

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2008
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _____ to _____

Commission File Number: 000-49772

SOUTHERN MICHIGAN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Michigan
(State or Other Jurisdiction
of Incorporation or Organization)

38-2407501
(I.R.S. Employer
Identification No.)

51 West Pearl Street
Coldwater, Michigan
(Address of Principal Executive Offices)

49036
(Zip Code)

(517) 279-5500
(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 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 (Check one):

Large accelerated filer Accelerated filer 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

The number of shares outstanding of the Registrant's Common Stock, \$2.50 par value, as of November 11, 2008, was 2,311,792 shares.

Forward-Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and Southern Michigan Bancorp, Inc. Forward-looking statements are identifiable by words or phrases such as "outlook", or "strategy"; that an event or trend "may", "should", "will", or "is likely" to occur or "continue" or "is scheduled" or "on track" or that Southern Michigan Bancorp, Inc. or its management "anticipates", "believes", "estimates", "plans", "forecasts", "intends", "predicts", "projects", or "expects" a particular result, or is "confident," "optimistic" or has an "opinion" that an event will occur, and variations of such words and similar expressions. All of the information concerning interest rate sensitivity is forward-looking. The future effect of changes in the real estate markets and the Michigan and national economy on the banking industry, generally, and Southern Michigan Bancorp, Inc., specifically, are also inherently uncertain. Management's determination of the provision and allowance for loan losses involves judgments that are inherently forward-looking. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("risk factors") that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Southern Michigan Bancorp, Inc. undertakes no obligation to update, amend or clarify forward-looking statements, whether as a result of new information, future events or otherwise.

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of Southern Michigan Bancorp, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2007; the timing and level of asset growth; changes in banking laws and regulations; changes in tax laws; changes in prices, levies and assessments; the impact of technological advances and issues; governmental and regulatory policy changes; opportunities for acquisitions and the effective completion of acquisitions and integration of acquired entities; the possibility that anticipated cost savings and revenue enhancements from acquisitions, restructurings, reorganizations and bank consolidations may not be realized at amounts projected, at all or within expected time frames; the local and global effects of the ongoing war on terrorism and other military actions, including actions in Iraq; and current uncertainties and fluctuations in the financial and credit markets and stocks of financial services providers due to concerns about credit availability and concerns about the Michigan economy in particular. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

Part I. Financial Information

Item 1. Financial Statements

SOUTHERN MICHIGAN BANCORP, INC. UNAUDITED INTERIM FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share data)

	September 30, 2008	December 31, 2007
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 Employee Stock Ownership Plan shares	(618)	(103)
Unearned restricted stock compensation	(122)	(55)
Total shareholders' equity	44,882	44,219
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 472,914	\$ 480,178

See accompanying notes to interim consolidated financial statements.

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
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	<u>6,391</u>	<u>5,895</u>	<u>19,946</u>	<u>17,187</u>
Interest expense:				
Deposits	1,615	2,022	5,453	5,726
Other	253	190	909	559
Total interest expense	<u>1,868</u>	<u>2,212</u>	<u>6,362</u>	<u>6,285</u>
Net Interest Income	4,523	3,683	13,584	10,902
Provision for loan losses	<u>1,580</u>	<u>145</u>	<u>2,730</u>	<u>345</u>
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	<u>1,555</u>	<u>1,080</u>	<u>5,021</u>	<u>3,029</u>
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	<u>4,709</u>	<u>3,150</u>	<u>14,379</u>	<u>9,316</u>
INCOME BEFORE INCOME TAXES	(211)	1,468	1,496	4,270
Federal income tax provision (credit)	<u>(232)</u>	<u>386</u>	<u>(75)</u>	<u>1,141</u>
NET INCOME	<u>\$ 21</u>	<u>\$ 1,082</u>	<u>\$ 1,571</u>	<u>\$ 3,129</u>
Basic Earnings Per Common Share	<u>\$.01</u>	<u>\$.61</u>	<u>\$.69</u>	<u>\$ 1.77</u>
Diluted Earnings Per Common Share	<u>\$.01</u>	<u>\$.61</u>	<u>\$.69</u>	<u>\$ 1.76</u>
Dividends Declared Per Common Share	<u>\$.20</u>	<u>\$.20</u>	<u>\$.60</u>	<u>\$.60</u>

See accompanying notes to interim consolidated financial statements.

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
(In thousands, except number of shares and per share data)
For the Nine Months Ending September 30, 2008 and 2007

	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss), Net</u>	<u>Unearned ESOP Shares</u>	<u>Unearned Compen- sation</u>	<u>Total</u>
Balance at January 1, 2007	\$ 4,200	\$ 5,446	\$ 19,021	\$ (42)	\$ (143)	\$ -	\$ 28,482
Comprehensive income:							
Net income			3,129				3,129
Net change in other comprehensive income items				103			103
Total comprehensive income							3,232
Cash dividends declared - \$.60 per share			(1,063)				(1,063)
Change in common stock subject to repurchase	(8)	(59)					(67)
Issuance of restricted stock (2,740 shares of common stock at \$24.58 per share)	7	60				(67)	-
Vesting of restricted stock						9	9
Net change in obligation under ESOP					40		40
Stock option expense		57					57
Balance at September 30, 2007	<u>\$ 4,199</u>	<u>\$ 5,504</u>	<u>\$ 21,087</u>	<u>\$ 61</u>	<u>\$ (103)</u>	<u>\$ (58)</u>	<u>\$ 30,690</u>
Balance at January 1, 2008	\$ 5,539	\$ 17,087	\$ 21,629	\$ 122	\$ (103)	\$ (55)	\$ 44,219
Comprehensive income:							
Net income			1,571				1,571
Net change in other comprehensive income items				162			162
Total comprehensive income							1,733
Cash dividends declared - \$.60 per share			(1,387)				(1,387)
Change in common stock subject to repurchase	(15)	746					731
Issuance of restricted stock (5,535 shares of common stock at \$18.00 per share)	14	86				(100)	-
Vesting of restricted stock						17	17
Forfeiture of restricted stock (900 shares of common stock at \$18.00 per share)	(3)	(13)				16	-
Net change in obligation under ESOP					94		94
Purchase of shares by ESOP (28,500 shares)					(609)		(609)
Stock option expense		84					84
Balance at September 30, 2008	<u>\$ 5,535</u>	<u>\$ 17,990</u>	<u>\$ 21,813</u>	<u>\$ 284</u>	<u>\$ (618)</u>	<u>\$ (122)</u>	<u>\$ 44,882</u>

See accompanying notes to interim consolidated financial statements.

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(Dollars in thousands)

	Nine Months Ended	September 30,
	2008	2007
Operating Activities		
Net income	\$ 1,571	\$ 3,129
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	2,730	345
Depreciation	909	554
Net accretion of investment securities	(52)	(72)
Loss on disposal of fixed assets	49	-
Loans originated for sale	(15,652)	(13,914)
Proceeds on loan sales	15,359	13,455
Net gains on loan sales	(295)	(317)
Gain on life insurance proceeds	(390)	-
Stock option and restricted stock grant compensation expense	101	66
Net securities gains	(15)	(2)
Amortization of other intangible assets	281	-
Net change in:		
Obligation under ESOP	94	40
Accrued interest receivable	622	(205)
Cash surrender value	(256)	(201)
Other assets	1,614	758
Accrued expenses and other liabilities	(729)	409
Net cash from operating activities	<u>5,941</u>	<u>4,045</u>
Investing Activities		
Activity in available for sale securities:		
Proceeds from maturities and calls	47,462	11,219
Purchases	(34,876)	(31,710)
Net change in federal funds sold	(11,628)	3,181
Loan originations and payments, net	(3,369)	(1,863)
Proceeds from life insurance	1,241	67
Additions to premises and equipment	(810)	(2,236)
Net cash used in investing activities	<u>(1,980)</u>	<u>(21,342)</u>
Financing Activities		
Net change in deposits	1,567	11,287
Net change in securities sold under agreements to repurchase and overnight borrowings	(6,042)	8,409
Proceeds from other borrowings	600	292
Repayments of other borrowings	(2,592)	(1,654)
Purchase of ESOP shares	(609)	-
Cash dividends paid	(1,387)	(1,063)
Net cash from (used in) financing activities	<u>(8,463)</u>	<u>17,271</u>
Net change in cash and cash equivalents	<u>(4,502)</u>	<u>(26)</u>
Beginning cash and cash equivalents	14,470	9,369
Ending cash and cash equivalents	<u>\$ 9,968</u>	<u>\$ 9,343</u>
Cash paid for interest	\$ 6,567	\$ 6,263
Cash paid for income taxes	445	855
Transfers from loans to foreclosed assets	1,570	1,514

See accompanying notes to interim consolidated financial statements.

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Southern Michigan Bancorp, Inc. and its wholly-owned subsidiaries, Southern Michigan Bank & Trust (SMB&T) and FNB Financial (FNB) after elimination of significant inter-company balances and transactions. SMB&T owns SMB Mortgage Company, which transacts all residential real estate loans. It is consolidated into SMB&T's financial statements. FNB owns FNB Financial Services, which conducts a brokerage business and is consolidated into FNB's financial statements. During 2004, the Company formed a special purpose trust, Southern Michigan Bancorp Capital Trust I for the sole purpose of issuing trust preferred securities. Under generally accepted accounting principles, the trust is not consolidated into the financial statements of the Company.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary in order to make the financial statements not misleading have been included. Operating results for the three months and nine month periods ending September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes of the Company for December 31, 2007 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission on March 28, 2008. As discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, the Company acquired FNB on December 1, 2007. The transaction was accounted for using the purchase method of accounting and therefore the operating results for the three and nine month periods ending September 30, 2007 do not include FNB.

Reclassifications

Some items in the prior period consolidated financial statements have been reclassified to conform to the current year presentation.

NOTE B – NEW ACCOUNTING PRONOUNCEMENTS

On February 15, 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (FAS 159). FAS 159 permits, but does not require, entities to measure selected financial assets and liabilities at fair value. Changes in fair value are recorded through the income statement in subsequent periods. The statement provides for a one time opportunity to transfer existing assets and liabilities to fair value at the point of adoption with a cumulative effect adjustment recorded against equity. After adoption, the election to report assets and liabilities at fair value must be made at the point of their inception. There was no impact on the consolidated financial statements of the Company as a result of the adoption of Statement 159 since the Company has not elected the fair value option for any eligible items, as defined in FAS 159.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" (FAS 157) which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. FAS 157 also establishes a fair value hierarchy which requires the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

On February 12, 2008, the FASB issued Staff Position 157-2 which defers the effective date of Statement 157 for certain non-financial assets and liabilities to fiscal years beginning after November 15, 2008. All other provisions of Statement 157 are effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years.

The Company adopted the provisions of FAS 157 for the quarter ended March 31, 2008 except for those non-financial assets and liabilities subject to deferral as a result of Staff Position 157-2. There was no impact on the consolidated financial statements of the Company as a result of the adoption of FAS 157.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Securities available for sale

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. Currently, all of the Company's securities are considered to be Level 1 or Level 2 securities and fair values are provided by a third party pricing provider.

Following is a description of the valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying consolidated balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans

Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using current market rates, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. This valuation would be considered Level 3, consisting of appraisals of underlying collateral and discounted cash flow analysis.

The FASB Emerging Issues Task Force finalized in 2007 Issues No. 06-4 and 06-10 dealing with the accounting for deferred compensation and post-retirement benefit aspects of endorsement and collateral assignment split-dollar life insurance arrangements. These Issues require that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. The Issues are effective for fiscal years beginning after December 15, 2007. The adoption of the Issues effective January 1, 2008 did not have a material impact on the Company's consolidated financial statements.

On November 5, 2007, the SEC issued Staff Accounting Bulletin No. 109, *Written Loan Commitments Recorded at Fair Value through Earnings* ("SAB 109"). Previously, SAB 105, *Application of Accounting Principles to Loan Commitments*, stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The adoption of this standard effective January 1, 2008 did not have a material impact on the Company's consolidated financial statements.

In December, 2007, FASB issued Statement No. 160, “Noncontrolling Interest in Consolidated Financial Statements” and revised Statement No. 141R, “Business Combinations.” Both are effective for annual periods beginning after December 15, 2008. The Company is currently evaluating the impact of these Statements, but does not believe that either will have a material impact on its financial statements.

In March 2008, FASB issued Statement No. 161, “Disclosures about Derivative Instruments and Hedging Activities” (FAS 161). FAS 161 is an amendment of FASB 133, “Accounting for Derivative Instruments and Hedging Activities”, and is intended to improve financial reporting transparency regarding derivative instruments and hedging activities. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. The Company is currently evaluating the impact of FAS 161 on the Company’s consolidated financial statements, but does not believe it will have a material impact on the consolidated financial statements.

NOTE C – EARNINGS PER SHARE

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options. Earnings and dividends per common share are restated for all stock splits and dividends through the date of issue of the financial statements.

A reconciliation of the numerators and denominators of basic and diluted earnings per share for the three and nine month periods ended September 30, 2008 and 2007 is as follows (dollars in thousands, except per share data):

	<u>Three Months Ended September 30, 2008</u>	<u>Three Months Ended September 30, 2007</u>	<u>Nine Months Ended September 30, 2008</u>	<u>Nine Months Ended September 30, 2007</u>
<u>Basic earnings per share:</u>				
Net income	\$ 21	\$ 1,082	\$ 1,571	\$ 3,129
Weighted average common shares outstanding	2,312,771	1,771,988	2,309,863	1,771,714
Less unallocated ESOP shares	<u>36,017</u>	<u>5,182</u>	<u>28,633</u>	<u>5,420</u>
Weighted average common shares outstanding for basic earnings per share	2,276,754	1,766,806	2,281,230	1,766,294
Basic earnings per share	<u>\$ 0.01</u>	<u>\$ 0.61</u>	<u>\$ 0.69</u>	<u>\$ 1.77</u>
<u>Diluted earnings per share:</u>				
Net income	\$ 21	\$ 1,082	\$ 1,571	\$ 3,129
Weighted average common shares outstanding for basic earnings per share	2,276,754	1,766,806	2,281,230	1,766,294
Add: Dilutive effect of assumed exercise of stock options	<u>-</u>	<u>5,276</u>	<u>947</u>	<u>6,009</u>
Weighted average common and dilutive potential common shares outstanding	<u>2,276,754</u>	<u>1,772,082</u>	<u>2,282,177</u>	<u>1,772,303</u>
Diluted earnings per share	<u>\$ 0.01</u>	<u>\$ 0.61</u>	<u>\$ 0.69</u>	<u>\$ 1.76</u>

Stock option awards outstanding that were anti-dilutive and therefore not included in the computation of earnings per share were as follows: 215,818 and 130,425 for the three months ended September 30, 2008 and 2007, respectively, and 193,675 and 130,425 for the nine months ended September 30, 2008 and 2007, respectively. Shares outstanding in 2008 included the issuance of 535,936 shares in connection with the purchase of FNB.

NOTE D – STOCK OPTIONS

Shareholders of the Company approved a stock option plan in April 2000 and a stock incentive plan in June 2005. The plans were authorized to issue up to 115,500 and 157,500 shares, respectively. In May 2008, shareholders of the Company ratified amendments to the Stock Incentive Plan of 2005, which among other things increased the authorized shares from 157,500 to 300,000. As of September 30, 2008, there were 44,841 shares available for future issuance under the 2000 plan and 140,057 shares available for future issuance under the 2005 plan.

A summary of stock option activity in the plans is as follows for the nine months ended September 30, 2008:

	<u>Shares</u>	<u>Weighted Average Price</u>
Outstanding at beginning of year	197,108	\$ 23.16
Granted	21,010	18.00
Exercised	-	-
Forfeited	<u>(2,700)</u>	<u>18.73</u>
Outstanding at September 30, 2008	<u>215,418</u>	<u>22.71</u>
Options exercisable at September 30, 2008	94,298	22.15

In January 2007, 2,740 shares of restricted stock were issued to employees and directors. The shares vest 20% per year over five years. In June 2008, 5,535 shares of restricted stock were issued to employees and directors. The shares also vest 20% per year over five years. Compensation expense of \$17,000 and \$9,000 was recorded during the nine months ended September 30, 2008 and 2007, respectively.

For the nine months ended September 30, 2008 and 2007, compensation expense of \$84,000 and \$57,000, respectively, was recorded with respect to options granted in 2007 and 2008. Such expense was computed in accordance with Statement of Financial Accounting Standards No. 123R, "Share-Based Payment."

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides information about the financial condition and results of operations of the Company and its subsidiary banks, Southern Michigan Bank & Trust (SMB&T) and FNB Financial (FNB), for the three and nine month periods ending September 30, 2008 and 2007. Financial results for 2008 were influenced by the acquisition of FNB on December 1, 2007. In accordance with the purchase method of accounting, FNB's results of operations were included in the Company's consolidated statements of income from the date of acquisition. Consequently, comparisons of year to date and quarterly results for the period ended September 30, 2008 to year to date and quarterly results for the period ended September 30, 2007 are affected by the inclusion of FNB's results. The purchase of FNB resulted in an increase in assets of \$150,406,000 and an increase in shareholders' equity of \$12,711,000.

Results of Operations

For the first nine months of 2008, net income was \$1,571,000 and basic and diluted earnings per share were \$0.69, compared with net income of \$3,129,000 and basic and diluted earnings per share of \$1.77 and \$1.76, respectively, for the first nine months of 2007. Included in the 2008 results was a \$390,000 tax free gain on life insurance proceeds. Negatively impacting income before income taxes for the nine month period of 2008 was a \$2,385,000 increase in the provision for loan losses. Over half of the 2008 increase in the provision for loan losses relates to a single large commercial credit in the automotive industry.

Net income for the third quarter of 2008 was \$21,000 compared to \$1,082,000 for the same period of 2007. Basic and diluted earnings per share decreased from \$0.61 for the third quarter of 2007 to \$0.01 for the same period of 2008. The Company's provision for loan losses for the third quarter of 2008 was \$1,580,000 compared to \$145,000 in the third quarter of 2007, a \$1,435,000 increase.

Return on average assets was .44% for the first nine months of 2008 compared to 1.24% for the first nine months of 2007. Return on average shareholders' equity was 4.56% for the first nine months of 2008, compared to 13.97% for the same period in 2007. Such rates were computed on an annualized basis.

Net Interest Income

The Company derives the greatest portion of its income from net interest income. During 2007, short-term rates were unchanged for the first eight months of the year. Beginning in September of 2007, the Federal Open Market Committee began lowering short-term rates. Through the third quarter of 2008, short-term rates dropped 225 basis points. The Company has been able to lower its cost of funds by 95 basis points compared to September 30, 2007, but tax equivalent yields on average assets declined to 6.44% from 7.61% for the same periods, a decline of 117 basis points. This resulted in a decline in the interest rate spread and net interest margin.

The following tables provide information regarding interest income and expense for the nine-month periods ended September 30, 2008 and 2007. Table 1 shows the year-to-date daily average balances for interest earning assets and interest bearing liabilities, interest earned or paid, and the annualized effective rate, for the nine-month periods ended September 30, 2008 and 2007. Table 2 shows the effect on interest income and expense of changes in volume and interest rates. Both tables are on a tax equivalent basis.

Table 1 – Average Balances and Tax Equivalent Interest Rates

(Dollars in Thousands):

	2008			2007		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
ASSETS						
Interest earning assets:						
Loans(1)(2)(3)	\$ 335,340	\$ 17,404	6.94%	\$ 251,940	\$ 15,200	8.07%
Federal funds sold	19,874	339	2.28	10,988	456	5.55
Taxable investment securities(4)	44,081	1,590	4.82	28,744	1,113	5.18
Tax-exempt investment securities(1)	24,562	1,085	5.91	15,318	698	6.09
Total interest earning assets	423,857	20,418	6.44	306,990	17,467	7.61
Non-interest earning assets:						
Cash and due from banks	11,977			8,963		
Other assets(5)	49,842			24,491		
Less allowance for loan losses	(5,284)			(3,352)		
Total assets	\$ 480,392			\$ 337,092		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest bearing liabilities:						
Demand deposits	\$ 161,742	1,739	1.44%	\$ 117,090	\$ 2,304	2.63%
Savings deposits	54,391	311	0.76	29,141	105	0.48
Time deposits	127,757	3,403	3.56	102,763	3,317	4.32
Securities sold under agreements to repurchase and federal funds purchased	10,091	138	1.83	420	12	3.82
Other borrowings	13,309	547	5.50	5,820	243	5.58
Subordinated debentures	5,155	224	5.81	5,155	304	7.88
Total interest bearing liabilities	372,445	6,362	2.28	260,389	6,285	3.23
Non-interest bearing liabilities:						
Demand deposits	55,577			40,517		
Other	4,818			4,147		
Common stock subject to repurchase obligation	1,663			2,182		
Shareholders' equity	45,889			29,857		
Total liabilities and shareholders' equity	\$ 480,392			\$ 337,092		
Net interest income		\$ 14,056			\$ 11,182	
Interest rate spread			4.16%			4.38%
Net yield on interest earning assets			4.43%			4.87%

- (1) Includes tax equivalent adjustment of interest (assuming a 34% tax rate) for securities and loans of \$369,000 and \$103,000, respectively, for 2008 and \$237,000 and \$43,000, respectively, for 2007.
- (2) Average balance includes average non-accrual loan balances of \$7,686,000 in 2008 and \$3,377,000 in 2007.
- (3) Interest income includes loan fees of \$487,000 in 2008 and \$262,000 in 2007.
- (4) Average balance includes average unrealized gain of \$758,000 in 2008 and unrealized loss of (\$28,000) in 2007 on available for sale securities. The yield was calculated without regard to this average unrealized gain or loss.
- (5) Includes \$16,382,000 in 2008 and \$620,000 in 2007 relating to goodwill and other intangible assets.

Table 2 – Changes in Tax-Equivalent Net Interest Income

(Dollars in Thousands)

	Nine Months Ended September 30, 2008 Over 2007 Increase (Decrease) Due To		
	<u>Volume</u>	<u>Rate</u>	<u>Net</u>
Interest income on:			
Loans	\$ 4,537	\$ (2,333)	\$ 2,204
Federal funds sold	243	(360)	(117)
Taxable investment securities	558	(81)	477
Tax-exempt investment securities	<u>409</u>	<u>(22)</u>	<u>387</u>
Total interest earning assets	<u>\$ 5,747</u>	<u>\$ (2,796)</u>	<u>\$ 2,951</u>
Interest expense on:			
Demand deposits	\$ 697	\$ (1,262)	\$ (565)
Savings deposits	123	83	206
Time deposits	725	(639)	86
Securities sold under agreements to repurchase & federal funds purchased	135	(9)	126
Other borrowings	308	(4)	304
Subordinated debentures	<u>-</u>	<u>(80)</u>	<u>(80)</u>
Total interest bearing liabilities	<u>\$ 1,988</u>	<u>\$ (1,911)</u>	<u>\$ 77</u>
Net interest income	<u>\$ 3,759</u>	<u>\$ (885)</u>	<u>\$ 2,874</u>

As shown in Tables 1 and 2, tax-equivalent net interest income increased \$2,874,000 in the first nine months of 2008 compared to the same period in 2007. Increases in the average balances primarily resulted from the FNB acquisition. Net interest income decreased \$885,000 due to rate changes comparing the nine months of 2008 with the nine months of 2007 on a tax equivalent basis. This decrease is due primarily to the rate decreases described above.

The presentation of net interest income on a tax equivalent basis is not in accordance with generally accepted accounting principles (“GAAP”), but is customary in the banking industry. This non-GAAP measure ensures comparability of net interest income arising from both taxable and tax-exempt loans and investment securities. The adjustments to determine net interest income on a tax equivalent basis were \$472,000 and \$280,000 for the nine months ended September 30, 2008 and 2007, respectively. These adjustments were computed using a 34% federal income tax rate.

Provision for Loan Losses

The provision for loan losses is based on an analysis of the required additions to the allowance for loan losses. The provision is charged to income to bring the allowance for loan losses to a level deemed appropriate by management. The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses in the loan portfolio. Some factors considered by management in determining the level at which the allowance is maintained include specific credit reviews, historical loan loss experience, current economic conditions and trends, results of examinations by regulatory agencies and the volume, growth and composition of the loan portfolio. The provision is adjusted quarterly, if necessary, to reflect changes in the factors above as well as actual charge-off experience and any known losses.

The provision for loan losses was \$1,580,000 for the three month period ending September 30, 2008. Specific reserves increased \$1,708,000 from June 30, 2008 levels to \$3,456,000 at September 30, 2008, net charge-offs totaled \$201,000 for the quarter, and non-performing loans increased 12.1% or \$1,131,000 from June 30, 2008 levels to \$10,449,000 at September 30, 2008. These increases reflect the difficult Michigan economy and the depressed real estate market, all of which contributed to the higher provision. A provision of \$145,000 was recorded for the third quarter of 2007.

For the nine month period ending September 30, 2008 the provision for loan losses was \$2,730,000 compared to \$345,000 for the same period of 2007.

The allowance was 2.07% of total loans at September 30, 2008 compared to 1.53% at December 31, 2007.

Charge-offs and recoveries for respective loan categories for the nine months ended September 30, 2008 and 2007 were as follows:

(Dollars in Thousands)

	2008		2007	
	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Charge-offs</u>	<u>Recoveries</u>
Commercial	\$ 495	\$ 40	\$ 158	\$ 62
Residential real estate	276	8	73	-
Consumer	260	84	163	79
Total	<u>\$ 1,031</u>	<u>\$ 132</u>	<u>\$ 394</u>	<u>\$ 141</u>

Net charge-offs in the first nine months of 2008 were \$899,000, or 0.36% of average loans on an annualized basis. Net charge-offs in the first nine months of 2007 were \$253,000, or 0.13% of average loans on an annualized basis.

Non-interest income

Total non-interest income increased \$475,000, or 44.0%, in the third quarter of 2008 compared to the same quarter of last year, and is up 65.8%, or \$1,992,000 year to date. The increase is primarily a result of the FNB acquisition which provided \$583,000 of non-interest income during the quarter and \$1,734,000 for the nine months. In addition, for the nine month period ending September 30, 2008, the Company recorded a \$390,000 gain from life insurance proceeds.

Non-interest expense

Total non-interest expense increased \$1,559,000, or 49.5%, in the third quarter of 2008 compared to the same quarter of last year, and is up 54.3%, or \$5,063,000, year to date. The FNB purchase generated \$1,416,000 of the third quarter increase and \$4,449,000 year to date. Salary and employee benefits are the Company's largest single area of expense, and for the quarter and nine month period, provided the largest increase, primarily caused by the staffing of FNB. Occupancy, equipment, telecommunication and software maintenance costs also increased for both the three and nine month periods as an additional 8 branch locations were added from FNB. Amortization of

other intangibles was \$281,000 higher for year to date 2008, as a result of the core deposit amortization from the FNB acquisition.

Federal income taxes

The provision (credit) for federal income taxes for the nine months ended September 30, 2008 and 2007 resulted in a credit of \$75,000 in 2008 and a provision of \$1,141,000 in 2007. The effective tax rate of 26.7% for 2007 is in line with the Company's normal effective tax rate, which was 25.8% for the full year 2007 and 27.1% for the full year 2006. Because of the significant decline in 2008 income before income taxes, a federal income tax credit resulted for the three and nine-months ended September 30, 2008 after consideration of tax-exempt interest income, non-taxable life insurance income and other normal tax reconciling items.

Financial Condition

The Company's balance sheet decreased 1.5%, or \$7,264,000 at September 30, 2008 compared to December 31, 2007.

Securities held for sale

Securities available for sale decreased \$12.3 million at September 30, 2008 from December 31, 2007. The Company has elected not to replace some maturing investments to meet anticipated liquidity needs. The Company's portfolio does not have any Fannie Mae or Freddie Mac equity securities or non-agency mortgage backed securities that have been the topic of much recent public discussion. The Company's current and projected tax position continues to make carrying tax-exempt securities beneficial. The investment in local municipal issues also reflects the Company's commitment to the development of the local area through support of its local political subdivisions. Unrealized gains and losses within the investment portfolio are temporary since they are a result of market changes, rather than a reflection of credit quality.

Federal funds sold

Federal funds sold at September 30, 2008 increased \$11.6 million as called and maturing investment securities were invested in overnight federal funds to meet liquidity needs.

Nonperforming assets

Nonperforming assets include non-accrual loans, accruing loans past due 90 days or more, and other real estate owned, which includes real estate acquired through foreclosures and deeds in lieu of foreclosure.

A loan generally is classified as non-accrual when full collectibility of principal or interest is doubtful or a loan becomes 90 days past due as to principal or interest, unless management determines that the estimated net realizable value of the collateral is sufficient to cover the principal balance and accrued interest. When interest accruals are discontinued, unpaid interest is reversed. Nonperforming loans are returned to performing status when the loan is brought current and has performed in accordance with contract terms for a period of time.

The following table sets forth the aggregate amount of nonperforming assets in each of the following categories:

(Dollars in thousands)

	<u>9/30/08</u>	<u>12/31/07</u>	<u>9/30/07</u>
Non-accrual loans:			
Commercial, financial and agricultural	\$ 7,071	\$ 3,032	\$ 1,957
Real estate mortgage	2,554	1,342	643
Installment	14	31	44
	<u>9,639</u>	<u>4,405</u>	<u>2,644</u>
Loans contractually past due 90 days or more and still on accrual:			
Commercial, financial and agricultural	349	411	106
Real estate mortgage	461	-	16
Installment	-	18	16
	<u>810</u>	<u>429</u>	<u>138</u>
Total nonperforming loans	10,449	4,834	2,782
Other real estate owned	<u>1,257</u>	<u>866</u>	<u>1,078</u>
Total nonperforming assets	<u>\$ 11,706</u>	<u>\$ 5,700</u>	<u>\$ 3,860</u>
Nonperforming loans to total loans	<u>3.10%</u>	<u>1.44%</u>	<u>1.10%</u>
Nonperforming assets to total assets	<u>2.48%</u>	<u>1.19%</u>	<u>1.10%</u>

Nonperforming loans are subject to continuous monitoring by management and estimated losses are specifically allocated for in the allowance for loan losses where appropriate.

In management's evaluation of the loan portfolio risks, any significant future increases in nonperforming loans is dependent to a large extent on the economic environment. In a deteriorating or uncertain economy, such as the Company is faced with today, management applies more conservative assumptions when assessing the future prospects of borrowers and when estimating collateral values. The highly publicized declines in the real estate markets and the economic issues in Michigan and nationally are impacting the Company, resulting in a higher number of loans being classified as nonperforming. Due to the uncertainty in the economy, both nationally and within Michigan, it's management's opinion that nonperforming assets will continue to remain at elevated levels into 2009.

The increase in non-accrual loans at September 30, 2008 is primarily the result of three commercial credits, totaling \$5,284,000, being placed on non-accrual, net of the payoff or charge-off of some non-accrual loans. Collection efforts continue with all delinquent borrowers.

Holdings of other real estate owned increased by \$391,000 since the end of 2007. Other real estate owned includes properties that were acquired through foreclosure or in lieu of foreclosure. The properties include residential homes and lots as well as commercial properties.

Securities sold under agreements to repurchase

Securities sold under agreements to repurchase decreased \$6.0 million or 61.8% as of September 30, 2008 compared to December 31, 2007, as one customer moved \$7.0 million to a short term certificate of deposit.

Deposits

Deposits increased \$1.6 million at September 30, 2008 compared to December 31, 2007. However, with the \$7.0 million moved into a certificate of deposit from the securities sold under agreements to repurchase, all other deposits are down a net \$5.4 million. The decrease is primarily in money market accounts and was reflective of normal fluctuations of a few large depositors.

Shareholders' equity

Total shareholders' equity at September 30, 2008 increased \$663,000 from the year ended December 31, 2007. The increase is attributable to the current year's net income, offset by dividends declared to shareholders, as well as the items described on page 5.

The following table summarizes the Company's capital ratios as of September 30, 2008 and December 31, 2007:

	<u>September 30, 2008</u>	<u>December 31, 2007</u>	<u>Regulatory Minimums</u>
Total risk-based capital ratio	10.9%	10.9%	8.0%
Tier I capital ratio	9.7%	9.5%	4.0%
Leverage ratio	8.0%	10.3%	4.0%

Liquidity

Liquidity management involves the ability to meet the cash flow requirements of customers who may be either depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. The subsidiary banks maintain certain levels of liquid assets (the most liquid of which are cash and cash equivalents, federal funds sold and investment securities) in order to meet these demands. Maturing loans and investment securities are the principal sources of asset liquidity.

The subsidiary banks maintain correspondent accounts with a number of other banks for various purposes. In addition, cash sufficient to meet the operating needs of its branches is maintained at its lowest practical levels. At times, the subsidiary banks are a participant in the federal funds market. Federal funds are generally borrowed or sold for one-day periods. The subsidiary banks have available credit arrangements at September 30, 2008 enabling them to purchase up to \$24,000,000 in federal funds should the need arise.

The Company's principal source of funds to pay cash dividends is the earnings and dividends paid by its subsidiary banks. The Company also has available \$3,000,000 at September 30, 2008 on a revolving line of credit for general working capital purposes.

Impact of Inflation and Changing Prices

The majority of assets and liabilities of a financial institution are monetary in nature and therefore differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. However, inflation does have an important impact on the growth of total assets in the banking industry and the resulting need to increase equity capital at higher than normal rates in order to maintain an appropriate equity-to-assets ratio. Another significant effect of inflation is on other expenses, which tend to rise during periods of general inflation.

Item 4T. Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of September 30, 2008. Based on and as of the time of that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

There was no change in the Company's internal control over financial reporting that occurred during the three months ended September 30, 2008 that has materially affected, or that is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. Other Information

Item 1A. Risk Factors

Information concerning risk factors is contained in the section entitled “Risk Factors” in Southern Michigan Bancorp, Inc.’s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission on March 28, 2008. As of the date of this report, Southern does not believe that there has been a material change in the nature or categories of the Company’s risk factors, as compared to the information disclosed in the Company’s Annual Report on Form 10-K.

Item 6. Exhibits

Exhibits. The following exhibits are filed as part of this report on Form 10-Q:

<u>Exhibit Number</u>	<u>Document</u>
2	Agreement and Plan of Merger between Southern Michigan Bancorp, Inc. and FNB Financial Corporation, dated April 17, 2007. Previously filed with the Commission on September 28, 2007 in Southern Michigan Bancorp Inc.’s Amendment No. 2 to Form S-4 Registration Statement, Exhibit 2. Here incorporated by reference.
3.1	Articles of Incorporation of Southern Michigan Bancorp, Inc., as amended. Previously filed with the Commission on September 28, 2007 in Southern Michigan Bancorp Inc.’s Amendment No. 2 to Form S-4 Registration Statement, Exhibit 3.1. Here incorporated by reference.
3.2	Amended and Restated Bylaws of Southern Michigan Bancorp, Inc., as amended. Previously filed with the Commission on September 28, 2007 in Southern Michigan Bancorp Inc.’s Amendment No. 2 to Form S-4 Registration Statement, Exhibit 3.2. Here incorporated by reference.
4.1	Selected provisions of Articles of Incorporation of Southern Michigan Bancorp, Inc., as amended. See Exhibit 3.1.
4.2	Selected provisions of Amended and Restated Bylaws of Southern Michigan Bancorp, Inc., as amended. See Exhibit 3.2.
4.3	Long-Term Debt. The registrant has outstanding long-term debt which at the time of this report does not exceed 10% of the registrant’s total consolidated assets. The registrant agrees to furnish copies of the agreements defining the rights of holders of such long-term debt to the Securities and Exchange Commission upon request.
10	Separation Agreement between Southern Michigan Bancorp, Inc. and Richard E. Dyer.
31.1	Certification of Chairman of the Board and Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Senior Vice President, Chief Financial Officer, Secretary and Treasurer under Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to 18 U.S.C. § 1350.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOUTHERN MICHIGAN BANCORP, INC.

Date: November 14, 2008

By: /s/ John H. Castle

John H. Castle
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

Date: November 14, 2008

By: /s/ Danice L. Chartrand

Danice L. Chartrand
Senior Vice President, Chief Financial
Officer, Secretary and Treasurer
(Principal Financial and Accounting Officer)

Exhibit Index

<u>Exhibit Number</u>	<u>Document</u>
2	Agreement and Plan of Merger between Southern Michigan Bancorp, Inc. and FNB Financial Corporation, dated April 17, 2007. Previously filed with the Commission on September 28, 2007 in Southern Michigan Bancorp Inc.'s Amendment No. 2 to Form S-4 Registration Statement, Exhibit 2. Here incorporated by reference.
3.1	Articles of Incorporation of Southern Michigan Bancorp, Inc., as amended. Previously filed with the Commission on September 28, 2007 in Southern Michigan Bancorp Inc.'s Amendment No. 2 to Form S-4 Registration Statement, Exhibit 3.1. Here incorporated by reference.
3.2	Amended and Restated Bylaws of Southern Michigan Bancorp, Inc., as amended. Previously filed with the Commission on September 28, 2007 in Southern Michigan Bancorp Inc.'s Amendment No. 2 to Form S-4 Registration Statement, Exhibit 3.2. Here incorporated by reference.
4.1	Selected provisions of Articles of Incorporation of Southern Michigan Bancorp, Inc., as amended. See Exhibit 3.1.
4.2	Selected provisions of Amended and Restated Bylaws of Southern Michigan Bancorp, Inc., as amended. See Exhibit 3.2.
4.3	Long-Term Debt. The registrant has outstanding long-term debt which at the time of this report does not exceed 10% of the registrant's total consolidated assets. The registrant agrees to furnish copies of the agreements defining the rights of holders of such long-term debt to the Securities and Exchange Commission upon request.
10	Separation Agreement between Southern Michigan Bancorp, Inc. and Richard E. Dyer.
31.1	Certification of Chairman of the Board and Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Senior Vice President, Chief Financial Officer, Secretary and Treasurer under Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to 18 U.S.C. § 1350.

EXHIBIT 10

SEPARATION AGREEMENT

This Separation Agreement ("Agreement") is between SOUTHERN MICHIGAN BANCORP, INC. ("Corporation") and RICHARD E. DYER ("Executive").

Executive has been employed by the Corporation and its Affiliate FNB Financial ("Bank") pursuant to an Amended and Restated Employment Agreement effective as of March 26, 2008 ("Employment Agreement"). This Agreement sets forth the agreed terms for Executive's separation from employment with the Corporation, the Bank, and all other Affiliates (as defined in the Employment Agreement). Therefore, the parties agree as follows.

1. Termination of Employment. Executive hereby resigns effective July 18, 2008 from all positions that he holds with or on behalf the Corporation and all Affiliates, including but not limited to his directorships on the Boards of Directors of the Corporation and the Bank.

2. Payments by the Corporation. The Corporation will make the following payments to the Executive.

(a) Salary Continuation. The Corporation will pay Executive \$6,170.92 per bi-weekly pay period (prorated for any partial payroll period) for the 52 week period beginning with the week of July 20, 2008 and ending with the week of July 12, 2009 (the "Severance Pay Period"), subject to required payroll withholding.

(b) Health Coverage Continuation. The Corporation will reimburse the Executive for the COBRA continuation premiums incurred by Executive to continue Executive's current employee and dependent health, dental, and prescription drug coverage in effect during the Severance Pay Period, provided (A) that Executive elects and remains eligible for COBRA continuation coverage, (B) that Executive continues to pay the normal employee contribution for such coverage, (C) that the Corporation's obligation to provide coverage will end if Executive becomes eligible for comparable coverage from a new employer and (D) that reimbursements under this Section will be made within thirty (30) days after the Executive submits documentation of the reimbursable expense.

(c) Outplacement Assistance. The Corporation will reimburse up to \$5,000.00 of outplacement assistance from an outplacement assistance firm selected by Executive and approved by the Corporation (whose approval shall not be unreasonably withheld). Expenses must be incurred under this Section not later than December 31, 2009 and will be reimbursed within 30 days after Executive submits documentation of the reimbursable expense.

(d) Unused Vacation. The Corporation will pay Executive for any accrued unused current-year vacation pay to which Executive is entitled under the Corporation's vacation pay policy, to be paid with the pay check for the first pay period after the effective date of this Agreement.

(e) Auto. The Corporation will promptly transfer to Executive free and clear title to the 2006 Buick Lucerne CSX that has been provided for Executive's use during his employment. Executive accepts the auto "as is", with no warranties from the Corporation or Affiliates, and understands that after transfer of title all insurance, maintenance and other expenses relating to the auto will be Executive's responsibility. The parties agree that the fair market value of the auto is \$18,760. Required payroll withholding will be deducted from the payments under Section 2(a).

(f) Additional Provisions Regarding Payments. No payments will be made under this Agreement until it takes effect pursuant to Section 7. Executive will receive the Salary Continuation provided in Section 2(a) notwithstanding any other earnings that Executive may have, and without any offset or deduction other than required payroll withholding. If Executive dies during the Severance Pay Period, Salary Continuation under Section 2(a) will continue for the remainder of the Severance Pay Period for the benefit of Executive's designated beneficiary (or Executive's estate if Executive fails to designate a beneficiary), and health coverage continuation under Section 2(b) will continue for Executive's eligible dependants for the remainder of the Severance Pay Period provided that they remain eligible for COBRA coverage and that they continue to pay the normal employee contribution for such coverage.

3. Release of Claims. Executive hereby waives and releases any claims that Executive might otherwise have against the Corporation, the Bank, any Affiliate, or any of their officers, directors, employees or agents. The released claims include: any claims related to Executive's employment with the Corporation, the Bank or any Affiliate; any right to further compensation or benefits from the Corporation or any Affiliate (except as specifically provided in this Agreement); any rights with respect to awards of stock options or restricted stock under the Corporation's Stock Incentive Plan of 2005 (all of which options and restricted stock rights are hereby terminated); any claims under any agreement (including the Employment Agreement except as specifically provided in this Agreement); and any claims relating to any legal duty, including but not limited to any claims under the federal Age Discrimination in Employment Act or any other statute. This release of claims does not apply, however: to the payments provided for in Section 2 above; to Executive's pending claims under the health insurance program; to any vested account under the Corporation's qualified retirement plan; or to any rights of indemnification to which the Executive may be entitled under the Articles of Incorporation or Bylaws of the Corporation or the Bank.

4. Transitional Assistance. During the first 30 days after termination of Executive's employment Executive will provide transitional assistance by telephone to the Corporation and its Affiliates as reasonably requested by the Corporation's Chief Executive Officer, at Executive's reasonable convenience and without substantial interference with Executive's other activities or commitments.

5. Reaffirmation of Commitments. Executive understands and agrees that his entitlement to the payments provided under Section 2 of this Agreement is conditioned on his continued compliance with his commitments in Sections 11, 12 and 13 of the Employment Agreement and the Transition Agreement dated effective December 1, 2007.

6. Period for Review and Consultation. The Corporation advises Executive to consult with an attorney regarding this Agreement before signing it. Executive has been given 21 days after the date on which he receives this Agreement to decide whether to sign it. If Executive elects to sign this Agreement before expiration of the 21-day period, Executive does so voluntarily, and intending to waive the balance of the 21-day period. By signing this Agreement, Executive acknowledges that he has read this Agreement, understands all of its provisions, and knowingly and voluntarily agrees to all of its terms and provisions subject to the period of revocation set forth in Section 7.

7. Revocation Period. Executive may revoke this Agreement at any time up to and including 7 calendar days after he signs it, by delivering written notice of revocation to the Corporation within that period. This Agreement shall not become effective or enforceable until this 7 day period has expired without Executive having so revoked this Agreement. Once this revocation period expires, if Executive has not revoked this Agreement, the Agreement will be a binding, irrevocable agreement between Executive and the Corporation.

8. Entire Agreement. This Agreement is the complete understanding between the parties and neither party is relying on any statement other than the provisions of this Agreement. No other promises or agreements shall be binding unless in writing signed by the parties to this Agreement.

The parties have signed below to confirm their agreement on the above terms.

SOUTHERN MICHIGAN BANCORP, INC.
"Corporation"

/s/ Richard E. Dyer
RICHARD E. DYER
"Executive"

By: /s/ John H. Castle

Its: Chairman and CEO

Date: July 22, 2008

Date: July 22, 2008

Certification

I, John H. Castle, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Southern Michigan Bancorp, Inc. for the fiscal quarter ended September 30, 2008;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2008

/s/ John H. Castle

John H. Castle

Chairman of the Board and Chief Executive Officer
Southern Michigan Bancorp, Inc.

Certification

I, Danice L. Chartrand, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Southern Michigan Bancorp, Inc. for the fiscal quarter ended September 30, 2008;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2008

/s/ Danice L. Chartrand
Danice L. Chartrand
Senior Vice President, Chief Financial
Officer, Secretary and Treasurer
Southern Michigan Bancorp, Inc.

Certification

Pursuant to 18 U.S.C. § 1350, each of the undersigned hereby certifies in his or her capacity as an officer of Southern Michigan Bancorp, Inc. (the "Company") that the Quarterly Report of the Company on Form 10-Q for the quarter ended September 30, 2008 fully complies with the requirements of Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such report fairly presents, in all material respects, the financial condition of the Company at the end of such period and the results of operations of the Company for such period.

Dated: November 14, 2008

/s/ John H. Castle

John H. Castle

Chairman of the Board and Chief Executive Officer

Dated: November 14, 2008

/s/ Danice L. Chartrand

Danice L. Chartrand

Senior Vice President, Chief Financial
Officer, Secretary and Treasurer

A signed original of this written statement required by Section 906 has been provided to Southern Michigan Bancorp, Inc. and will be retained by Southern Michigan Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.