100656

2009 QUARTERLY REPORT

THIRD Quarter

Corporate Highlights

To Our Shareholders:

I am pleased to report that Southern Michigan Bancorp, Inc. earned $771,000, or $.34 per diluted share, for the third quarter of 2009 compared with $751,000, or $.33 per diluted share, for the second quarter ending June 30, 2009. Our most recent quarterly earnings substantially exceeded net income of $21,000, or $.01 per diluted share, for the third quarter of 2008. Southern's net income for the nine month period ending September 30, 2009 was $1,251,000, or $.55 per diluted share, compared to $1,571,000, or $.69 per diluted share, for the same period a year ago.

Several months ago, as economic trends continued to decline, our management team and directors initiated a thorough analysis of our capital, liquidity, credit processes and loan portfolio. We wanted to ensure that we had the capital necessary to withstand a prolonged weakened economy, the liquidity to meet our customers' needs and the confidence that we were appropriately reserving for and managing the credit risk inherent within our loan portfolio. In addition, we created an Internal Loan Review function to provide more breadth and depth of coverage of our existing loans and our credit practices. We will continue to utilize innovative approaches to risk management as we measure and test the strength of our balance sheet.

As a result of these and other programs, non-performing loans as of September 30, 2009 declined by $2.3 million, or 22 percent, to $8.2 million compared with the same quarter last year. At September 30, 2009, non-performing loans amounted to 2.43 percent of gross loans compared with $10.4 million, or 3.10 percent for the same period a year ago. Our provision for loan losses during the third quarter of 2009 was $350,000, a substantial reduction from the $500,000 provision expense incurred for the second quarter of this year. For the third quarter of 2008, our provision expense exceeded $1.5 million. The allowance for loan losses as of September 30, 2009 totaled $6.7 million, or 2 percent of total loans. This is high by historic standards and reflects the Company's emphasis on prudence, caution, and preparation for the possibility of a prolonged economic recession.

Southern's net interest margin of 4.14 percent for the nine-month period ending September 30, 2009 remained strong, especially compared with our banking peers. We also experienced growth in non-interest income, driven by gains on sales of residential mortgages and by residual strength of our trust and deposit services areas.

In addition, our management team continues to identify opportunities for implementing strategies to improve operational efficiencies. For the third quarter of 2009, non-interest expense declined by $148,000 over the same period last year. Monitoring non-interest expense is especially important in light of the negative impact to earnings all banks are experiencing due to increases in FDIC deposit insurance assessments, and the additional costs associated with higher levels of non-performing assets. Southern's FDIC assessments increased $140,000 and $620,000, respectively, for the three and nine months ending September 30, 2009, compared with the same periods in 2008.

Southern's financial performance over the past several quarters is noteworthy considering the economic uncertainties affecting all Michigan-based companies and families in our service area. We are all experiencing challenges and conditions few could ever have imagined. Your support and encouragement are appreciated.

Sincerely,

JH Castle

John H. Castle
Chairman and Chief Executive Officer

SOUTHERN MICHIGAN BANCORP, INC.

SOUTHERN MICHIGAN BANCORP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2009	December 31, 2008
	(Unaudited)	(A)
	(In thousands, except share and per share data)	
ASSETS		
Cash and cash equivalents	$ 27,792	$ 27,989
Federal funds sold	2,942	3,320
Securities available for sale	58,969	65,718
Loans held for sale, net of valuation of - 0 - in 2009 and 2008	258	121
Loans, net of allowance for loan losses of $6,720 - 2009 ($7,104 - 2008)	328,867	328,206
Premises and equipment, net	12,893	13,286
Accrued interest receivable	2,504	2,614
Net cash surrender value of life insurance	9,774	9,523
Goodwill	13,422	13,422
Other intangible assets	2,445	2,717
Other assets	7,971	8,080
TOTAL ASSETS	$ 467,837	$ 474,996
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Non-interest bearing	$ 50,988	$ 57,216
Interest bearing	331,701	336,827
TOTAL DEPOSITS	382,689	394,043
Securities sold under agreements to repurchase and overnight borrowings	13,895	13,890
Accrued expenses and other liabilities	3,842	4,272
Other borrowings	15,954	12,492
Subordinated debentures	5,155	5,155
Common stock subject to repurchase obligation in Employee Stock Ownership Plan, 102,502 shares outstanding in 2009 (100,392 in 2008)	871	728
TOTAL LIABILITIES	422,406	430,580
Shareholders' equity:		
Preferred stock, 100,000 shares authorized; none issued or outstanding	-	-
Common stock, $2.50 par value:		
Authorized—4,000,000 shares		
Issued—2,323,410 shares in 2009 (2,311,740 shares in 2008)		
Outstanding (other than ESOP shares) - 2,220,908 shares in 2009 (2,211,348 shares in 2008)	5,552	5,528
Additional paid-in capital	18,405	18,473
Retained earnings	21,494	20,593
Accumulated other comprehensive income, net	446	413
Unearned Employee Stock Ownership Plan shares	(466)	(591)
Total shareholders' equity	45,431	44,416
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 467,837	$ 474,996

(A) The balance sheet at December 31, 2008 has been derived from the audited consolidated financial statements at that date.

SOUTHERN MICHIGAN BANCORP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(In thousands, except per share amounts)			
Interest income:				
Loans, including fees	$ 4,966	$ 5,587	$ 14,881	$ 17,301
Federal funds sold and balances with banks	22	116	42	339
Securities:				
Taxable	228	455	895	1,590
Tax exempt	231	233	684	716
Total interest income	5,447	6,391	16,502	19,946
Interest expense:				
Deposits	1,128	1,615	3,561	5,453
Other	142	253	544	909
Total interest expense	1,270	1,868	4,105	6,362
Net interest income	4,177	4,523	12,397	13,584
Provision for loan losses	350	1,580	2,300	2,730
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	3,827	2,943	10,097	10,854
Non-interest income:				
Service charges on deposit accounts	786	726	2,091	2,076
Trust fees	237	297	716	844
Net gains on security calls and sales	-	-	407	15
Net gains on loan sales	173	81	603	295
Earnings on life insurance assets	83	84	251	256
Gain on life insurance proceeds	-	-	-	390
Income and fees from automated teller machines	181	166	514	475
Other	214	201	718	670
TOTAL NON-INTEREST INCOME	1,674	1,555	5,300	5,021
Non-interest expense:				
Salaries and employee benefits	2,413	2,715	7,355	7,977
Occupancy, net	325	273	1,047	1,048
Equipment	217	307	672	927
Printing, postage and supplies	158	169	470	489
Telecommunication expenses	88	87	263	283
Professional and outside services	339	324	999	1,096
FDIC assessments	157	17	676	56
Software maintenance	101	82	315	304
Amortization of other intangibles	91	94	272	281
Other	672	641	2,113	1,918
Total non-interest expense	4,561	4,709	14,182	14,379
INCOME BEFORE INCOME TAXES	940	(211)	1,215	1,496
Federal income tax provision (credit)	169	(232)	(36)	(75)
NET INCOME	771	21	1,251	1,571
Basic Earnings Per Common Share	$ 0.34	$ 0.01	$ 0.55	$ 0.69
Diluted Earnings Per Common Share	$ 0.34	$ 0.01	$ 0.55	$ 0.69
Dividends Declared Per Common Share	$ 0.05	$ 0.20	$ 0.15	$ 0.60

Market Information

The Trust Department of Southern Michigan Bank & Trust acts as the transfer agent for the Company's stock. For information concerning the transfer of the Company's stock, or to participate in the dividend reinvestment program, please contact the Trust Department at (517) 279-5503 or (800) 379-7628.

The following brokerage firms make a market for Southern Michigan Bancorp, Inc. stock:

Boenning & Scattergood
Powell, Ohio
(866) 326-8113

Howe Barnes Investments, Inc.
Chicago, Illinois
(312) 655-2954 or
(800) 800-4693

Stifel, Nicolaus & Company, Inc.
Grand Rapids, Michigan
(800) 676-0477

Hilliard Lyons, Inc.
Coldwater, Michigan
(517) 278-4333 or
(800) 211-5257

Robert Baird & Company
Grand Rapids, Michigan
(616) 459-4491 or
(800) 888-6200

Officers of Southern Michigan Bank & Trust

COMMERCIAL LOANS

David Clow
Senior Vice President /
Head of Commercial Lending

Nick Grabowski
Vice President

Sarah Headley
Vice President

Robert Hungerford
Vice President

Doug Kiessling
Vice President

Joan Trenary
Vice President

Tom Swoish
Vice President

Cindy Woolner
Assistant Vice President /
Special Assets Manager

Marcia McClellan
Administration Officer

LOAN REVIEW

Trisha Pawloski
Assistant Vice President /
Loan Review Officer

TRUST DEPARTMENT

Mary Guthrie
Senior Vice President /
Senior Trust Officer

David Rumsey
Vice President /
Senior Investment Officer

Jean Winans
Vice President /
Senior Trust Officer

Susan White
Vice President /
Trust Officer

INVESTMENTS

Melissa Barlow
Vice President /
Senior Investment Officer

Jared Hoffmaster
Investment Sales Officer

RETAIL BANKING SERVICES

Rick Feller
Senior Vice President /
Retail Lending

Sally Cotton
First Vice President /
Senior Branch Administration Officer

Phyllis Wingate
Vice President /
Head of Retail Loan Operations

DeAnne Hawley
Assistant Vice President /
Retail Loan Officer

Judie Ratering
Mortgage Officer

Desiree Kauffman
Mortgage Originator*

Connie Swain
Collections Manager*

Debbie Leer
Collections Officer

ACCOUNTING

Sara Herrmann
Vice President / Finance

INFORMATION SYSTEMS

Jeff Kiersey
First Vice President /
Network and Systems Manager

Matt Siefken
Network and Systems Officer

OPERATIONS

Kelli Talbot
First Vice President Operations

Christine Hagaman
Vice President /
Compliance Officer

Paul Mahle
Assistant Vice President /
Senior Data Processing Officer

Vikki Kline
Information Systems Officer

Jamie Tobalske
Electronic Services Officer

HUMAN RESOURCES

Cheryl Moeslein
Human Resources Director

MARKETING

Patty Parker
Vice President

ATHENS BRANCH

Marcia Carman
Branch Manager

BATTLE CREEK BRANCH

Claudia Murch
Assistant Vice President /
Branch Manager

Deborah Davis
Vice President /
Loan Officer

CAMDEN BRANCH

Lori Neill
Branch Supervisor*

COLDWATER MAIN & EAST CHICAGO BRANCHES

Veronica Hannah
Assistant Vice President /
Branch Manager

CASSOPOLIS BRANCH

Janet Nosich
Branch Manager

CENTREVILLE BRANCH

Phyllis Nusbaum
Branch Manager

CONSTANTINE BRANCH

Lorraine Fifer
Branch Manager

HILLSDALE BRANCH

Jason Williams
Vice President /
Commercial Lender

Ann Marie Bentley
Assistant Vice President/
Regional Branch Manager

Shari Kline
Assistant Vice President /
Retail Loan Officer

MARSHALL BRANCH

Annette Campau
Assistant Vice President /
Community Bank Officer

Diane Krimmel
Retail Loan Officer

MENDON BRANCH

Doreen Tobin
Assistant Vice President /
Regional Branch Manager

NORTH ADAMS BRANCH

Leonce Towers
Branch Supervisor*

TEKONSHA BRANCH

Dawn Copas
Branch Manager

THREE RIVERS MAIN BRANCH

Sharon Bachinski
Assistant Vice President /
Regional Branch Manager

THREE RIVERS WESTLAND BRANCH

Lynette Lorenz
Branch Manager

UNION CITY BRANCH

Ken Brooks
Vice President /
Regional Branch Manager

*Non Officer Position

Officers of Southern Michigan Bancorp, Inc.

John H. Castle
Chairman & Chief Executive Officer

Kurt G. Miller
President

Danice L. Chartrand
Senior Vice President /
Chief Financial Officer

Loren V. Happel
Senior Vice President

Executive Officers of Southern Michigan Bank & Trust

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Senior Vice President /
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Loren V. Happel
Senior Vice President

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Cover Photo: Cass County Building, Cassopolis, Michigan