2016 QUARTERLY REPORT

THIRD Quarter

Corporate Highlights

Southern Michigan BANCORP, INC.
Continuous Banking Since 1872

To Our Shareholders:

I am pleased to announce that Southern Michigan Bancorp, Inc. reported net income of $1,658,000, or $0.69 per share, for the third quarter of 2016, representing historic record high third quarter earnings. Our results for the period represent an increase of 8.9 percent over net income of $1,523,000, or $.64 per share, reported for the third quarter of 2015. Through the first nine months of 2016, Southern earned $4,430,000, or $1.84 per share, a slight decrease, or 3.9 percent, as compared with $4,612,000, or $1.92 per share, for the nine month period ending September 30, 2015. It is noteworthy that the results for the same nine month period a year ago included $555,000 of tax-free income from death benefits on bank-owned life insurance policies that was recorded in the second quarter.

Southern's annualized return on average assets for the nine month periods ending September 30, 2016 and 2015 was 0.98 percent and 1.09 percent, respectively. The annualized return on average equity was 8.45 percent for the first nine months of 2016 compared to 9.89 percent for the same period of 2015. Our tax equivalent net interest margin for the nine month periods ending September 30, 2016 and 2015 was 3.80 percent and 3.91 percent, respectively.

Total assets for the first nine months of the year increased significantly to $621.0 million at September 30, 2016, compared with $582.8 million at December 31, 2015. Other noteworthy changes in the balance sheet include deposit growth of $36.8 million, or 7.7 percent, while loan totals at $422.4 million remained nearly identical to year end 2015 levels of $422.0 million. Year-over-year loan totals increased by $12 million, or 3.0 percent, from September 30, 2015 levels of $410.4 million.

Asset quality momentum remained strong as delinquencies at quarter-end were .66 percent of total loans as compared to 1.09 percent as of September 30, 2015. Net loan losses for the third quarter of 2016 totaled only $27,000; unallocated losses, or those losses without specific reserves, totaled only $4,000. For the nine month period ending September 30, 2016, net loan losses totaled $484,000, or annualized .15 percent of total loans, and unallocated losses for the period totaled $211,000, or annualized 0.07 percent of total loans. Non-performing asset totals as of September 30, 2016 were $3.0 million, a decrease of $4.7 million, or 61 percent, from $7.7 million as of September 30, 2015. No provision for loan loss expense was recognized for the third quarter and the allowance for loan losses as of September 30, 2016 was $4.9 million, or 1.16 percent of total loans. From a coverage perspective, the allowance remained at nearly two times the dollar amount of non-performing loans.

Southern's board of directors approved an increase in the quarterly cash dividend to $0.20 per share, which was paid October 21, 2016. The $0.20 per share dividend represents an increase of $0.02 per share over the July 2016 cash dividend of $0.18 per share, and an increase of $0.04 per share over the January 2016 cash dividend. The new annualized dividend rate of $0.80 per share represents a dividend yield of 3.04 percent based on the current market price of $26.30 per share. Our current level of earnings supports this level of cash dividends while allowing us to generate capital requisite to support loan growth.

Please feel free to contact me, members of our management team or any of our directors should you have any questions or comments. Your continued support is appreciated.

Sincerely,

JH Castle

John H. Castle
Chairman and Chief Executive Officer

SOUTHERN MICHIGAN BANCORP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2016	December 31, 2015
	(Unaudited)	(A)
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents	$ 16,051	$ 13,487
Federal funds sold	24,974	6,941
Securities available for sale	109,930	97,150
Loans held for sale	1,255	328
Loans, net of allowance for loan losses of $4,889 - 2016 ($5,273 - 2015)	417,532	416,716
Premises and equipment, net	12,813	12,685
Accrued interest receivable	3,005	2,517
Net cash surrender value of life insurance	14,294	11,939
Goodwill	13,422	13,422
Other intangible assets, net	294	489
Other assets	7,472	7,097
TOTAL ASSETS	$ 621,042	$ 582,771
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Non-interest bearing	$ 103,910	$ 101,186
Interest bearing	410,384	376,299
TOTAL DEPOSITS	514,294	477,485
Securities sold under agreements to repurchase and overnight borrowings	12,852	15,943
Accrued expenses and other liabilities	7,686	6,419
Other borrowings	10,200	10,000
Subordinated debentures	5,155	5,155
TOTAL LIABILITIES	550,187	515,002
Shareholders' equity		
Preferred stock, 100,000 shares authorized; none issued or outstanding	-	-
Common stock, $2.50 par value:		
Authorized—4,000,000 shares		
Issued and outstanding—2,405,412 shares in 2016 (2,406,508 shares in 2015)	6,014	6,011
Additional paid-in capital	19,126	19,572
Retained earnings	45,107	42,029
Accumulated other comprehensive income, net	1,043	414
Unearned Employee Stock Ownership Plan shares	(435)	(257)
TOTAL SHAREHOLDERS' EQUITY	70,855	67,769
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 621,042	$ 582,771

(A) The balance sheet at December 31, 2015 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, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
	(In thousands, except per share amounts)			
Interest income:				
Loans, including fees	$ 4,924	$ 4,973	$ 14,880	$ 14,559
Federal funds sold and balances with banks	43	15	112	36
Securities:				
Taxable	283	184	717	538
Tax-exempt	211	219	653	632
TOTAL INTEREST INCOME	5,461	5,391	16,362	15,765
Interest expense:				
Deposits	326	304	931	921
Other	133	121	389	284
TOTAL INTEREST EXPENSE	459	425	1,320	1,205
Net interest income	5,002	4,966	15,042	14,560
Provision for loan losses	-	50	100	200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,002	4,916	14,942	14,360
Non-interest income:				
Service charges on deposit accounts	420	478	1,171	1,343
Trust fees	354	310	1,202	975
Net gains on security calls and sales	58	-	100	24
Net gains on loan sales	273	294	744	841
Earnings on life insurance assets	92	59	249	773
ATM and debit card fee income	352	348	1,038	1,003
Other	179	219	597	685
TOTAL NON-INTEREST INCOME	1,728	1,708	5,101	5,644
Non-interest expense:				
Salaries and employee benefits	2,559	2,630	7,811	8,080
Occupancy, net	368	259	1,032	821
Equipment	199	177	625	542
Printing, postage and supplies	97	104	331	330
Telecommunication expenses	70	60	215	185
Professional and outside services	207	341	959	887
FDIC assessments	73	82	216	247
Software maintenance	260	208	721	626
Amortization of other intangibles	65	68	195	204
Loan related expenses	29	45	160	236
ATM expenses	162	138	538	392
Other	414	389	1,210	1,279
TOTAL NON-INTEREST EXPENSE	4,503	4,501	14,013	13,829
INCOME BEFORE INCOME TAXES	2,227	2,123	6,030	6,175
Federal income tax provision	569	600	1,600	1,563
NET INCOME	$ 1,658	$ 1,523	$ 4,430	$ 4,612
Basic Earnings Per Common Share	$ 0.69	$ 0.64	$ 1.85	$ 1.93
Diluted Earnings Per Common Share	0.69	0.64	1.84	1.92
Dividends Declared Per Common Share	0.20	0.16	0.56	0.47

Market Information

Inquiries regarding stock certificate administration, address changes, transfers, and other related services should be directed to:
American Stock Transfer and Trust Company, LLC
Website: www.amstock.com
Phone: (718) 921-8124
Toll free: (888) 509-4619
Email: info@amstock.com
Address: 6201 15th Avenue
Brooklyn, NY 11219

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

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

Raymond James Financial Associates
Chicago, Illinois
(312) 655-2961 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

Royal Securities Company
Grand Rapids, Michigan
(616) 459-2844 or (888) 804-8891

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Commercial Loan Manager

Timothy Kilmartin
Kalmazoo Regional President

Tom Swoish
Regional Vice President /
Commercial Loan Manager

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Adam Losinski
Assistant Vice President

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Senior Collections Administrator

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Vice President / Head of Retail
Loan Operations

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Assistant Vice President

Shari Kline
Assistant Vice President

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Assistant Vice President

Lori Lemmon
Assistant Vice President

Cassidy Munn
Assistant Vice President

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Retail Loan Operations Manager

Desiree Kauffman
Loan Operations Specialist

Connie Caudill
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Senior Collections Manager

Lynn Roper
Secondary Market /
Loan Servicing Officer

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Assistant Vice President

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Risk Management Officer

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Senior Vice President /
Senior Trust Officer

Matt Moses
First Vice President /
Head of Wealth Management

R. David Rumsey
Vice President /
Senior Investment Officer

Susan White
Vice President /
Trust Officer

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EAST CHICAGO BRANCHES
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Branch Manager

BATTLE CREEK BRANCH
Lisa Walker
Assistant Vice President /
Branch Manager

MARSHALL BRANCH
Kara Mead
Vice President / Commercial
Loan Officer / Branch Manager

HILLSDALE & CAMDEN BRANCHES
Lori Neill
Assistant Vice President /
Regional Branch Manager

UNION CITY BRANCH
Tim Fox
Assistant Vice President / Branch
Manager / Retail Loan Officer

TEKONSHA BRANCH
Dawn Copas
Branch Manager

CENTREVILLE & CONSTANTINE
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Assistant Vice President /
Regional Branch Manager

MENDON BRANCH
Doreen Tobin
Assistant Vice President /
Branch Manager

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THREE RIVERS WEST BRANCHES
Sharon Bachinski
Assistant Vice President /
Branch Manager

PORTAGE BRANCH
Cammy Fleckenstein
Branch Manager

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Vice President of Finance

OPERATIONS / INFORMATION SYSTEMS

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Head of Operations

Angie Smith
Assistant Vice President /
Operations Manager

Becky Omo
Assistant Vice President /
Operations Representative

Vikki Kline
Project / Research Officer

Laurel Walkup
Assistant Vice President /
eServices Officer

Executive Officers of Southern Michigan Bank & Trust and Southern Michigan Bancorp, Inc.

John H. Castle
Chairman / Chief Executive Officer

Kurt G. Miller
President / Chief Credit Officer

Nicholas M. Grabowski
Executive Vice President /
Head of Lending

Danice L. Chartrand
Senior Vice President /
Chief Financial Officer

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Continuous Banking Since 1872
www.smb-t.com