.5	33,766,000	3.3	5.8
Total retail	73,992,000	7.2	72,683,000	7.0	1.8
Total loans	$ 1,022,956,000	100.0%	$ 1,041,189,000	100.0%	(1.8%)

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Nonperforming loans as of March 31, 2013 and December 31, 2012 were as follows:

	March 31, 2013	December 31, 2012
Loans past due 90 days or more still accruing interest	$ 0	$ 0
Nonaccrual loans	12,395,000	18,970,000
Total nonperforming loans	$ 12,395,000	$ 18,970,000

The recorded principal balance of nonaccrual loans, including troubled debt restructurings, was as follows:

	March 31, 2013	December 31, 2012
Commercial:		
Commercial and industrial	$ 1,802,000	$ 1,677,000
Vacant land, land development, and residential construction	1,444,000	2,194,000
Real estate owner occupied	1,256,000	2,087,000
Real estate non-owner occupied	4,905,000	9,010,000
Real estate multi-family and residential rental	1,085,000	2,021,000
Total commercial	10,492,000	16,989,000
Retail:		
Home equity and other	838,000	889,000
1-4 family mortgages	1,065,000	1,092,000
Total retail	1,903,000	1,981,000
Total nonaccrual loans	$ 12,395,000	$ 18,970,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. **LOANS AND ALLOWANCE FOR LOAN LOSSES** (Continued)

An age analysis of past due loans is as follows as of March 31, 2013:

	30 59 Days Past Due	60 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Recorded Balance > 89 Days and Accruing
Commercial:							
Commercial and industrial	$ 0	$ 0	$ 771,000	$ 771,000	$ 272,119,000	$ 272,890,000	$ 0
Vacant land, land development, and residential construction	0	0	1,140,000	1,140,000	44,034,000	45,174,000	0
Real estate owner occupied	92,000	51,000	749,000	892,000	252,197,000	253,089,000	0
Real estate non-owner occupied	0	1,860,000	632,000	2,492,000	325,284,000	327,776,000	0
Real estate multi-family and residential rental	290,000	0	196,000	486,000	49,549,000	50,035,000	0
Total commercial	382,000	1,911,000	3,488,000	5,781,000	943,183,000	948,964,000	0
Retail:							
Home equity and other	17,000	0	13,000	30,000	38,227,000	38,257,000	0
1-4 family mortgages	0	0	436,000	436,000	35,299,000	35,735,000	0
Total retail	17,000	0	449,000	466,000	73,526,000	73,992,000	0
Total past due loans	$ 399,000	$ 1,911,000	$ 3,937,000	$ 6,247,000	$ 1,016,709,000	$ 1,022,956,000	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. **LOANS AND ALLOWANCE FOR LOAN LOSSES** (Continued)

An age analysis of past due loans is as follows as of December 31, 2012:

	30 59 Days Past Due	60 89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Recorded Balance > 89 Days and Accruing
Commercial:							
Commercial and industrial	$ 80,000	$ 0	$ 871,000	$ 951,000	$ 284,371,000	$ 285,322,000	$ 0
Vacant land, land development, and residential construction	289,000	0	614,000	903,000	47,196,000	48,099,000	0
Real estate owner occupied	199,000	0	1,337,000	1,536,000	257,741,000	259,277,000	0
Real estate non-owner occupied	303,000	0	1,123,000	1,426,000	323,460,000	324,886,000	0
Real estate multi-family and residential rental	0	0	613,000	613,000	50,309,000	50,922,000	0
Total commercial	871,000	0	4,558,000	5,429,000	963,077,000	968,506,000	0
Retail:							
Home equity and other	1,000	0	13,000	14,000	38,903,000	38,917,000	0
1-4 family mortgages	47,000	190,000	437,000	674,000	33,092,000	33,766,000	0
Total retail	48,000	190,000	450,000	688,000	71,995,000	72,683,000	0
Total past due loans	$ 919,000	$ 190,000	$ 5,008,000	$ 6,117,000	$ 1,035,072,000	$ 1,041,189,000	$ 0

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired loans were as follows as of March 31, 2013:

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Year-To-Date Average Recorded Principal Balance
With no related allowance recorded:				
Commercial:				
Commercial and industrial	$ 2,972,000	$ 1,556,000		$ 1,587,000
Vacant land, land development and residential construction	2,342,000	1,378,000		1,389,000
Real estate owner occupied	2,314,000	1,349,000		1,453,000
Real estate non-owner occupied	7,440,000	4,717,000		5,105,000
Real estate multi-family and residential rental	1,729,000	684,000		549,000
Total commercial	16,797,000	9,684,000		10,083,000
Retail:				
Home equity and other	580,000	480,000		481,000
1-4 family mortgages	1,630,000	767,000		778,000
Total retail	2,210,000	1,247,000		1,259,000
Total with no related allowance recorded	$ 19,007,000	$ 10,931,000		$ 11,342,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Year-To-Date Average Recorded Principal Balance
With an allowance recorded:				
Commercial:				
Commercial and industrial	$ 2,616,000	$ 2,506,000	$ 1,407,000	$ 2,216,000
Vacant land, land development and residential construction	1,958,000	1,480,000	726,000	1,849,000
Real estate owner occupied	3,417,000	2,953,000	1,162,000	3,289,000
Real estate non-owner occupied	30,428,000	30,322,000	10,411,000	31,643,000
Real estate multi-family and residential rental	2,761,000	2,691,000	910,000	3,307,000
Total commercial	41,180,000	39,952,000	14,616,000	42,304,000
Retail:				
Home equity and other	369,000	346,000	155,000	370,000
1-4 family mortgages	559,000	471,000	122,000	473,000
Total retail	928,000	817,000	277,000	843,000
Total with an allowance recorded	$ 42,108,000	$ 40,769,000	$ 14,893,000	$ 43,147,000
Total impaired loans:				
Commercial	$ 57,977,000	$ 49,636,000	$ 14,616,000	$ 52,387,000
Retail	3,138,000	2,064,000	277,000	2,102,000
Total impaired loans	$ 61,115,000	$ 51,700,000	$ 14,893,000	$ 54,489,000

Interest income of $0.6 million was recognized on impaired loans during the first quarter of 2013.

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired loans were as follows as of December 31, 2012:

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Year-To-Date Average Recorded Principal Balance
With no related allowance recorded:				
Commercial:				
Commercial and industrial	$ 1,926,000	$ 1,617,000		$ 3,140,000
Vacant land, land development and residential construction	2,356,000	1,401,000		1,848,000
Real estate owner occupied	2,368,000	1,557,000		3,139,000
Real estate non-owner occupied	9,984,000	5,492,000		6,578,000
Real estate multi-family and residential rental	1,188,000	413,000		756,000
Total commercial	17,822,000	10,480,000		15,461,000
Retail:				
Home equity and other	580,000	483,000		579,000
1-4 family mortgages	1,636,000	789,000		730,000
Total retail	2,216,000	1,272,000		1,309,000
Total with no related allowance recorded	$ 20,038,000	$ 11,752,000		$ 16,770,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. **LOANS AND ALLOWANCE FOR LOAN LOSSES** (Continued)

	Unpaid Contractual Principal Balance	Recorded Principal Balance	Related Allowance	Year-To-Date Average Recorded Principal Balance
With an allowance recorded:				
Commercial:				
Commercial and industrial	$ 3,221,000	$ 1,926,000	$ 924,000	$ 3,110,000
Vacant land, land development and residential construction	2,333,000	2,219,000	1,367,000	3,267,000
Real estate owner occupied	4,307,000	3,626,000	1,388,000	4,913,000
Real estate non-owner occupied	33,818,000	32,964,000	11,773,000	25,061,000
Real estate multi-family and residential rental	4,471,000	3,923,000	1,408,000	7,429,000
Total commercial	48,150,000	44,658,000	16,860,000	43,780,000
Retail:				
Home equity and other	423,000	394,000	204,000	286,000
1-4 family mortgages	555,000	475,000	125,000	482,000
Total retail	978,000	869,000	329,000	768,000
Total with an allowance recorded	$ 49,128,000	$ 45,527,000	$ 17,189,000	$ 44,548,000
Total impaired loans:				
Commercial	$ 65,972,000	$ 55,138,000	$ 16,860,000	$ 59,241,000
Retail	3,194,000	2,141,000	329,000	2,077,000
Total impaired loans	$ 69,166,000	$ 57,279,000	$ 17,189,000	$ 61,318,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Indicators. We utilize a comprehensive grading system for our commercial loans. All commercial loans are graded on a ten grade rating system. The rating system utilizes standardized grade paradigms that analyze several critical factors such as cash flow, operating performance, financial condition, collateral, industry condition and management. All commercial loans are graded at inception and reviewed and, if appropriate, re-graded at various intervals thereafter. The risk assessment for retail loans is primarily based on the type of collateral and payment activity.

Loans by credit quality indicators were as follows as of March 31, 2013:

Commercial credit exposure credit risk profiled by internal credit risk grades:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Internal credit risk grade groupings:					
Grades 1 4	$ 190,314,000	$ 8,065,000	$ 148,122,000	$ 166,374,000	$ 23,568,000
Grades 5 7	79,038,000	33,858,000	100,606,000	124,228,000	22,613,000
Grades 8 9	3,538,000	3,251,000	4,361,000	37,174,000	3,854,000
Total commercial	$ 272,890,000	$ 45,174,000	$ 253,089,000	$ 327,776,000	$ 50,035,000

Retail credit exposure credit risk profiled by collateral type:

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Total retail	$ 38,257,000	$ 35,735,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Loans by credit quality indicators were as follows as of December 31, 2012:

Commercial credit exposure credit risk profiled by internal credit risk grades:

	Commercial and Industrial	Commercial Vacant Land, Land Development, and Residential Construction	Commercial Real Estate - Owner Occupied	Commercial Real Estate - Non-Owner Occupied	Commercial Real Estate - Multi-Family and Residential Rental
Internal credit risk grade groupings:					
Grades 1 4	$ 180,314,000	$ 6,526,000	$ 150,467,000	$ 154,127,000	$ 24,015,000
Grades 5 7	101,832,000	37,697,000	102,988,000	128,041,000	22,082,000
Grades 8 9	3,176,000	3,876,000	5,822,000	42,718,000	4,825,000
Total commercial	$ 285,322,000	$ 48,099,000	$ 259,277,000	$ 324,886,000	$ 50,922,000

Retail credit exposure credit risk profiled by collateral type:

	Retail Home Equity and Other	Retail 1-4 Family Mortgages
Total retail	$ 38,917,000	$ 33,766,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

All commercial loans are graded using the following criteria:

Grade 1.	Excellent credit rating that contain very little, if any, risk of loss.
Grade 2.	Strong sources of repayment and have low repayment risk.
Grade 3.	Good sources of repayment and have limited repayment risk.
Grade 4.	Adequate sources of repayment and acceptable repayment risk; however, characteristics are present that render the credit more vulnerable to a negative event.
Grade 5.	Marginally acceptable sources of repayment and exhibit defined weaknesses and negative characteristics.
Grade 6.	Well defined weaknesses which may include negative current cash flow, high leverage, or operating losses. Generally, if the credit does not stabilize or if further deterioration is observed in the near term, the loan will likely be downgraded and placed on the Watch List (i.e., list of lending relationships that receive increased scrutiny and review by the Board of Directors and senior management).
Grade 7.	Defined weaknesses or negative trends that merit close monitoring through Watch List status.
Grade 8.	Inadequately protected by current sound net worth, paying capacity of the obligor, or pledged collateral, resulting in a distinct possibility of loss requiring close monitoring through Watch List status.
Grade 9.	Vital weaknesses exist where collection of principal is highly questionable.
Grade 10.	Considered uncollectable and of such little value that continuance as an asset is not warranted.

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

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. **LOANS AND ALLOWANCE FOR LOAN LOSSES** (Continued)

Activity in the allowance for loan losses and the recorded investments in loans as of and during the three months ended March 31, 2013 are as follows:

	Commercial Loans	Retail Loans	Unallocated	Total
Allowance for loan losses:				
Beginning balance	$ 26,043,000	$ 2,645,000	$ (11,000)	$ 28,677,000
Provision for loan losses	(1,164,000)	(363,000)	27,000	(1,500,000)
Charge-offs	(2,412,000)	(3,000)	0	(2,415,000)
Recoveries	1,250,000	23,000	0	1,273,000
Ending balance	$ 23,717,000	$ 2,302,000	$ 16,000	$ 26,035,000
Ending balance: individually evaluated for impairment	$ 14,616,000	$ 277,000	$ 0	$ 14,893,000
Ending balance: collectively evaluated for impairment	$ 9,101,000	$ 2,025,000	$ 16,000	$ 11,142,000
Total loans:				
Ending balance	$ 948,964,000	$ 73,992,000		$ 1,022,956,000
Ending balance: individually evaluated for impairment	$ 49,636,000	$ 2,064,000		$ 51,700,000
Ending balance: collectively evaluated for impairment	$ 899,328,000	$ 71,928,000		$ 971,256,000

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MERCANTILE BANK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Activity in the allowance for loan losses and the recorded investments in loans as of and during the three months ended March 31, 2012 are as follows:

	Commercial Loans	Retail Loans	Unallocated	Total
Allowance for loan losses:				
Beginning balance	$ 33,431,000	$ 3,019,000	$ 82,000	$ 36,532,000
Provision for loan losses	(99,000)	94,000	5,000	0
Charge-offs	(7,464,000)	(112,000)	0	