



# SECOND Quarter

## *Corporate Highlights*

Dear Shareholders:

It is a great pleasure to announce that Southern Michigan Bancorp, Inc. earned a record \$1.02 million for the second quarter of 2006. This is the first occasion in Southern Michigan's long history that quarterly earnings exceeded \$1 million. Earnings per fully diluted share for the quarter were \$.57. For the first six months of 2006, net income exceeded \$1.94 million, or \$1.10 per share.

Financial results for the first quarter and six-month period ending June 30, 2006 showed improvement over comparable periods in 2005. Earnings per share in 2005 were \$.54 and \$1.02, and net income was \$966,000 and \$1.84 million, respectively.

Return on average assets through the first half of 2006 was 1.22 percent. Return on average shareholders' equity was 14.39 percent for the same period. Both measures of financial performance rank us highly among our community bank peers.

While the uncertainty of the Michigan economy presents many business challenges for the remainder of this year and into 2007, our personal service approach toward clients throughout our tri-state market is enabling us to mitigate much of the impact of a slowing economy. Southern Michigan's strategic emphasis on small business banking relationships is positioning the company to grow both commercial loans and deposits throughout the second half of 2006. In addition, we have begun construction on our new Marshall office, which will be our 9th full service facility. Scheduled for opening early in 2007, our Marshall office will allow us to better serve a substantial base of consumer and commercial banking clients and prospects in the area.

Southern's board of directors and management team are committed to maintaining high performance banking standards on behalf of shareholders and clients. Last quarter, our directors approved the issuance of a five percent stock dividend. For the second quarter of 2006, the directors approved an 11 percent increase in the quarterly dividend from \$.18 per share to \$.20 per share. Compared with the first six months of 2005, dividends per share through June 30 of this year have increased by more than 15 percent.

Your support of Southern Michigan and our team of directors, officers and staff is appreciated. We welcome your comments and suggestions for better serving our many loyal customers throughout the region.

Respectfully,

John H. Castle  
Chairman and Chief Executive Officer

**CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**  
**SOUTHERN MICHIGAN BANCORP, INC.**

	June 30, 2006	December 31, 2005
	(Unaudited)	(A)
	(In thousands, except share and per share data)	
<b>ASSETS</b>		
Cash and due from banks . . . . .	\$ 9,051	\$ 10,498
Federal funds sold . . . . .	6,217	7,436
Securities available for sale . . . . .	40,823	37,165
Loans held for sale, net of valuation allowance of \$0 in 2006 and 2005 . . . . .	598	435
Loans, net of allowance for loan losses of \$3,115 (2005 - \$3,167) . . . . .	243,768	239,547
Premises and equipment, net . . . . .	7,370	7,195
Accrued interest receivable . . . . .	1,871	2,111
Net cash surrender value of life insurance . . . . .	7,654	7,540
Goodwill . . . . .	620	620
Other intangible assets . . . . .	10	22
Other assets . . . . .	5,190	5,383
<b>TOTAL ASSETS</b>	<u>\$323,172</u>	<u>\$317,952</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Non-interest bearing . . . . .	\$ 43,201	\$ 44,196
Interest bearing . . . . .	226,717	223,882
<b>TOTAL DEPOSITS</b>	<u>269,918</u>	<u>268,078</u>
Accrued expenses and other liabilities . . . . .	7,588	4,534
Other borrowings . . . . .	11,413	12,164
Subordinated debentures . . . . .	5,155	5,155
Common stock subject to repurchase obligation in Employee Stock Ownership Plan, shares outstanding— 86,359 in 2006 (79,575 in 2005) . . . . .	1,982	1,911
Shareholders' equity:		
Preferred stock, 100,000 shares authorized; none issued or outstanding		
Common stock, \$2.50 par value:		
Authorized—4,000,000 shares		
Issued—1,769,737 shares (2005 - 1,689,362)		
Outstanding—1,683,378 shares (2005 - 1,609,787) . . . . .	4,208	4,025
Additional paid-in capital . . . . .	5,675	3,974
Retained earnings . . . . .	17,636	18,419
Accumulated other comprehensive income, net . . . . .	(219)	(124)
Unearned Employee Stock Ownership Plan shares . . . . .	(184)	(184)
Total shareholders' equity . . . . .	27,116	26,110
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$323,172</u>	<u>\$317,952</u>

(A) The balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date.

**Board of Directors**

MARCIA S. ALBRIGHT  
Cequent Electrical Products, Inc.

JOHN H. CASTLE  
Chairman & CEO of SMB, Inc.  
and SMB&T

H. KENNETH COLE  
Hillsdale College

GARY H. HART  
Infinisource, Inc.

NOLAN E. (RICK) HOOKER  
Hooker Oil  
Best American Car Washes

GREGORY J. HULL  
Farmer

THOMAS E. KOLASSA  
HUB International, Inc.

DONALD J. LABRECQUE  
Labrecque Management

KURT G. MILLER  
President of SMB, Inc. and SMB&T

FREEMAN E. RIDDLE  
Spoor-Parlin, Inc.

**Honorary Directors**

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WILLIAM (BUZZ) GALLIERS

JAMES T. GROHALSKI

HARVEY RANDALL

JANE L. RANDALL

RAYMOND W. SMITH

JERRY L. TOWNS

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(In thousands, except per share amounts)			
Interest income:				
Loans, including fees	\$ 4,790	\$ 4,226	\$ 9,380	\$ 8,164
Securities:				
Taxable	316	250	661	517
Tax exempt	139	126	282	252
Total interest income	5,245	4,602	10,323	8,933
Interest expense:				
Deposits	1,409	909	2,715	1,733
Other	223	364	435	721
Total interest expense	1,632	1,273	3,150	2,454
Net interest income	3,613	3,329	7,173	6,479
Provision for loan losses	50	250	50	300
	<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>			
	3,563	3,079	7,123	6,179
Non-interest income:				
Service charges on deposit accounts	453	497	865	944
Trust fees	178	165	348	326
Net gains on loan sales	167	228	305	391
Earnings on life insurance assets	60	84	114	138
Other	119	132	232	235
	<b>TOTAL NON-INTEREST INCOME</b>			
	977	1,106	1,864	2,034
Non-interest expense:				
Salaries and employee benefits	1,678	1,673	3,316	3,367
Occupancy, net	189	183	394	398
Equipment	205	195	374	380
Printing, postage and supplies	107	92	197	176
Professional and outside services	315	148	661	285
Telecommunication expenses	41	40	86	101
Other	606	532	1,298	989
Total non-interest expense	3,141	2,863	6,326	5,696
	<b>INCOME BEFORE INCOME TAXES</b>			
	1,399	1,322	2,661	2,517
	<b>Federal income taxes</b>			
	382	356	718	678
	<b>NET INCOME \$</b>			
	1,017	\$ 966	\$ 1,943	1,839
<b>Basic Earnings Per Common Share</b>	\$ 0.58	\$ 0.54	\$ 1.10	\$ 1.02
<b>Diluted Earnings Per Common Share</b>	\$ 0.57	\$ 0.54	\$ 1.10	\$ 1.02
<b>Dividends Declared Per Common Share</b>	\$ 0.20	\$ 0.17	\$ 0.38	\$ 0.33

\*Restated to reflect the 5% stock dividend of February 2006

## 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, call the Trust Department at (517) 279-5503, or call (800) 379-7628.

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

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

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

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

Stifel, Nicolaus & Company, Inc.  
Grand Rapids, Michigan  
(877) 676-0477

Ferris, Baker Watts, Inc.  
Dublin, Ohio  
(614) 718-2224  
(866) 313-4803

**Officers of  
Southern Michigan  
Bancorp, Inc.**

John H. Castle  
*Chairman & Chief Executive Officer*  
jcastle@smb-t.com

Kurt G. Miller  
*President*  
kgmiller@smb-t.com

Jaylen T. Johnson  
*Executive Vice President /  
Chief Operations Officer*  
jay@smb-t.com

Danice L. Chartrand  
*Senior Vice President /  
Chief Financial Officer*  
dchartrand@smb-t.com

**Officers of  
Southern Michigan  
Bank & Trust**

**EXECUTIVE**

John H. Castle  
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Kurt G. Miller  
*President*

Jaylen T. Johnson  
*Executive Vice President /  
Chief Operations Officer*

Danice L. Chartrand  
*Senior Vice President /  
Chief Financial Officer*

Loren V. Happel  
*First Vice President /  
Controller*

**OPERATIONS**

Kelli Talbot  
*Vice President*

Christine Hagaman  
*Compliance Officer*

Paul Mahle  
*Assistant Vice President/  
Senior Data Processing Officer*

**INFORMATION SYSTEMS**

Jeff Kiersey  
*Vice President /  
Network and Systems Manager*

**MARKETING**

Patty Parker  
*Vice President*

**COMMERCIAL LOANS**

David Clow  
*First Vice President /  
Head of Commercial Lending*

Joan Trenary  
*Vice President*

Tom Swoish  
*Vice President*

Doug Kiessling  
*Vice President*

Nick Grabowski  
*Assistant Vice President*

Heidi O'Dell  
*Assistant Vice President*

**HUMAN RESOURCES**

Andrew Karr  
*Vice President*

**TRUST DEPARTMENT**

Mary Guthrie  
*First Vice President /  
Senior Trust Officer*

Jay Carlson  
*Vice President /  
Trust Investment Officer*

Susan White  
*Vice President /  
Trust Officer*

**RETAIL BANKING SERVICE**

Rick Feller  
*First Vice President*

Jodie Johnson  
*Vice President/  
Retail Loan Officer*

Deanne Hawley  
*Assistant Vice President/  
Retail Loan Officer*

Dave Pierce  
*Assistant Vice President/  
Retail Loan Officer*

Phyllis Wingate  
*Assistant Vice President/  
Retail Loan Officer*

**BATTLE CREEK REGION**

Tim Creech  
*President /  
Battle Creek Region*

Claudia Murch  
*Assistant Vice President/  
Branch Manager*

**ATHENS BRANCH**

Marcia Carman  
*Branch Manager*

**CAMDEN BRANCH**

Jody Pope  
*Branch Supervisor\**

**COLDWATER MAIN &  
EAST CHICAGO BRANCHES**

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*Assistant Vice President /  
Branch Manager*

**HILLSDALE BRANCH**

Jason Williams  
*Vice President/  
Commercial Lender*

Ann-Marie Bentley  
*Assistant Vice President /  
Regional Branch Manager*

**NORTH ADAMS BRANCH**

Leonce Towers  
*Branch Supervisor\**

**MARSHALL BRANCH**

Annette Campau  
*Community Bank Officer*

Catherine Yates  
*Assistant Vice President/  
Commercial Lender*

**TEKONSHA BRANCH**

Dawn Copas  
*Branch Manager*

**UNION CITY BRANCH**

Ken Brooks  
*Vice President /  
Regional Branch Manager*

\*Non Officer Position



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