



THIRD Quarter

Corporate Highlights

To Our Shareholders:

Recently many shareholders have asked me about news reports pertaining to the turmoil in the financial services industry. The challenge for all of us has been to separate fact from speculation and then determine how it may affect our personal circumstances.

Let me offer some thoughts on what is occurring in the banking sector and how the current environment may affect Southern Michigan Bancorp, as well as other financial service companies;

- We are all familiar with the plight of Michigan's economy; our state and local economies will improve to the extent the automobile industry successfully completes its realignment. Southern's prudently conservative credit philosophy will enable us to withstand further economic shocks to our service area until a turnaround takes hold;
- The financial services industry is in the early stages of a massive restructuring that is transforming bank regulation, competition, and the manner by which we manage our business; our financial and managerial strengths will allow us to readily adapt to the new banking landscape more effectively than many of our competitors; and
- Southern ranks highly among its peers in terms of capital strength, core earnings, liquidity and overall financial performance; we expect to emerge from this volatile environment in a strong position to take advantage of the many opportunities that are likely to emerge over the next several years.

Although we are not immune to the negative impact of the current economic cycle, Southern earned \$1,571,000, or \$.69 per diluted share, for the first nine months ended September 30, 2008. Southern's net income for the three months ended September 30, 2008 was \$21,000, or \$0.01 per diluted share, compared with \$1,082,000, or \$0.61 per diluted share, for the same three-month period a year ago.

Our third quarter 2008 earnings were largely impacted by an increase in non-performing loans which rose by \$1.1 million from the June 30, 2008 period. Total non-performing loans at September 30, 2008 were \$10.4 million, or 3.1 percent of total loans. The allowance for loan losses for the period grew to \$6.99 million, or 2.07% of total loans, from \$5.61 million, or 1.66% of total loans at the prior quarter end. In the third quarter of 2008, provision for loan losses was \$1.58 million compared with \$800,000 last quarter. On a year-to-date basis, Southern's provision for loan losses totaled \$2,730,000 versus \$345,000 a year ago. Over half of the 2008 increase in the provision for loan losses relates to a single large commercial credit in the automotive industry.

Finalization of the integration process of back office systems and procedures between the banks occurred this quarter with the completion of the retail and mortgage lending software component. The process of streamlining operations corporate-wide began last December and has required a great deal of time and effort on the part of our staff. Much of the direct expense related to this initiative is non-recurring in nature and we remain confident that the banks will operate more efficiently going forward.

Southern's 4.43% net interest margin for the nine-month period ending September 30, 2008 remained strong when compared to peers and was relatively flat compared with the June 30, 2008 six-month period of 4.41%. Southern's net interest margin declined from the 4.87% reported for the nine month period ending September 30, 2007. The decline is attributable to the declining rate environment as well as the reversal of interest related to loans placed on non-accrual status.

Shareholders' equity as of September 30, 2008 totaled \$44.9 million, compared with \$44.2 million as of year-end 2007. Our capital ratios at the Company and for both subsidiary banks exceed the "well capitalized" levels under regulatory capital guidelines.

Although the future appears to be more unpredictable than in years past, the Southern management team and directors believe that substantial opportunities for success will emerge from a restructured financial services industry. We will continue to evaluate each one to determine how it may strengthen the Company and enable us to better serve our customers and communities.

Please feel free to contact me or members of Southern's management team or board of directors with your comments, suggestions and ideas. Your continued support is greatly appreciated.

Sincerely,

John H. Castle,
Chairman and Chief Executive Officer

SOUTHERN MICHIGAN BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2008	December 31, 2007
	(Unaudited)	(A)
	(In thousands, except share and per share data)	
ASSETS		
Cash and cash equivalents	\$ 9,968	\$ 14,470
Federal funds sold	18,077	6,449
Securities available for sale	65,242	77,515
Loans held for sale, net of valuation of - 0 - in 2008 and 2007	854	624
Loans, net of allowance for loan losses of \$6,987 - 2008 (\$5,156 - 2007))	330,249	330,822
Premises and equipment, net	13,187	13,335
Accrued interest receivable	2,765	3,387
Net cash surrender value of life insurance	9,418	10,015
Goodwill	13,422	13,422
Other intangible assets	2,810	3,091
Other assets	6,922	7,048
TOTAL ASSETS	472,914	\$ 480,178
LIABILITIES		
Deposits:		
Non-interest bearing	\$ 52,119	\$ 57,027
Interest bearing	348,617	342,142
TOTAL DEPOSITS	400,736	399,169
Securities sold under agreements to repurchase and overnight borrowings	3,734	9,776
Accrued expenses and other liabilities	4,339	5,077
Other borrowings	12,770	14,753
Subordinated debentures	5,155	5,155
TOTAL LIABILITIES	426,734	433,930
Common stock subject to repurchase obligation in Employee Stock Ownership Plan, 98,357 shares outstanding in 2008 (92,203 in 2007))	1,298	2,029
SHAREHOLDERS' EQUITY		
Preferred stock, 100,000 shares authorized; none issued or outstanding	-	-
Common stock, \$2.50 par value:		
Authorized—4,000,000 shares		
Issued—2,312,507 shares in 2008 (2,307,924 shares in 2007)		
Outstanding (other than ESOP shares) - 2,214,150 shares in 2008 (2,215,721 shares in 2007)	5,535	5,539
Additional paid-in capital	17,990	17,087
Retained earnings	21,813	21,629
Accumulated other comprehensive income, net	284	122
Unearned restricted stock compensation	(122)	(55)
Unearned Employee Stock Ownership Plan shares	(618)	(103)
Total shareholders' equity	44,882	44,219
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 472,914	\$ 480,178

(A) The balance sheet at December 31, 2007 has been derived from the audited consolidated financial statements at that date.

Southern Michigan Bancorp, Inc. Board of Directors

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

	Three Months Ended September 30, 2008		Nine Months Ended September 30, 2008	
	2007	2008	2007	2008
	(In thousands, except per share amounts)			
Interest income:				
Loans, including fees	\$ 5,587	\$ 5,105	\$ 17,301	\$ 15,157
Federal funds sold	116	133	339	456
Securities:				
Taxable	455	502	1,590	1,113
Tax exempt	233	155	716	461
Total interest income	6,391	5,895	19,946	17,187
Interest expense:				
Deposits	1,615	2,022	5,453	5,726
Other	253	190	909	559
Total interest expense	1,868	2,212	6,362	6,285
Net interest income	4,523	3,683	13,584	10,902
Provision for loan losses	1,580	145	2,730	345
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	2,943	3,538	10,854	10,557
Non-interest income:				
Service charges on deposit accounts	726	512	2,076	1,406
Trust fees	297	197	844	556
Net gains on security calls and sales	-	2	15	2
Net gains on loan sales	81	96	295	317
Earnings on life insurance assets	84	64	256	201
Gain on life insurance proceeds	-	-	390	-
Income and fees from automated teller machines	166	86	475	245
Other	201	123	670	302
TOTAL NON-INTEREST INCOME	1,555	1,080	5,021	3,029
Non-interest expense:				
Salaries and employee benefits	2,715	1,884	7,977	5,624
Occupancy, net	273	251	1,048	699
Equipment	307	193	927	567
Printing, postage and supplies	169	81	489	262
Telecommunication expenses	87	47	283	150
Professional and outside services	324	201	1,096	506
Software maintenance	82	64	304	176
Amortization of other intangibles	94	-	281	-
Other	658	429	1,974	1,332
Total non-interest expense	4,709	3,150	14,379	9,316
INCOME BEFORE INCOME TAXES	\$ (211)	1,468	1,496	4,270
Federal income taxes	\$ (232)	386	(75)	1,141
NET INCOME	\$ 21	\$ 1,082	\$ 1,571	\$ 3,129
Basic Earnings Per Common Share	\$ 0.01	\$ 0.61	\$ 0.69	\$ 1.77
Diluted Earnings Per Common Share	\$ 0.01	\$ 0.61	\$ 0.69	\$ 1.76
Dividends Declared Per Common Share	\$ 0.20	\$ 0.20	\$ 0.60	\$ 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, call the Trust Department at (517) 279-5503 or (800) 379-7628.

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

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

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 Bancorp, Inc.

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Kurt G. Miller
President

Danice L. Chartrand
Senior Vice President / Chief Financial Officer

Loren V. Happel
Senior Vice President

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Infinisource, Inc.

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Hooker Oil/Best American Car Washes

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St. Joseph County United Way

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Meyer Ventures, LLC

Kurt G. Miller
President & CEO of FNB Financial / President of SMB, Inc. and SMB&T



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