MGM MIRAGE
Form 10-K
March 13, 2006

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

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]**

For the fiscal year ended December 31, 2005

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]**

For the transition period __________ to __________

Commission File No. 0-16760

MGM MIRAGE
(Exact name of Registrant as specified in its charter)

DELAWARE	**88-0215232**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

3600 Las Vegas Boulevard South Las Vegas, Nevada 89109
(Address of principal executive office) (Zip Code)
(702) 693-7120
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $.01 Par Value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K:__________

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act): Yes o No þ

The aggregate market value of the Registrant s Common Stock held by non-affiliates of the Registrant as of June 30, 2005 (based on the closing price on the New York Stock Exchange Composite Tape on June 30, 2005 was $5.1 billion. As of March 10, 2006, 284,758,777 shares of Registrant s Common Stock, $.01 par value, were outstanding.

Portions of the Registrant s definitive Proxy Statement for its 2006 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

Overview

MGM MIRAGE is one of the largest gaming companies in the world. We believe that we own the world s finest collection of casino resorts. Our strategy is predicated on creating resorts of memorable character, treating our employees well and providing superior service for our guests. MGM MIRAGE was organized as MGM Grand, Inc. on January 29, 1986 and is a Delaware corporation. MGM MIRAGE acts largely as a holding company and its operations are conducted through wholly-owned subsidiaries. MGM MIRAGE is referred to as the Company or the Registrant, and together with our subsidiaries may also be referred to as we, us or our.

Acquisition of Mandalay Resort Group

On April 25, 2005, we closed our merger with Mandalay Resort Group (Mandalay) under which we acquired Mandalay for $71 in cash for each share of common stock of Mandalay. The total acquisition cost, including the assumption of debt and transaction costs, was approximately $7.3 billion. As a result of the acquisition we are a much larger company, with ownership of or investments in 26 casino resorts versus 13, over 66,000 employees versus 40,000, and total assets of over $20 billion versus $11 billion. The acquisition expands our portfolio of resorts on the Las Vegas Strip, provides additional sites for future development and expands our employee and customer bases significantly.

Our Operating Casino Resorts

We have provided below certain information about our casino resorts as of December 31, 2005. Except as otherwise indicated, we wholly own and operate the resorts shown below.

Name and Location	Number of Guestrooms and Suites	Approximate Casino Square Footage	Slots (1)	Gaming Tables (2)
Las Vegas Strip, Nevada (3)				
Bellagio	3,933	155,000	2,409	143
MGM Grand Las Vegas	5,044	156,000	2,593	172
Mandalay Bay (4)	4,756	157,000	1,949	127
The Mirage	3,044	118,000	2,056	109
Luxor	4,403	100,000	1,778	88
Treasure Island (TI)	2,885	90,000	1,800	64
New York-New York	2,024	84,000	1,867	85
Excalibur	3,990	100,000	1,762	73
Monte Carlo	3,002	102,000	1,726	74
Circus Circus Las Vegas (5)	3,764	133,000	2,364	92
Subtotal	36,845	1,195,000	20,304	1,027
Other Nevada				
Primm Valley Resorts *(Primm)* (6)	2,642	137,000	2,854	94
Circus Circus Reno *(Reno)*	1,572	69,000	1,369	52
Silver Legacy 50% owned *(Reno)*	1,710	87,000	1,707	68
Gold Strike *(Jean)*	811	37,000	737	15
Nevada Landing *(Jean)*	303	36,000	733	14
Colorado Belle *(Laughlin)*	1,173	50,000	1,167	39
Edgewater *(Laughlin)*	1,356	57,000	1,099	33
Railroad Pass *(Henderson)*	120	13,000	347	6

Other Domestic Operations				
MGM Grand Detroit *(Detroit, Michigan)*	N/A	75,000	2,841	72
Beau Rivage *(Biloxi, Mississippi)* (7)	N/A	N/A	N/A	N/A
Gold Strike *(Tunica, Mississippi)*	1,133	40,000	1,345	48
Borgata 50% owned *(Atlantic City, NewJersey)*	2,000	125,000	3,572	133
Grand Victoria 50% owned *(Elgin, Illinois)*	N/A	34,000	1,100	37
Grand Total	49,665	1,955,000	39,175	1,638

(1) Includes slot machines, video poker machines and other electronic gaming devices.

(2) Includes blackjack (21), baccarat, craps, roulette and other table games; does not include poker.

(3) Excludes Boardwalk, which closed in January 2006.

(4) Includes the Four Seasons Hotel with 424 guest rooms and THEhotel with 1,117 suites.

(5) Includes Slots-a-Fun.

(6) Includes Primm Valley, Buffalo Bill s and Whiskey Pete s, along with the Primm Center gas station and convenience store.

(7) Beau Rivage sustained significant damage in late August 2005 as a result of Hurricane Katrina and has been closed since. We expect to reopen Beau Rivage in the third quarter of 2006.

Bellagio

Bellagio is widely recognized as one of the premier destination resorts in the world. Located at the heart of the Las Vegas Strip, Bellagio is the only casino resort to earn the prestigious Five Diamond award from the American Automobile Association (AAA), which it has earned for the last five years. The resort is richly decorated, including a conservatory filled with unique botanical displays that change with the seasons. At the front of Bellagio is an eight-acre lake featuring over 1,000 fountains that come alive at regular intervals in a choreographed ballet of water, music and lights. Bellagio features 200,000 square feet of convention space for the discerning group planner. For both business and leisure customers, Bellagio s restaurants offer the finest choices, including Five Diamond award winners Picasso and Le Cirque. Entertainment options include *O*, produced and performed by Cirque du Soleil, the Light nightclub, and several other bars and lounges. Leisure travelers can also enjoy Bellagio s expansive pool, world-class spa and Gallery of Fine Arts.

MGM Grand Las Vegas

MGM Grand Las Vegas, located on the corner of the Las Vegas Strip and Tropicana Avenue, is one of the largest casino resorts in the world, and is the largest to receive the AAA's Four Diamond award. The resort s guest rooms feature unique themes, including: West Wing, a recently remodeled area offering boutique-style rooms; Skylofts, ultra-suites on the 29th floor featuring the ultimate in personal service; and the exclusive Mansion for premium gaming customers. MGM Grand Las Vegas features an extensive array of restaurants, including two new restaurants by renowned chef Joël Robuchon, Craftsteak, NOBHILL, SeaBlue, Pearl, Shibuya and Fiamma Trattoria. Other amenities include the Studio 54 nightclub, Tabu, the Ultra Lounge, Teatro, numerous retail shopping outlets, a 380,000 square foot state-of-the-art conference center, and an extensive pool and spa complex. During 2005, the resort opened a state-of-the-art poker room and a renovated sports book.

Entertainment options at MGM Grand Las Vegas include *KÀ*, by Cirque du Soleil, performed in a custom-designed theatre seating almost 2,000 guests; headliner entertainment in the Hollywood Theatre; and *La Femme*. The MGM Grand Garden is a special events center with a seating capacity of over 16,000 that provides a venue for concerts by such stars as Madonna, Paul McCartney, the Rolling Stones, U2 and others, as well as championship boxing and other sporting events.

We own a 50% interest in The Signature at MGM Grand, a condominium hotel development adjacent to the resort. The other 50% is owned by an affiliate of Turnberry Associates. All three luxury condominium towers are currently under construction. When complete, The Signature at MGM Grand will consist of over 1,700 total residences, and we will have the opportunity to rent the condominiums to third parties on behalf of owners who elect to have us do so.

Mandalay Bay

Mandalay Bay is the first major resort on the Las Vegas Strip to greet visitors arriving by automobile from southern California. This AAA Four Diamond, South Seas-themed resort features numerous restaurants, such as Charlie Palmer s Aureole, Wolfgang Puck s Trattoria Del Lupo, China Grill, Hubert Keller s Fleur de Lys, and Border Grill. Mandalay Bay s pool area consists of an 11-acre tropical lagoon with numerous pools, a surfing beach, a lazy river, and Moorea Beach, a European-style ultra beach. Mandalay Bay also has a 30,000-square-foot spa. Mandalay Bay offers multiple entertainment venues that include a 12,000-seat special events arena, a 1,760-seat showroom featuring the Broadway hit *Mamma Mia!*, the House of Blues, and the Rumjungle restaurant and nightclub. In addition, Mandalay Bay features the Shark Reef, exhibiting sharks and rare sea predators.

Included within Mandalay Bay is a Four Seasons Hotel with its own lobby, restaurants and pool and spa, providing visitors with a luxury five-diamond hospitality experience. THEhotel is an all-suite hotel tower within the Mandalay Bay complex. THEhotel includes its own spa and fitness center, a lounge and two restaurants, including Mix Las Vegas, created by famed chef Alain Ducasse and located on the top floor of THEhotel.

The Mandalay Bay Conference Center is a convention and meeting complex adjacent to Mandalay Bay. The complex includes more than one million square feet of exhibit space. With this building and Mandalay Bay s original conference center, Mandalay Bay offers almost two million gross square feet of conference and exhibit space. Connecting Mandalay Bay to Luxor is Mandalay Place, a retail center that includes approximately 90,000 square feet of retail space and approximately 40 boutique stores and restaurants, including stores by GF Ferre, Nike Golf and Urban Outfitters, restaurants by celebrity chefs Pierro Selvaggio, Hubert Keller and Rick Moonen, and the burlesque

club Forty Deuce.

The Mirage

The Mirage is a luxurious, tropically-themed resort located on a site shared with TI at the center of the Las Vegas Strip. The Mirage is recognized by AAA as a Four Diamond resort. The exterior of the resort is landscaped with palm trees, abundant foliage and more than four acres of lagoons and other water features centered around a 54-foot volcano and waterfall. Each evening, the volcano erupts at regular intervals, with flames that spectacularly illuminate the front of the resort. Inside the front entrance is an atrium with a tropical garden and additional water features capped by a 100-foot-high glass dome, designed to replicate the sights, sounds and fragrances of the South Seas. Located at the rear of the hotel, adjacent to the swimming pool area, is a dolphin habitat featuring Atlantic bottlenose dolphins and *The Secret Garden of Siegfried & Roy*, an attraction that allows guests to view the beautiful exotic animals of Siegfried & Roy, the world-famous illusionists.

The Mirage features a wide array of restaurants, including Kokomos, Fin, Stack, Cravings, and Carnegie Deli. Several of these restaurants have been recently opened or renovated. Entertainment at The Mirage includes a show featuring Danny Gans, the renowned singer/impersonator, in The Danny Gans Theatre. We recently opened Jet, a 16,000-square foot nightclub. We are also constructing a custom theatre for a new Cirque du Soleil production based on the works of The Beatles, scheduled to open in mid-2006. The Mirage also has numerous retail shopping outlets and 170,000 square feet of convention space, including the 90,000-square foot Mirage Events Center.

Luxor

Luxor is an Egyptian-themed hotel and casino complex situated between Mandalay Bay and Excalibur, which are all connected by a tram. Luxor offers 20,000 square feet of convention space, a 20,000-square-foot spa, the RA nightclub, and food and entertainment venues on three different levels beneath a soaring hotel atrium. Above the pyramid s casino, the property offers a special format motion base ride and an IMAX 2D/3D theater. Luxor s other public areas include restaurants, several cocktail lounges and a variety of specialty shops. Recently, the Luxor opened the Broadway hit musical *Hairspray* and added new headline entertainment from comedian Carrot Top.

Treasure Island (TI)

TI is a Caribbean-themed resort located next to The Mirage and also holds the AAA Four Diamond rating. TI and The Mirage are connected by a monorail and a pedestrian bridge links TI to the Fashion Show Mall through a re-designed north entrance. TI features several restaurants, including Dishes, Isla Mexican Kitchen, Kahunaville, and Canter s Deli. Bars and lounges at TI include Mist and Tangerine, which features indoor/outdoor space with views of the Las Vegas Strip and nightly burlesque entertainment. The showroom at TI features *Mystère*, produced and performed by Cirque du Soleil. The Sirens of TI Show is performed at the front of the resort, providing a significant presence to visitors on the Las Vegas Strip and beckoning visitors into TI.

New York-New York

New York-New York is located at the corner of the Las Vegas Strip and Tropicana Avenue. Pedestrian bridges link New York-New York with both MGM Grand Las Vegas and Excalibur. The architecture at New York-New York replicates many of New York City s landmark buildings and icons, including the Statue of Liberty, the Empire State Building, Central Park, the Brooklyn Bridge and a Coney Island-style roller coaster. The casino features highly themed interiors including *Park Avenue* with retail shops, a *Central Park* setting in the central casino area, and *Little Italy* with its traditional food court set inside a typical residential neighborhood. New York-New York also features several restaurants and numerous bars and lounges, including nationally recognized Coyote Ugly and ESPNZone and Nine Fine Irishmen, an authentic Irish Pub. Entertainment includes *Zumanity* by Cirque du Soleil and headline performer Rita Rudner.

Excalibur

Excalibur is a castle-themed hotel and casino complex situated immediately north of Luxor at the corner of the Las Vegas Strip and Tropicana Avenue. Excalibur s public areas include a Renaissance fair, a medieval village, an amphitheater with a seating capacity of nearly 1,000 where mock jousting tournaments and costume drama are presented nightly, two dynamic motion theaters, various artisans booths and medieval games of skill. In addition, Excalibur has a buffet restaurant, several themed restaurants, as well as several snack bars, cocktail lounges and a variety of specialty shops. The property also features a 13,000-square-foot spa. Excalibur, Luxor and Mandalay are connected by a tram, allowing guests to easily travel among these resorts.

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Monte Carlo

Through the acquisition of Mandalay we now own 100% of Monte Carlo, which is located on the Las Vegas Strip adjacent to New York-New York. Monte Carlo has a palatial style reminiscent of the Belle Époque, the French Victorian architecture of the late 19th century. The resort has amenities such as fine dining at Andre s, a brew pub featuring live entertainment, a health spa, a beauty salon, and a 1,200-seat theatre featuring the world-renowned magician Lance Burton.

Circus Circus Las Vegas

Circus Circus Las Vegas is a circus-themed hotel and casino complex situated on the north end of the Las Vegas Strip. From a Big Top above the casino, Circus Circus Las Vegas offers its guests a variety of circus acts performed daily, free of charge. A mezzanine area overlooking the casino has a circus midway with carnival-style games and an arcade that offers a variety of amusements and electronic games. Specialty restaurants, a buffet, a coffee shop, snack bars, several cocktail bars and a variety of specialty shops are also available to guests. The Adventuredome, covering approximately five acres, offers theme park entertainment that includes thrills rides for adults and children, themed carnival-style midway games, an arcade, food kiosks and souvenir shops, all in a climate-controlled setting under a giant space-frame dome.

Primm Valley Resorts

The Primm Valley Resorts consist of three hotel-casinos on both sides of Interstate 15 at the California/Nevada state line in Primm, Nevada, approximately 40 miles south of Las Vegas. Buffalo Bill s Resort & Casino, Primm Valley Resort & Casino, Whiskey Pete s Hotel & Casino, Primm Valley Golf Club and three gas stations including the Primm Center (collectively, the Primm Valley Resorts) form a major destination location and offer visitors driving from California the first opportunity to wager upon entering Nevada and the last opportunity before leaving.

Primm Valley Resorts offer an array of amenities and attractions, including a 25,000-square foot conference center, numerous restaurants, and a variety of amusement rides. The 6,100-seat Star of the Desert Arena hosts top-name entertainers. Connected to Primm Valley Resorts is the Fashion Outlet of Las Vegas, a shopping mall containing approximately 400,000 square feet of retail space with over 100 retail outlet stores. The Fashion Outlet is owned and operated by a third party.

Circus Circus Reno

Circus Circus Reno is a circus-themed hotel and casino complex situated in downtown Reno, Nevada. Like its sister property in Las Vegas, Circus Circus Reno offers its guests a variety of circus acts performed daily, free of charge. A mezzanine area has a circus midway with carnival-style games and an arcade that offers a variety of amusements and electronic games. The property also has specialty restaurants, a buffet, a coffee shop, a deli/bakery, a snack bar, cocktail lounges, a gift shop and specialty shops.

Silver Legacy

Through a wholly-owned entity, we are a 50% participant with Eldorado Limited Liability Company in Circus and Eldorado Joint Venture, which owns and operates Silver Legacy, a hotel-casino and entertainment complex situated in downtown Reno, Nevada. Silver Legacy is located between Circus Circus Reno and the Eldorado Hotel & Casino, which is owned and operated by an affiliate of our joint venture partner at Silver Legacy. Silver Legacy is connected at the mezzanine level with Circus Circus Reno and the Eldorado by enclosed climate-controlled skyways above the streets between the respective properties. The resort s exterior is themed to evoke images of historical Reno. Silver Legacy features several restaurants and bars, a special events center, custom retail shops, a health spa and an outdoor pool and sun deck.

Gold Strike

This property is an Old West -themed hotel-casino located on the east side of Interstate-15 in Jean, Nevada. Jean is located approximately 25 miles south of Las Vegas and approximately 15 miles north of the California-Nevada state line. The property has, among other amenities, a swimming pool and spa, several restaurants, a banquet center, a gift shop and an arcade. The casino has a stage bar with regularly scheduled live entertainment and a casino bar.

Nevada Landing

Nevada Landing is a turn-of-the-century riverboat-themed hotel-casino located in Jean across Interstate 15 from Gold Strike. Nevada Landing includes a specialty restaurant, a full-service coffee shop, a buffet, a snack bar, a gift shop, a swimming pool and spa and a 300-guest banquet facility.

Colorado Belle

Colorado Belle is situated on the bank of the Colorado River in Laughlin, Nevada, approximately 90 miles south of Las Vegas. Colorado Belle features a 600-foot replica of a Mississippi riverboat, and also includes a buffet, a coffee shop, specialty restaurants, a microbrewery, snack bars and cocktail lounges, as well as a gift shop and other specialty shops.

Edgewater

Edgewater is located adjacent to Colorado Belle along the Colorado River. Edgewater s facilities include a specialty restaurant, a coffee shop, a buffet, a snack bar and cocktail lounges.

Railroad Pass

Railroad Pass is located in Henderson, Nevada, a suburb located southeast of Las Vegas, and is situated along US Highway 93, the direct route between Las Vegas and Phoenix, Arizona. The property includes, among other amenities, full-service restaurants, a buffet, a gift shop, a swimming pool and a banquet facility. In contrast with our other Nevada properties, Railroad Pass caters to local residents, particularly from Henderson and Boulder City.

MGM Grand Detroit

MGM Grand Detroit is our interim casino facility in Detroit, Michigan. MGM Grand Detroit is one of three casinos licensed in Detroit and is operated by MGM Grand Detroit, LLC. MGM Grand Detroit, Inc., our wholly-owned subsidiary, holds a controlling interest in MGM Grand Detroit, LLC. A minority interest in MGM Grand Detroit, LLC is held by Partners Detroit, LLC, a Michigan limited liability company owned by residents and entities located in the Detroit metropolitan area. MGM Grand Detroit s interior is decorated in an Art Deco motif with themed bars, a VIP lounge and several restaurants. The site is conveniently located off the Howard Street exit from the John C. Lodge Expressway in downtown Detroit, and has parking for over 3,000 vehicles in two parking garages and additional on-site covered parking.

Beau Rivage

Beau Rivage sustained significant damage in late August 2005 as a result of Hurricane Katrina and has been closed since. We expect to reopen Beau Rivage in stages beginning in the third quarter of 2006. The damage was primarily concentrated on the lower levels, including the casino, restaurant and retail areas. We intend to rebuild Beau Rivage at its existing beachfront site where Interstate 110 meets the Gulf Coast in Biloxi, Mississippi. When fully reopened, Beau Rivage will include 1,740 guest rooms, over 2,000 slot machines and 90 table games, new and restored restaurants, a state-of-the-art convention center, and pool and spa amenities. Construction is also continuing on a world-class golf course, Fallen Oak, designed by renowned golf course architect Tom Fazio, to be located approximately 20 miles from the resort and scheduled to open in November 2006.

Gold Strike-Tunica

Gold-Strike Tunica is a dockside casino located along the Mississippi River, 20 miles south of Memphis and approximately three miles west of Mississippi State Highway 61, a major north/south highway connecting Memphis with Tunica County. The property features an 800-seat showroom, a coffee shop, a specialty restaurant, a buffet, a snack bar and several cocktail lounges. Gold Strike-Tunica is part of a three-casino development covering approximately 72 acres. The other two casinos are owned and operated by unaffiliated third parties. We also own an undivided one-half interest in an additional 388 acres of land that may be used for future development.

Borgata

The Borgata Hotel Casino and Spa is located at Renaissance Pointe in Atlantic City, New Jersey. In addition to its 2,000 guest rooms and suites and extensive gaming floor, Borgata includes several specialty restaurants, retail shops, a European-style health spa, meeting space and unique entertainment venues. Borgata was the first new casino in Atlantic City in over 13 years when it opened in July 2003. Through a wholly-owned subsidiary, we own 50% of the limited liability company that owns Borgata. Boyd Gaming Corporation (Boyd) owns the other 50% and also operates the resort.

Borgata is currently expanding its gaming and non-gaming amenities, adding 36 casino table games and 500 slot machines, expanding its poker room and race book, and adding additional restaurant, entertainment and other amenities. This $200 million project is expected to be completed in the second quarter of 2006. Additionally, Borgata has plans to add another hotel tower, the Water Club at Borgata, featuring 800 guestrooms and suites, along with a new spa, parking garage and meeting rooms. This $325 million project is expected to be completed in late 2007. Neither project is expected to require contributions from us, as existing operating cash flow and Borgata s recently renegotiated bank credit facility is anticipated to provide for the cost of the expansions.

Grand Victoria

Through wholly-owned entities, we are a 50% participant with RBG, L.P. in an entity which owns Grand Victoria, a Victorian-themed riverboat casino and land-based entertainment complex in Elgin, Illinois, a suburb approximately 40 miles northwest of downtown Chicago. The riverboat offers dockside gaming, which means its operation is conducted at dockside without cruising. The property also features a dockside complex that contains an approximately 83,000-square-foot pavilion with a buffet, a fine dining restaurant, a VIP lounge and a gift shop.

Golf Courses

We own and operate an exclusive world-class golf course, Shadow Creek, designed by Tom Fazio and located approximately ten miles north of our Las Vegas Strip resorts. Shadow Creek is ranked 3rd in Golf Digest s ranking of America s 100 Greatest Public Courses. We also own and operate the Primm Valley Golf Club, located four miles south of the Primm Valley Resorts in California, which includes two 18-hole championship courses. These golf courses were also designed by Tom Fazio.

Future Development

Project CityCenter

In November 2004 we announced a plan to develop a multi-billion dollar urban metropolis, Project CityCenter, on 66 acres of land on the Las Vegas Strip, between Bellagio and Monte Carlo. Project CityCenter will feature a 4,000-room casino resort designed by world-famous architect Cesar Pelli; two 400-room non-gaming boutique hotels, one of which will be managed by luxury hotelier Mandarin Oriental; approximately 470,000 square feet of retail shops, dining and entertainment venues; and approximately 2.3 million square feet of residential space in over 2,900 luxury condominium and condominium-hotel units in multiple towers.

As currently contemplated, we believe Project CityCenter will cost approximately $7 billion, excluding preopening and land costs. After estimated proceeds of $2.5 billion from the sale of residential units, we believe the net project cost will be approximately $4.5 billion. We expect to complete the design work for Project CityCenter in mid-2006 and expect the project to open in 2009. The design, budget and schedule of Project CityCenter are still preliminary, and the ultimate timing, cost and scope of Project CityCenter are subject to risks attendant to large-scale projects.

Detroit, Michigan

MGM Grand Detroit, LLC has operated an interim casino facility in downtown Detroit since July 1999. In August 2002 the Detroit City Council approved revised development agreements with our subsidiary and two other developers. The revised development agreement released us and the City from certain of the obligations under the original agreement and significantly changed other provisions of the original agreement.

In April 2005, the 6th Circuit Court of Appeals lifted its injunction prohibiting commencement of construction of the permanent hotel and casino complexes. We have obtained land and began construction on our permanent facility, which will be located near the site of our interim facility. The permanent facility is expected to open in late 2007 at a cost of approximately $765 million, including land and preopening costs, and will feature a 400-room hotel, 100,000-square foot casino, numerous restaurant and entertainment amenities, and spa and convention facilities. The

complete design, timing and cost of the permanent facility are at a preliminary stage, and are subject to risks attendant to large-scale projects.

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Macau

We own 50% of MGM Grand Paradise Limited, an entity which is developing, and will operate, MGM Grand Macau, a hotel-casino resort in Macau S.A.R. Pansy Ho Chiu-king owns the other 50% of MGM Grand Paradise Limited. MGM Grand Macau will be located on a prime waterfront site and will feature at least 345 table games and 1,035 slots with room for significant expansion. Other features will include a 600-room hotel, a luxurious spa, convertible convention space, a variety of dining destinations, and other attractions. Construction of MGM Grand Macau, which is estimated to cost $1.1 billion including license and land rights and preopening costs, began in the second quarter of 2005 and the resort is anticipated to open in late 2007. The complete design, timing, cost and scope of the project are at a preliminary stage and are subject to the risks attendant to large-scale projects. We have invested $180 million in the venture, and are committed to loaning the venture up to $100 million. The venture has obtained commitments from lenders for a credit facility sufficient, along with equity contributions and shareholder loans, to fund the construction of MGM Grand Macau.

New York Racing Association

We have entered into a definitive agreement with the New York Racing Association (NYRA) to manage video lottery terminals (VLTs) at NYRA s Aqueduct horseracing facility in metropolitan New York. We will assist in the development of the approximately $170 million facility, including providing project financing, and will manage the facility for a term of five years, extended automatically if the financing provided by us is not fully repaid, for a fee. Recent legislative changes will allow us to operate the VLTs past the expiration date of the current NYRA franchise agreement.

Atlantic City, New Jersey

We own approximately 130 acres on Renaissance Pointe in Atlantic City, New Jersey. We lease 10 acres to Borgata under long-term leases for use in its current operations and for its expansion. Of the remaining 120 acres, approximately 72 acres are suitable for development. We lease nine of these acres to Borgata on a short-term basis for surface parking and a portion of the remaining acres consists of common roads, landscaping and master plan improvements which we designed and developed as required by our agreement with Boyd. We own an additional 15 developable acres in the Marina District near Renaissance Pointe.

We must apply for and receive numerous governmental permits and satisfy other conditions before construction of a new resort on the Renaissance Pointe site could begin. No assurance can be given that we will develop a casino resort in New Jersey, or its ultimate schedule, size, configuration or cost if we do develop a casino resort.

United Kingdom

We continue to pursue development opportunities in the United Kingdom. We have entered into agreements or have formed strategic alliances with several companies in order to further these development efforts. We are currently pursuing opportunities in Birmingham, Glasgow, Newcastle and Sheffield. These opportunities are subject to certain conditions, including obtaining regional casino licenses and regulatory approvals, and the implementation of an acceptable tax regime. The Gambling Act 2005 includes authorization for only one initial regional casino (unlimited table games and a maximum of 1,250 slot machines) and eight large casinos (unlimited table games and a maximum of 150 slot machines), a significant reduction from previous proposals. The Gambling Act 2005 allows for an increase in the number of regional casinos, but it is uncertain whether more regional casinos will be approved in the near term.

Singapore

In 2005 we agreed to form a joint venture with CapitaLand, a listed company in Singapore, to pursue one of two gaming licenses in Singapore. We will own 60% of the joint venture and would manage the resort. In April 2005, we and our partner CapitaLand, together with 11 other applicants, were successful in qualifying for the second round of the proposal process for the development of an integrated resort complex in the Marina Bayfront of Singapore. The Singapore government issued the request for proposals in the fourth quarter of 2005 and we are in the process of preparing our proposal response. Only three other bidders have indicated they expect to submit responses for the Marina site.

Other

We regularly evaluate possible expansion and acquisition opportunities in both the domestic and international markets. These opportunities may include the ownership, management and operation of gaming and other entertainment facilities in Nevada or in states other than Nevada or outside of the United States. We may undertake these opportunities either alone or in cooperation with one or more third parties. Development and operation of any gaming facility in a new jurisdiction is subject to many contingencies. Several of these contingencies are outside of our control and may include the passage of appropriate gaming legislation, the issuance of necessary permits, licenses and approvals, the availability of appropriate financing and the satisfaction of other conditions. We cannot be sure that we will decide or be able to proceed with any acquisition or expansion opportunities.

Operations

We operate primarily in one segment, the operation of casino resorts, which includes offering gaming, hotel, dining, entertainment, retail and other resort amenities. Giving effect to the Mandalay merger, over half of our net revenue is now derived from non-gaming activities, a higher percentage than many of our competitors, as our operating philosophy is to provide a complete resort experience for our guests, including non-gaming amenities which command a premium price based on their quality. We believe that we own several of the premier casino resorts in the world, and a main focus of our strategy is to continually reinvest in these resorts to maintain our competitive advantage.

As a resort-based company, our operating results are highly dependent on the volume of customers at our resorts, which in turn impacts the price we can charge for our hotel rooms and other amenities. We also generate a significant portion of our operating income from the high-end gaming segment, which can cause variability in our results.

Most of our revenue is essentially cash-based, through customers wagering with cash or paying for non-gaming services with cash or credit cards. Our resorts, like many in the industry, generate significant operating cash flow. Our industry is capital intensive and we rely heavily on the ability of our resorts to generate operating cash flow to repay debt financing, fund maintenance capital expenditures and provide excess cash for future development.

Our results of operations do not tend to be seasonal in nature, though a variety of factors can affect the results of any interim period, including the timing of major Las Vegas conventions, the amount and timing of marketing and special events for our high-end customers, and the level of play during major holidays, including New Year and Chinese New Year. Our significant convention and meeting facilities allow us to maximize hotel occupancy and customer volumes during off-peak times such as mid-week or during traditionally slower leisure travel periods, which also leads to better labor utilization.

All of our casino resorts operate 24 hours each day, every day of the year, with the exception of Grand Victoria which operates 22 hours a day, every day of the year. Our primary casino operations are owned and managed by us. Other resort amenities may be owned and operated by us, owned by us but managed by third parties for a fee, or leased to third parties. We generally have an operating philosophy that prefers ownership of amenities, since guests have direct contact with staff in these areas and we prefer to control all aspects of the guest experience. However, we do lease space to retail and food and beverage operators in certain situations, particularly for branding opportunities. We also operate many managed outlets, utilizing third party management for specific expertise in areas such as restaurants and nightclubs, as well as for branding opportunities. Since we believe that the number of walk-in customers also affects the success of our casino resorts, we design our facilities to maximize their attraction to guests of other hotels.

We utilize technology to maximize revenue and efficiency in our operations. We are in the process of combining our Players Club with Mandalay s One Club program. When the process is complete, Players Club will link our major resorts, and consolidate all slots and table games activity for customers with a Players Club account. Under the combined program, customers will qualify for benefits across all of these resorts, regardless of where they play. We believe that our Players Club enables us to more effectively market to our customers. A significant portion of the slot machines at our resorts operate with International Game Technology s EZ-Pay cashless gaming system, including the Mandalay resorts where we recently converted many of the slot machines to EZ-Pay . We believe that this system enhances the customer experience and increases the revenue potential of our slot machines.

Technology is a critical part of our strategy in non-gaming operations and administrative areas as well. Our hotel systems include yield management modules which allow us to maximize occupancy and room rates. Additionally, these systems capture most charges made by our customers during their stay, including allowing customers of any of our resorts to charge meals and services at other MGM MIRAGE resorts to their hotel accounts. We are implementing a new hotel management system at all our resorts in 2006 and 2007, which we expect will enhance our guest service and improve our yield management across our portfolio of resorts.

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Marketing and Competition

General

Our casino resorts generally operate in highly competitive environments. We compete against other gaming companies as well as other hospitality and leisure and business travel companies. Our primary methods of competing successfully in a competitive environment include:

- Locating our resorts in desirable leisure and business travel markets, and operating at superior sites within those markets.
- Constructing and maintaining high-quality resorts and facilities, including luxurious guestrooms along with premier dining, entertainment and retail amenities;
- Recruiting, training and retaining well-qualified and motivated employees who provide superior and friendly customer service;
- Providing unique, must-see entertainment attractions; and
- Developing distinctive and memorable marketing and promotional programs.

Customers and Competition

Our Las Vegas casino resorts compete for customers with a large number of other hotel-casinos in the Las Vegas area, including major hotel-casinos on or near the Las Vegas Strip, major hotel-casinos in the downtown area, which is about five miles from the center of the Strip, and several major facilities elsewhere in the Las Vegas area. According to the Las Vegas Convention and Visitors Authority, there were approximately 133,200 guestrooms in Las Vegas at December 31, 2005, up 1% from approximately 131,500 rooms at December 31, 2004. Las Vegas visitor volume was 38.6 million in 2005, a 3% increase from the 37.4 million reported for 2004. The principal segments of the Las Vegas gaming market are leisure travel, premium gaming customers, conventions, including small meetings and corporate incentive programs, and tour and travel. Our high-end properties, which include Bellagio, MGM Grand Las Vegas, Mandalay Bay, and The Mirage, appeal to the upper end of each market segment, balancing their business by using the convention and tour and travel segments to fill the mid-week and off-peak periods. Our marketing strategy for TI, New York-New York, Luxor and Monte Carlo is aimed at attracting middle- to upper-middle-income wagerers, largely from the leisure travel and, to a lesser extent, the tour and travel segments. Excalibur and Circus Circus Las Vegas generally cater to the value-oriented and middle-income leisure travel and tour and travel segments.

Outside Las Vegas, our other wholly-owned Nevada operations, including those in Reno and Laughlin, compete with each other and with many other similar sized and larger operations. A significant portion of our customers at these resorts come from California. We believe the expansion of Native American gaming has had a negative impact on all of our Nevada resorts not located on the Las Vegas Strip, and the anticipated additional expansion in California could have a further adverse effect on these resorts. Our Nevada resorts not located in Las Vegas appeal primarily to middle-income customers attracted by room, food and beverage and entertainment prices that are lower than those offered by major Las Vegas hotel-casinos. Our target customer for these resorts is the value-oriented leisure traveler and the value-oriented local customer.

Outside Nevada, our wholly-owned resorts mainly compete for customers in local gaming markets, where location is a critical success factor. In Tunica, Mississippi, one of our competitors is closer to Memphis, the area s principal market. In addition, we compete with gaming operations in surrounding jurisdictions and other leisure destinations in each region. For instance, in Detroit, Michigan we also compete with a casino in nearby Windsor, Canada. In Biloxi, Mississippi we also compete with regional riverboat and land-based casinos in Louisiana, Native American casinos in central Mississippi, the south Florida leisure market, and with casinos in the Bahamas.

Our unconsolidated affiliates mainly compete for customers against casino resorts in their respective markets, and in some cases against our wholly-owned operations. Much like our wholly-owned resorts, our unconsolidated affiliates compete through the quality of amenities, the value of the experience offered to guests, and the location of their resorts.

Our Company s facilities also compete for gaming customers with hotel-casino operations located in other areas of the United States and other parts of the world, and for leisure and business travelers with non-gaming tourist destinations such as Hawaii, Florida and cruise ships. Our hotel-casinos compete to a lesser extent with state-sponsored lotteries, off-track wagering, card parlors, and other forms of legalized gaming in the United States.

Marketing

We advertise on radio, television and billboards and in newspapers and magazines in selected cities throughout the United States and overseas, as well as on the Internet and by direct mail. We also advertise through our regional marketing offices located in major United States and foreign cities. A key element of marketing to premium gaming customers is personal contact by our marketing personnel. Direct marketing is also important in the convention segment. We maintain Internet websites which inform customers about our resorts and allow our customers to reserve hotel rooms and make restaurant and show reservations. We also operate call centers to allow customer contact by phone to make hotel, restaurant and show reservations.

We utilize our world-class golf courses in marketing programs at our Las Vegas Strip and other Nevada resorts. Our major Las Vegas resorts offer luxury suite packages that include golf privileges at Shadow Creek. In connection with our marketing activities, we also invite our premium gaming customers to play Shadow Creek on a complimentary basis. We use Primm Valley Golf Club for marketing purposes at our Las Vegas and Primm resorts, including offering room and golf packages at special rates.

Competitive Risks

The principal negative factors relating to our competitive position are:

- Our limited geographic diversification-our major resorts are concentrated on the Las Vegas Strip and some of our largest competitors operate in more gaming markets than we do;
- There are a number of gaming facilities located closer to where our customers live than our resorts;
- Our guestroom, dining and entertainment prices are often higher than those of most of our competitors in each market, although we believe that the quality of our facilities and services is also higher;
- Our hotel-casinos compete to some extent with each other for customers. Bellagio, MGM Grand Las Vegas, Mandalay Bay and The Mirage, in particular, compete for some of the same premium gaming customers; and
- Additional new hotel-casinos and expansion projects at existing Las Vegas hotel-casinos are under construction or have been proposed. We are unable to determine to what extent increased competition will affect our future operating results.

Control Over Gaming Activities

General

In connection with the supervision of gaming activities at our casinos, we maintain stringent controls on the recording of all receipts and disbursements. These controls include:

- Locked cash boxes on the casino floor;
- Daily cash and coin counts performed by employees who are independent of casino operations;
- Constant observation and supervision of the gaming area;
- Observation and recording of gaming and other areas by closed-circuit television;
- Constant computer monitoring of our slot machines; and
- Timely analysis of deviations from expected performance.

Issuance of Markers

Marker play represents a significant portion of the table games volume at Bellagio, MGM Grand Las Vegas, Mandalay Bay and The Mirage. Our other facilities do not emphasize marker play to the same extent, although we offer markers to customers at certain of those casinos as well.

We maintain strict controls over the issuance of markers and aggressively pursue collection from those customers who fail to pay their marker balances timely. These collection efforts are similar to those used by most large corporations when dealing with overdue customer accounts, including the mailing of statements and delinquency notices, personal contacts, the use of outside collection agencies and civil litigation. A significant portion of our Company s accounts receivable, for amounts unpaid resulting from markers which are not collectible through banking channels, is owed by major casino customers from the Far East. The collectibility of unpaid markers is affected by a number of factors, including changes in currency exchange rates and economic conditions in the customers home countries.

In Nevada, Mississippi, Michigan, and Illinois, amounts owed for markers which are not timely paid are enforceable under state laws. All other states are required to enforce a judgment for amounts owed for markers entered into in Nevada, Mississippi, Illinois or Michigan which are not timely paid, pursuant to the Full Faith and Credit Clause of the United States Constitution. Amounts owed for markers which are not timely paid are not legally enforceable in some foreign countries, but the United States assets of foreign customers may be reached to satisfy judgments entered in the United States.

Employees and Labor Relations

As of December 31, 2005, we had approximately 54,500 full-time and 12,000 part-time employees. At that date, we had collective bargaining contracts with unions covering approximately 29,000 of our employees. We consider our employee relations to be good.

Regulation and Licensing

The gaming industry is highly regulated, and we must maintain our licenses and pay gaming taxes to continue our operations. Each of our casinos is subject to extensive regulation under the laws, rules and regulations of the jurisdiction where it is located. These laws, rules and regulations generally concern the responsibility, financial stability and character of the owners, managers, and persons with financial interest in the gaming operations. Violations of laws in one jurisdiction could result in disciplinary action in other jurisdictions. A more detailed description of the regulations to which we are subject is contained in Exhibit 99 to this Annual Report on Form 10-K, which Exhibit is incorporated herein by reference.

Our businesses are subject to various federal, state and local laws and regulations in addition to gaming regulations. These laws and regulations include, but are not limited to, restrictions and conditions concerning alcoholic beverages, environmental matters, employees, currency transactions, taxation, zoning and building codes, and marketing and advertising. Such laws and regulations could change or could be interpreted differently in the future, or new laws and regulations could be enacted. Material changes, new laws or regulations, or material differences in interpretations by courts or governmental authorities could adversely affect our operating results.

Forward-looking Statements

(Cautionary Statements Under the Private Securities Litigation Reform Act of 1995)

This Form 10-K and our 2005 Annual Report to Stockholders contain some forward-looking statements. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They contain words such as anticipate, estimate, expect, project, intend, plan, believe, may, could, might and other words or p
meaning in connection with any discussion of future operating or financial performance. In particular, these include statements relating to future actions, new projects, future performance, the outcome of contingencies such as legal proceedings and future financial results. From time to time, we also provide oral or written forward-looking statements in our Forms 10-Q and 8-K, press releases and other materials we release to the public. Any or all of our forward-looking statements in this Form 10-K, in our 2005 Annual Report to Stockholders and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in this Form 10-K for example, government regulation and the competitive environment will be important in determining our future results. Consequently, no forward-looking statement can be guaranteed. Our actual future results may differ materially.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Forms 10-K, 10-Q and 8-K reports to the Securities and Exchange Commission. Also note that we provide the following discussion of risks, uncertainties and possible inaccurate assumptions relevant to our business. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

You should also be aware that while we from time to time communicate with securities analysts, we do not disclose to them any material non-public information, internal forecasts or other confidential business information. Therefore, you should not assume that we agree with any statement or report issued by any analyst, irrespective of the content of the statement or report. To the extent that reports issued by securities analysts contain projections, forecasts or opinions, those reports are not our responsibility.

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Factors that May Affect Our Future Results

You should be aware that the occurrence of any of the events described in this section and elsewhere in this report or in any other of our filings with the SEC could have a material adverse effect on our business, financial position, results of operations and cash flows. In evaluating us, you should consider carefully, among other things, the risks described below.

We have significant indebtedness. At December 31, 2005, we had approximately $12.4 billion of indebtedness. The interest rate on a large portion of our long-term debt will be subject to fluctuation based on changes in short-term interest rates and the level of debt-to-EBITDA (as defined) under the provisions of our senior credit facility. Our current bank credit agreements and the indentures governing our debt securities do not prohibit us from borrowing additional funds in the future. Our interest expense could increase as a result of these factors. Additionally, our indebtedness could increase our vulnerability to general adverse economic and industry conditions, limit our flexibility in planning for or reacting to changes in our business and industry, limit our ability to borrow additional funds and place us at a competitive disadvantage compared to other less leveraged competitors. Our ability to reduce our outstanding debt will be subject to our future cash flows, other capital requirements and other factors, some of which are not within our control.

Our casinos in Las Vegas and elsewhere are destination resorts that compete with other destination travel locations throughout the United States and the world. We do not believe that our competition is limited to a particular geographic area, and gaming operations in other states or countries could attract our customers. To the extent that new casinos enter our markets or hotel room capacity is expanded by others in major destination locations, competition will increase. Major competitors, including new entrants, have either recently expanded their hotel room capacity or are currently expanding their capacity or constructing new resorts in Las Vegas. Also, the recent growth of gaming in areas outside Las Vegas, including California, has increased the competition faced by our operations in Las Vegas and elsewhere. In particular, as large scale gaming operations in Native American tribal lands increase, competition will increase.

The expansion of Native American gaming in California has already impacted our operations. According to the California Gambling Control Commission, more than 60 compacts with tribes had been approved by the federal government as of December 31, 2005, with more than 50 of the tribes legally operating casinos in California in accordance with these compacts. Additional expansion of gaming in California could have an adverse impact on our results of operations.

The ownership and operation of gaming facilities are subject to extensive federal, state and local laws, regulations and ordinances, which are administered by the relevant regulatory agencies in each jurisdiction. These laws, regulations and ordinances vary from jurisdiction to jurisdiction, but generally concern the responsibility, financial stability and character of the owners and managers of gaming operations as well as persons financially interested or involved in gaming operations. As such, our gaming regulators can require us to disassociate ourselves from suppliers or business partners found unsuitable by the regulators. For a summary of gaming regulations that affect our business, see Regulation and Licensing. The regulatory environment in any particular jurisdiction may change in the future and any such change could have a material adverse effect on our results of operations. In addition, we are subject to various gaming taxes, which are subject to possible increase at any time. For instance, the gaming tax rate in Michigan was increased in 2004.

Our business is affected by economic and market conditions in the markets in which we operate and in the locations our customers reside. Bellagio, MGM Grand Las Vegas, Mandalay Bay and The Mirage are particularly affected by economic conditions in the Far East, and all of our Nevada resorts are affected by economic conditions in the United States, and California in particular. A recession or economic slowdown could cause a reduction in visitation to our resorts, which would adversely affect our operating results.

Certain of our casino properties are located in areas that may be subject to extreme weather conditions, including, but not limited to, hurricanes. Such extreme weather conditions may interrupt our operations, damage our properties, and reduce the number of customers who visit our facilities in such areas. Although we maintain both property and business interruption insurance coverage for certain extreme weather conditions, such coverage is subject to deductibles and limits on maximum benefits, including limitation on the coverage period for business interruption, and we cannot assure you that we will be able to fully insure such losses or fully collect, if at all, on claims resulting from such extreme weather conditions. Furthermore, such extreme weather conditions may interrupt or impede access to our affected properties and may cause visits to our affected properties to decrease for an indefinite period. For example, in August 2005, Hurricane Katrina caused significant damage to our Beau Rivage resort. See Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Statement Impact of Hurricane Katrina.

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We are a large consumer of electricity and other energy. Accordingly, increases in energy costs, such as those experienced recently may have a negative impact on our operating results. Additionally, higher energy and gasoline prices which affect our customers may result in reduced visitation to our resorts and a reduction in our revenues. For example, Nevada Power, which supplies power to our Las Vegas resorts, recently submitted a rate request which would significantly increase our cost of electricity at those resorts.

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Executive Officers of the Registrant

The following table sets forth, as of March 1, 2006, the name, age and position of each of our executive officers. Executive officers are elected by and serve at the pleasure of the Board of Directors.

Name	Age	Position
J. Terrence Lanni	62	Chairman and Chief Executive Officer
James J. Murren	44	President, Chief Financial Officer, Treasurer and Director
John T. Redmond	47	President and Chief Executive Officer of MGM Grand Resorts, LLC and Director
Robert H. Baldwin	55	President and Chief Executive Officer of Mirage Resorts, Incorporated, President of Project CityCenter and Director
Gary N. Jacobs	60	Executive Vice President, General Counsel, Secretary and Director
Glenn D. Bonner	54	Senior Vice President and Chief Information Officer
Daniel J. D Arrigo	37	Senior Vice President Finance
Alan Feldman	47	Senior Vice President Public Affairs
Bruce Gebhardt	58	Senior Vice President Global Security
Phyllis A. James	53	Senior Vice President and Senior Counsel
Punam Mathur	45	Senior Vice President Corporate Diversity and Community Affairs
Cynthia Kiser Murphey	48	Senior Vice President Human Resources
Shawn T. Sani	40	Senior Vice President Taxes
Robert C. Selwood	50	Senior Vice President Accounting
Bryan L. Wright	42	Senior Vice President, Assistant General Counsel and Assistant Secretary

Mr. Lanni has served as Chairman of the Company since July 1995. He served as Chief Executive Officer of the Company from June 1995 to December 1999, and since March 2001. Prior thereto, he served in various executive capacities at Caesars World, Inc., including its President and Chief Operating Officer from 1981 to 1995.

Mr. Murren has served as President of the Company since December 1999, as Chief Financial Officer since January 1998 and as Treasurer since November 2001. He served as Executive Vice President of the Company from January 1998 to December 1999. Prior thereto, he was Managing Director and Co-Director of Research for Deutsche Morgan Grenfell, having served that firm in various other capacities since 1984.

Mr. Redmond has served as President and Chief Executive Officer of MGM Grand Resorts, LLC since March 2001. He served as Co-Chief Executive Officer of the Company from December 1999 to March 2001. He served as President and Chief Operating Officer of Primadonna Resorts from March 1999 to December 1999. He served as Vice Chairman of MGM Grand Detroit, LLC from April 1998 to February 2000, and as its Chairman since February 2000. He served as Senior Vice President of MGM Grand Development, Inc. from August 1996 to September 1998. Prior thereto, he was Senior Vice President and Chief Financial Officer of Caesars World, Inc. s Caesars Palace and Desert Inn hotel-casinos and served in various other senior operational and development positions with Caesars World, Inc.

Mr. Baldwin has served as President and Chief Executive Officer of Mirage Resorts since June 2000 and as President of Project CityCenter since March 2005. He served as Chief Financial Officer and Treasurer of Mirage Resorts from September 1999 to June 2000. He was President and Chief Executive Officer of Bellagio, LLC from June 1996 to March 2005. He served as President and Chief Executive Officer of The Mirage from August 1987 to April 1997.

Mr. Jacobs has served as Executive Vice President and General Counsel of the Company since June 2000 and as Secretary since January 2002. Prior thereto, he was a partner with the law firm of Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP, and is currently of counsel to that firm.

Mr. Bonner has served as Senior Vice President and Chief Information Officer of the Company since January 2005. He served as Vice President Chief Information Officer of the Company from June 2000 to January 2005. He served as Chief Information Officer of Mirage Resorts from January 1997 to May 2000. Prior thereto, he was a Managing Consultant with Microsoft Corporation from October 1994 to January 1997.

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Mr. D Arrigo has served as Senior Vice President Finance of the Company since February 2005. He served as Vice President Finance of the Company from December 2000 to February 2005. He served as Assistant Vice President of the Company from January 2000 to December 2000. Prior thereto, he served as Director of Corporate Finance of the Company from January 1997 to January 2000 and as Manager of Corporate Finance of the Company from October 1995 to January 1997.

Mr. Feldman has served as Senior Vice President Public Affairs of the Company since September 2001. He served as Vice President Public Affairs of the Company from June 2000 to September 2001, and served as Vice President of Public Affairs for Mirage Resorts from March 1990 to May 2000.

Mr. Gebhardt has served as Senior Vice President Global Security of the Company since November 2004. Prior thereto, he served as a Special Agent of the Federal Bureau of Investigation for over 30 years, and was the FBI s Deputy Director for two years prior to his retirement in October 2004.

Ms. James has served as Senior Vice President and Senior Counsel of the Company since March 2002. From 1994 to 2001 she served as Corporation (General) Counsel and Law Department Director for the City of Detroit. In that capacity she also served on various public and quasi-public boards and commissions on behalf of the City, including the Election Commission, the Detroit Building Authority and the Board of Ethics. Prior thereto, from 1985 until 1994, she practiced law as a partner with the firm of Pillsbury, Madison & Sutro.

Ms. Mathur has served as Senior Vice President Corporate Diversity and Community Affairs of the Company since May 2004. She served as Vice President Corporate Diversity and Community Affairs of the Company from December 2001 to May 2004. She served as Vice President Community Affairs of the Company from November 2000 to December 2001 and as Director of Community Affairs of the Company from June 2000 to October 2000. She served as Director of Community Affairs of Mirage Resorts from April 1996 to May 2000.

Ms. Murphey has served as Senior Vice President Human Resources of the Company since November 2000. She served as Senior Vice President Human Resources and Administration of MGM Grand Las Vegas from November 1995 to October 2000.

Mr. Sani has served as Senior Vice President Taxes of the Company since July 2005. He served as Vice President Taxes of the Company from June 2002 to July 2005. Prior thereto he was a partner in the Transaction Advisory Services practice of Arthur Andersen LLP, having served that firm in various other capacities since 1988.

Mr. Selwood has served as Senior Vice President Accounting of the Company since February 2005. He served as Vice President Accounting of the Company from December 2000 to February 2005. He served as Director of Corporate Finance of Mirage Resorts from April 1993 to December 2000.

Mr. Wright has served as Senior Vice President and Assistant General Counsel of the Company since March 2005. He served as Vice President and Assistant General Counsel of the Company from July 2001 to March 2005. He has served as Assistant Secretary of the Company since January 2002. Prior to joining the Company, Mr. Wright served as Vice President and Assistant General Counsel of Boyd Gaming Corporation from February 2000 to July 2001 and as Associate General Counsel of Boyd Gaming Corporation from September 1993 to February 2000.

Available Information

We maintain a website, www.mgmmirage.com, which includes financial and other information for investors. We provide access to our SEC filings on our website, free of charge, through a link to the SEC s EDGAR database. Through that link, our filings are available as soon as reasonably practicable after we file the documents.

ITEM 1A. RISK FACTORS

We incorporate by reference the information appearing under Factors that May Affect Our Future Results in Item 1 of this Form 10-K .

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

Our principal executive offices are located at Bellagio. The following table lists our significant land holdings. Unless otherwise indicated, all properties are wholly-owned.

Name and Location	Approximate Acres	Notes
Las Vegas, Nevada operations:		
Bellagio	78	One acre is subject to a ground lease that expires (giving effect to our options to renew) in 2073.
MGM Grand Las Vegas	104	
Mandalay Bay	100	
The Mirage	100	Site is shared with TI.
Luxor	60	
TI	NA	See The Mirage.
New York-New York	24	Approximately 2 acres will be used for the Project CityCenter residential sales office.
Excalibur	52	
Monte Carlo	28	Approximately 4 acres will be used for Project CityCenter.
Circus Circus Las Vegas	69	Includes Slots-a-Fun.
Shadow Creek Golf Course	240	
Other Nevada operations:		
Circus Circus Reno	7	A portion of the site is subject to two ground leases, which expire in 2032 and 2033, respectively.
Primm Valley Resorts	143	Substantially all leased under a ground lease that expires (giving effect to our renewal option) in 2068.
Primm Valley Golf Club	448	Located in California, 4 miles from the Primm Valley Resorts.
Laughlin properties	38	Colorado Belle occupies 22 acres; Edgewater occupies 16 acres.
Jean, Nevada properties	106	Gold Strike occupies 51 acres; Nevada Landing occupies 55 acres.
Railroad Pass, Aenderson, Nevada	9	
Other domestic operations:		
MGM Grand Detroit	8	
Beau Rivage, Biloxi, Mississippi	41	Includes 10 acres of tidelands leased from the State of Mississippi under a lease that expires (giving effect to our option to renew) in 2049.
Gold Strike, Tunica, Mississippi	24	
Other land:		
Las Vegas Strip central	66	Future site of Project CityCenter; includes the site of the former Boardwalk.

	10	Located immediately behind New York-New York; a portion of this site will be used for temporary facilities related to construction of Project CityCenter.
Las Vegas Strip south	20	Located immediately south of Mandalay Bay.
	15	Located across the Las Vegas Strip from Luxor.
North Las Vegas, Nevada	66	Located adjacent to Shadow Creek.
Henderson, Nevada	47	Adjacent to Railroad Pass.
Primm, Nevada	141	Approximately 16 acres immediately north of Buffalo Bill s and approximately 125 acres adjacent to Primm Valley Golf Club.
Jean, Nevada	61	Located adjacent to Gold Strike.
Sloan, Nevada	89	
Detroit, Michigan	25	Future site of permanent MGM Grand Detroit casino.
Biloxi, Mississippi	508	Future site of Fallen Oak Golf Course.
Tunica, Mississippi	388	We own an undivided 50% interest in this site with another, unaffiliated, gaming company.
Atlantic City, New Jersey	153	Approximately 19 acres are leased to Borgata, including nine acres under a short-term lease. Of the remaining land, approximately 77 acres are suitable for development.

Prior to February 2005, substantially all of the Company s assets other than assets of its foreign subsidiaries and certain assets in use at MGM Grand Detroit were pledged as collateral for our senior notes and principal credit facilities. As a result of the redemption of our 6.875% Senior Notes due February 2008 and the repayment of our 6.95% senior notes due February 2005, we applied for, and received, release of collateral under our credit facility and senior notes.

We have contributed approximately 7 acres of land adjacent to MGM Grand Las Vegas to ventures formed with Turnberry Associates to develop The Signature at MGM Grand. The land is collateralized by construction financing for Towers 1 and 2 in the amount of up to $440 million. As of December 31, 2005, $121 million was outstanding under the construction financing.

Silver Legacy occupies approximately 5 acres in Reno, Nevada, adjacent to Circus Circus Reno. The site is collateralized by a mortgage securing Silver Legacy s senior credit facility and 10.125% mortgage notes. As of December 31, 2005, $160 million of principal of the 10.125% mortgage notes were outstanding.

Primm Valley Resorts are not served by a municipal water system. We have rights to water in various wells located on federal land in the vicinity of the Primm Valley Resorts and have received permits to pipe the water to the Primm Valley Resorts. These permits and rights are subject to the jurisdiction and ongoing regulatory authority of the U.S. Bureau of Land Management, the States of Nevada and California and local governmental units. We believe that adequate water for the Primm Valley Resorts is available; however, we cannot be certain that the future needs will be within the permitted allowance. Also, we can give no assurance that any future requests for additional water will be approved or that no further requirements will be imposed by governmental agencies on our use and delivery of water for the Primm Valley Resorts.

Borgata occupies approximately 46 acres at Renaissance Pointe, including 19 acres we lease to Borgata. Borgata owns approximately 27 acres which are collateralized by a mortgage securing bank credit facilities in the amount of up to $750 million. As of December 31, 2005, $342 million was outstanding under the bank credit facility.

We also own or lease various other improved and unimproved property in Las Vegas and other locations in the United States and certain foreign countries.

ITEM 3. LEGAL PROCEEDINGS

Poulos Slot Machine Litigation

On April 26, 1994, an individual filed a complaint in a class action lawsuit in the United States District Court for the Middle District of Florida against 41 manufacturers, distributors and casino operators of video poker and electronic slot machines, including the Company. On May 10, 1994, another plaintiff filed a complaint in a class action lawsuit alleging substantially the same claims in the same court against 48 defendants, including the Company. On September 26, 1995, another plaintiff filed a complaint in a class action lawsuit alleging substantially the same claims in the United States District Court for the District of Nevada against 45 defendants, including the Company. The court consolidated the three cases in the United States District Court for the District of Nevada.

The consolidated complaint claims that we and the other defendants have engaged in a course of fraudulent and misleading conduct intended to induce people to play video poker and electronic slot machines based on a false belief concerning how the gaming machines operate, as well as the chances of winning. Specifically, the plaintiffs allege that the gaming machines are not truly random as advertised to the public, but are pre-programmed in a predictable and manipulative manner. The complaint alleges violations of the Racketeer Influenced and Corrupt Organizations Act, as well as claims of common law fraud, unjust enrichment and negligent misrepresentation, and asks for unspecified compensatory and punitive damages. In December 1997, the court granted in part and denied in part the defendants motions to dismiss the complaint for failure to state a claim and ordered the plaintiffs to file an amended complaint, which they filed in February 1998. We, along with most of the other defendants, answered the amended complaint and continue to deny the allegations contained in the amended complaint. The parties have fully briefed the issues regarding class certification, which are currently pending before the court.

In June 2002, the U.S. District Court in Nevada ruled that the plaintiffs met certain prerequisite requirements for class action status, but the court denied the plaintiffs motion for class action certification, on the grounds that the proposed class lacked the cohesiveness required to settle common claims against the casino industry. The court had previously stayed discovery pending resolution of these class certification issues. In August 2004, the Ninth Circuit Court of Appeals affirmed the District Court s ruling denying class action status for the case. In November 2004, the District Court set a discovery deadline of April 2005 and trial in September 2005. After plaintiffs dismissal of certain operator and cruise ship defendants, the remaining defendants in April 2005 filed dispositive motions for summary judgment. In September 2005, the District Court entered an order granting summary judgment to all defendants that remained in the case on all of plaintiffs claims, dismissed the case in its entirety and entered judgment in favor of defendants. In October 2005, plaintiffs filed an appeal to the Ninth Circuit Court of Appeals of the judgment granting summary judgment to defendants, and of two prior discovery orders that had been entered in the case. The appeal remains pending.

Boardwalk Shareholder Litigation

On September 28, 1999, a former stockholder of our subsidiary which owns and, until January 2006 operated, the Boardwalk Hotel and Casino filed a first amended complaint in a putative class action lawsuit in District Court for Clark County, Nevada against Mirage Resorts and certain former directors and principal stockholders of the Boardwalk subsidiary. The complaint alleged that Mirage Resorts induced the other defendants to breach their fiduciary duties to Boardwalk s minority stockholders by devising and implementing a scheme by which Mirage Resorts acquired Boardwalk at significantly less than the true value of its shares. The complaint sought an unspecified amount of compensatory damages from Mirage Resorts and punitive damages from the other defendants, whom we are required to defend and indemnify.

In June 2000, the court granted our motion to dismiss the complaint for failure to state a claim upon which relief may be granted. The plaintiff appealed the ruling to the Nevada Supreme Court. The parties filed briefs with the Nevada Supreme Court, and oral arguments were conducted in October 2001. In February 2003, the Nevada Supreme Court overturned the District Court s order granting our motion to dismiss the complaint and remanded the case to the District Court for further proceedings on the elements of the lawsuit involving wrongful conduct in approving the merger and/or in the valuation of the merged corporation s shares. The Nevada Supreme Court affirmed the District Court s dismissal of the plaintiff s claims for lost profits and mismanagement. The Nevada Supreme Court s ruling relates only to the District Court s ruling on our motion to dismiss and is not a determination of the merits of the plaintiff s case. The plaintiff filed an amended complaint, and in November 2003, the District Court certified the action as a class action.

In March 2005, the District Court for Clark County, Nevada granted summary judgment in our favor. In May 2005 plaintiffs filed an appeal of the dismissal to the Nevada Supreme Court. At a mediation conference mandated by court rule, the parties reached a settlement agreement on terms favorable to us, which is in the process of documentation and is subject to final approval by the Nevada Supreme Court.

Mandalay Resort Group Shareholder Litigation

On April 25, 2005, the Company consummated its acquisition of Mandalay pursuant to an Agreement and Plan of Merger, dated as of June 15, 2004 (the Merger Agreement), among the Company, MGM MIRAGE Acquisition Co. #61, a Nevada corporation, that was a wholly-owned subsidiary of the Company (Merger Sub), and Mandalay. The acquisition was effected by merging Merger Sub with and into Mandalay (the Merger), with Mandalay continuing as the surviving corporation.

In connection with the Merger, Mandalay and its directors were named defendants in *Stephen Ham, Trustee for the J.C. Ham Residuary Trust v. Mandalay Resort Group, et al.*, which was filed in June 2004 in the 8th Judicial District Court for Clark County, Nevada, and *Robert Lowinger v. Mandalay Resort Group, et al.*, which was filed in June 2004, also in the 8th Judicial District Court for Clark County, Nevada. Both of these actions make claims concerning the Merger, including claims of breach of fiduciary duty against Mandalay s directors, and seek injunctive relief and unspecified monetary damages. The plaintiffs in both actions agreed that Mandalay and the directors did not need to respond to the pending complaints, as they intended to file a joint amended complaint and consolidate both actions. In December 2004, the plaintiff in *Ham* filed a motion for temporary restraining order and motion for preliminary injunction enjoining the Mandalay shareholder vote on the proposed merger and for an order shortening time to allow plaintiff to conduct expedited discovery. The plaintiff s motion was denied. In January 2005, the plaintiff in *Ham* filed an amended complaint for breach of fiduciary duty in connection with the defendants approval of the proposed merger. Mandalay moved to dismiss the amended complaint in April 2005. In October 2005, the Nevada District Court issued a minute order dismissing the *Ham* case. In November 2005, a formal decision, order and judgment of dismissal of the case was entered. Plaintiff in the *Lowinger* case has indicated his intention to file a voluntary dismissal of his action, but the dismissal has not yet been filed. The Company will continue to monitor and protect its interest in these cases until their final conclusion.

Other

We and our subsidiaries are also defendants in various other lawsuits, most of which relate to routine matters incidental to our business. We do not believe that the outcome of this other pending litigation, considered in the aggregate, will have a material adverse effect on the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of our security holders during the fourth quarter of 2005.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Effective May 2, 2005, our common stock is traded on the New York Stock Exchange under the symbol MGM formerly our stock trading symbol was MGG. The following table sets forth, for the calendar quarters indicated, the high and low sale prices of our common stock on the New York Stock Exchange Composite Tape. These prices, along with all share and per share information in this Form 10-K, have been adjusted for a 2-for-1 stock split effected in May 2005.

	2005		2004	
	High	**Low**	**High**	**Low**
First quarter	$39.80	$34.50	$23.09	$18.36
Second quarter	42.98	32.58	24.89	20.50
Third quarter	46.75	39.30	25.07	19.81
Fourth quarter	44.75	35.30	36.75	24.58

There were approximately 3,703 record holders of our common stock as of March 1, 2006.

We have not paid dividends on our common stock in the last two fiscal years. We intend to retain our earnings to fund the operation of our business, to service and repay our debt, to make strategic investments in high return growth projects at our proven resorts, to repurchase shares of common stock and to reserve our capital to raise our capacity to capture investment opportunities overseas and in emerging domestic markets. Furthermore, as a holding company with no independent operations, our ability to pay dividends will depend upon the receipt of dividends and other payments from our subsidiaries. Our senior credit facility contains financial covenants that could restrict our ability to pay dividends. Our Board of Directors periodically reviews our policy with respect to dividends, and any determination to pay dividends in the future will be at the sole discretion of the Board of Directors.

The following table includes information about our stock option plans at December 31, 2005:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
	(in thousands, except per share data)		
Equity compensation plans approved by security holders	34,607	$ 22.85	6,540
Equity compensation plans not approved by security holders (1)			

(1) In May 2002, the Board of Directors approved a restricted stock plan, not approved by security holders, under which 1,806,000 shares were issued. In November 2002, the Board of Directors determined that no more restricted stock awards would be granted. At December 31, 2005, there were 834,000 restricted shares outstanding, all of which will become unrestricted in 2006.

Our share repurchases are only conducted under repurchase programs approved by our Board of Directors and publicly announced. The following table includes information about our share repurchases for the quarter ended December 31, 2005:

	Total Shares Purchased	Average Price Per Share	Shares Purchased As Part of a Publicly-Announced Program	Maximum Shares Still Available for Repurchase
October 1 October 31, 2005	1,107,000	$ 37.59	1,107,000	16,893,000 (1)
November 1 November 30, 2005	2,393,000	37.92	2,393,000	14,500,000 (1)
December 1 December 31, 2005				14,500,000 (1)
	3,500,000		3,500,000	

(1) The July 2004 repurchase program allows for the repurchase of up to 20 million shares with no expiration.

The amounts in the above table exclude approximately 3,200 shares surrendered by certain recipients of restricted shares who elected to use a portion of the shares on which restrictions lapsed in October 2005 to pay required withholding taxes.

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ITEM 6. SELECTED FINANCIAL DATA

	For the Years Ended December 31,				
	2005	2004	2003	2002	2001
	(In thousands, except per share data)				
Net revenues	$ 6,481,967	$ 4,238,104	$ 3,862,743	$ 3,756,928	$ 3,699,852
Operating income	1,357,208	950,860	699,729	746,538	599,892
Income from continuing operations	443,256	349,856	230,273	289,476	160,440
Net income	443,256	412,332	243,697	292,435	169,815
Basic earnings per share					
Income from continuing operations	$ 1.56	$ 1.25	$ 0.77	$ 0.92	$ 0.51
Net income per share	1.56	1.48	0.82	0.93	0.53
Weighted average number of shares	284,943	279,325	297,861	315,618	317,542
Diluted earnings per share					
Income from continuing operations	$ 1.50	$ 1.21	$ 0.76	$ 0.90	$ 0.50
Net income per share	1.50	1.43	0.80	0.91	0.53
Weighted average number of shares	296,334	289,333	303,184	319,880	321,644
At year-end					
Total assets	$20,699,420	$11,115,029	$10,811,269	$10,568,698	$10,542,568
Total debt, including capital leases	12,358,829	5,463,619	5,533,462	5,222,195	5,465,608
Stockholders equity	3,235,072	2,771,704	2,533,788	2,664,144	2,510,700
Stockholders equity per share	$ 11.35	$ 9.87	$ 8.85	$ 8.62	$ 7.98
Number of shares outstanding	285,070	280,740	286,192	309,148	314,792

In June 2003, we ceased operations of PLAYMGMMIRAGE.com, our online gaming website (Online). In January 2004, we sold the Golden Nugget Las Vegas and the Golden Nugget Laughlin including substantially all of the assets and liabilities of those resorts (the Golden Nugget Subsidiaries). In July 2004, we sold the subsidiaries that owned and operated MGM Grand Australia. The results of Online, the Golden Nugget Subsidiaries and MGM Grand Australia are classified as discontinued operations for all periods presented. The Mandalay acquisition occurred on April 25, 2005.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Executive Overview

Current Operations

At December 31, 2005, our operations consisted of 24 wholly-owned casino resorts and 50% investments in three other casino resorts, including:

Las Vegas, Nevada:	Bellagio, MGM Grand Las Vegas, Mandalay Bay, The Mirage, Luxor, TI, New York-New York, Excalibur, Monte Carlo, Circus Circus Las Vegas, Slots-A-Fun and Boardwalk (Boardwalk closed in January 2006 in preparation for Project CityCenter see Other Factors Affecting Liquidity).
Other domestic:	The Primm Valley Resorts (Whiskey Pete s, Buffalo Bill s and Primm Valley Resort) in Primm, Nevada; Circus Circus Reno and Silver Legacy (50% owned) in Reno, Nevada; Colorado Belle and Edgewater in Laughlin, Nevada; Gold Strike and Nevada Landing in Jean, Nevada; Railroad Pass in Henderson, Nevada; MGM Grand Detroit; Beau Rivage in Biloxi, Mississippi and Gold Strike Tunica in Tunica, Mississippi; Borgata (50% owned) in Atlantic City, New Jersey; and Grand Victoria (50% owned) in Elgin, Illinois.

Other operations include the Shadow Creek golf course in North Las Vegas; two golf courses at Primm Valley; a 50% investment in The Signature at MGM Grand, a condominium-hotel development adjacent to MGM Grand Las Vegas; and a 50% investment in MGM Grand Paradise Limited, which is constructing a casino resort in Macau.

Mandalay Acquisition

On April 25, 2005, we closed our merger with Mandalay Resort Group (Mandalay) under which we acquired Mandalay for $71 in cash for each share of common stock of Mandalay. The total acquisition cost of $7.3 billion included equity value of approximately $4.8 billion, the assumption or repayment of outstanding Mandalay debt with a fair value of approximately $2.9 billion and $0.1 billion of transaction costs, offset by the $0.5 billion received by Mandalay from the sale of its interest in MotorCity Casino in Detroit, Michigan.

The Mandalay acquisition expands our portfolio of resorts on the Las Vegas Strip, provides additional sites for future development and expands our employee and customer bases significantly. These factors result in the recognition of certain intangible assets and significant goodwill. The purchase price allocation is preliminary and may be adjusted up to one year after the acquisition. In particular, we are still evaluating certain customer relationship intangible assets related to individual and group hotel reservations as well as gaming loyalty program members. We did not incur any significant employee termination costs or other exit costs in connection with the Mandalay acquisition.

Key Performance Indicators

We operate primarily in one segment, the operation of casino resorts, which includes offering gaming, hotel, dining, entertainment, retail and other resort amenities. Giving effect to the Mandalay merger, over half of our net revenue is now derived from non-gaming activities, a higher percentage than many of our competitors, as our operating philosophy is to provide a complete resort experience for our guests, including non-gaming amenities which command a premium price based on their quality. We believe that we own several of the premier casino resorts in the world, and a main focus of our strategy is to continually reinvest in these resorts to maintain our competitive advantage.

As a resort-based company, our operating results are highly dependent on the volume of customers at our resorts, which in turn impacts the price we can charge for our hotel rooms and other amenities. We also generate a significant portion of our operating income from the high-end gaming segment, which can cause variability in our results. Key performance indicators related to revenue are:

Gaming revenue indicators table games drop and slots handle (volume indicators); win or hold percentage, which is not fully controllable by us. Our normal table games win percentage is in the range of 18% to 22% of table games drop and our normal slots win percentage is in the range of 6.5% to 7.5% of slots handle;

Hotel revenue indicators hotel occupancy (volume indicator); average daily rate (ADR , price indicator); revenue per available room (REVPAR), a summary measure of hotel results, combining ADR and occupancy rate.

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Most of our revenue is essentially cash-based, through customers wagering with cash or paying for non-gaming services with cash or credit cards. Our resorts, like many in the industry, generate significant operating cash flow. Our industry is capital intensive and we rely heavily on the ability of our resorts to generate operating cash flow to repay debt financing, fund maintenance capital expenditures and provide excess cash for future development.

We generate a majority of our net revenues and operating income from our resorts in Las Vegas, Nevada, which exposes us to certain risks outside of our control, such as competition from other recently opened Las Vegas resorts, including several expanded resorts and a major new competitor, and the impact from expansion of gaming in California. We are also exposed to risks related to tourism and the general economy, including national and global economic conditions and terrorist attacks or other global events.

Our results of operations do not tend to be seasonal in nature, though a variety of factors can affect the results of any interim period, including the timing of major Las Vegas conventions, the amount and timing of marketing and special events for our high-end customers, and the level of play during major holidays, including New Year and Chinese New Year. Our results do not depend on key individual customers, though our success in marketing to customer groups, such as convention customers, or the financial health of customer groups, such as business travelers or high-end gaming customers from a particular country or region, can impact our results.

Overall Outlook

We have invested heavily in our existing operations in the past three years, and expect to continue to do so on a targeted basis in 2006. Our Las Vegas Strip resorts require ongoing capital investment to maintain their competitive advantages. We believe these investments in additional non-gaming amenities have enhanced our ability to generate increased visitor volume and allowed us to charge premium prices for our amenities.

The most likely significant factors affecting operating results at our existing resorts in 2006 will be the addition of Mandalay, the expected continued positive impact of our targeted capital improvements, and the completion of Towers 1 and 2 of The Signature at MGM Grand. The Mandalay acquisition will continue to affect year-over-year comparisons through April 2006 as a result of the net revenues and operating income of these resorts, which includes the impact on depreciation and amortization expense of recognizing depreciable real property and amortizable intangible assets at fair value, and additional interest expense as a result of financing the merger through borrowings under our senior credit facility. Additionally, ongoing impacts of cost savings and revenue enhancements will positively affect earnings throughout 2006.

Some of the capital improvements we made in 2005 were made towards the end of the year, so 2006 will be the first full year of results including these improvements, particularly at The Mirage, where the Jet nightclub and several restaurants were added at or near year-end. In addition, this resort will benefit from the Beatles-themed show by Cirque du Soleil expected to open in mid-2006. These improvements, along with improvements at other resorts, are expected to drive continued increases in REVPAR and increased customer volumes in gaming areas, restaurants, shops, entertainment venues and our other resort amenities.

Towers 1 and 2 of The Signature at MGM Grand are expected to be completed in the second and fourth quarters of 2006, respectively. At that time, we will recognize our share of the venture s net income, which will consist of the sales and costs associated with the sales of the condominium units, along with deferred profit from our contribution of land to the venture, within income from unconsolidated affiliates in the consolidated statement of income. Upon completion of each tower, we will have the opportunity to rent the condominiums to third parties on behalf of owners who elect to have us do so, providing a potential ongoing revenue stream.

Financial Statement Impact of Hurricane Katrina

Beau Rivage sustained significant damage in late August 2005 as a result of Hurricane Katrina and has been closed since. We expect to reopen Beau Rivage in the third quarter of 2006, although some of the resort s rooms, restaurants and other amenities will not reopen until the fourth quarter. The Company maintains insurance covering both property damage and business interruption as a result of the storm. The deductible under this coverage is approximately $15 million, based on the amount of damage incurred. Based on current estimates, insurance proceeds are expected to exceed the net book value of damaged assets; therefore, the Company will not record an impairment charge related to the storm and upon ultimate settlement of the claim will likely record a gain. The damaged assets have been written off and a corresponding insurance receivable, classified within Other long-term assets in the accompanying consolidated balance sheets, has been recorded.

Business interruption coverage covers lost profits and other costs incurred during the period of closure and up to six months following the reopening of the facility. The costs expected to be incurred during the interruption period are less than the anticipated business interruption proceeds; therefore, post-storm costs are being offset by the expected recoveries. All post-storm costs and expected recoveries are recorded net within General and administrative expenses in the accompanying consolidated statements of income, except for depreciation of non-damaged assets, which is classified as Depreciation and amortization.

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Results of Operations

Summary Financial Results

The following table summarizes our financial results:

	Year Ended December 31,				
	2005	Percentage Change	2004	Percentage Change	2003
	(In thousands, except per share data)				
Net revenues	$6,481,967	53%	$4,238,104	10%	$3,862,743
Operating income	1,357,208	43%	950,860	36%	699,729
Income from continuing operations	443,256	27%	349,856	52%	230,273
Diluted income from continuing operations per share	$ 1.50	24%	$ 1.21	59%	$ 0.76

References to same-store results throughout Management s Discussion and Analysis exclude the Mandalay resorts and Monte Carlo for all periods. Same-store results also exclude Beau Rivage for all periods.

On a consolidated basis, the most important factors and trends contributing to our performance over the last three years have been:

- The addition of Mandalay s resorts on April 25, 2005. For the eight months we owned the Mandalay resorts, net revenue for these operations was $1.9 billion and operating income was $433 million;

- The ongoing capital investments in our resorts, which we believe is allowing us to market more effectively to visitors, capture a greater share of our visitors increased travel budgets, and generate premium pricing for our resorts rooms and other amenities. These investments include the Spa Tower at Bellagio, which opened in December 2004, and the repositioning of MGM Grand Las Vegas, highlighted by *KÀ*, by Cirque du Soleil, and the Skylofts and West Wing room enhancements;

- The overall positive economic environment in the United States since early 2004, particularly in the leisure and business travel segments, resulting in increases in room pricing and increased visitation, particularly at our Las Vegas Strip resorts;

- The closure of Beau Rivage in August 2005 after Hurricane Katrina. Operating income was $60 million at Beau Rivage in 2004 and decreased to $40 million in 2005 as a result of only having eight months of operations;

- The war with Iraq and the outbreak of SARS in Asia, both of which negatively impacted leisure travel and our high-end gaming business in late 2003 and early 2004;

- The new labor contract covering employees at our Las Vegas Strip resorts since mid-2002, which provides for significant annual wage and benefits increases through 2007.

As a result of the above trends, our net revenues increased 53% in 2005, and 11% on a same-store basis. Operating margins were relatively flat with 2004 21% in 2005 compared to 22% in 2004. The 2004 margin was a significant increase over the 18% operating margin in 2003. See further discussion of operating income and operating margins in Operating Results below. The increase in income from continuing operations generally resulted from the increased operating income, offset in part by increased interest expense, discussed below in Non-operating Results.

Operating Results

The following table includes key information about our operating results:

	Year Ended December 31,			
		Percentage		Percentage

	2005	Change	2004	Change	2003
			(In thousands)		
Net revenues	$ 6,481,967	53%	$ 4,238,104	10%	$ 3,862,743
Operating expenses:					
Casino and hotel operations	3,547,059	55%	2,289,249	6%	2,152,236
General and administrative	958,263	56%	612,632	5%	585,161
Corporate expense	130,633	68%	77,910	27%	61,541
Preopening, restructuring and property transactions, net	52,573	114%	24,566	45%	16,922
Depreciation and amortization	588,102	46%	402,545	1%	400,766
	5,276,630	55%	3,406,902	6%	3,216,626
Income from unconsolidated affiliates	151,871	27%	119,658	123%	53,612
Operating income	$ 1,357,208	43%	$ 950,860	36%	$ 699,729

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The 2005 increase in net revenues resulted from the addition of Mandalay and an 11% increase in same-store net revenues. Same-store net revenues increased largely as a result of strong room pricing and increased volumes in slots and across all non-gaming areas. These trends were particularly prominent at Bellagio and MGM Grand Las Vegas as a result of new and expanded amenities at those resorts.

The 2004 increase in net revenues was largely due to strong room pricing, increased gaming volumes, and the impact of targeted capital investments in 2003 and 2004 at New York-New York and MGM Grand Las Vegas.

In 2005, operating income did not increase to the same extent as net revenues, largely due to already strong operating margins, a lower-than-normal bad debt provision in 2004, higher corporate expense and higher preopening, restructuring and property transactions, net. This resulted in an operating margin of 21% versus 22% in 2004. Corporate expense increased as a percentage of revenue due primarily to merger integration costs.

Our operating income in 2004 increased 36%, due primarily to the strong revenue trends and a full year of Borgata s results. The increase in income from unconsolidated affiliates was responsible for approximately one-third of the increase in operating income, while improvements at our operating resorts, particularly Bellagio, MGM Grand Las Vegas and New York-New York, made up the rest of the increase. Operating income at MGM Grand Detroit was essentially flat in 2004 compared to 2003, despite an increase in the gaming tax rate from 18% to 24% effective September 2004.

We expect operating margins to stay relatively consistent with current levels in 2006. Anticipated revenue gains at Mandalay resorts and continued realization of merger cost savings will offset typical increases in labor costs, the additional 2% gaming tax payable to the City of Detroit beginning January 1, 2006, and the inclusion of stock compensation expense (see Recently issued Accounting Standards).

Operating Results Detailed Revenue Information

The following table presents detail of our net revenues:

	Year Ended December 31,				
	2005	Percentage Change	2004 (In thousands)	Percentage Change	2003
Casino revenue, net:					
Table games	$ 1,140,053	21%	$ 943,343	9%	$ 866,096
Slots	1,741,556	43%	1,218,589	9%	1,115,029
Other	100,042	61%	62,033	10%	56,389
Casino revenue, net	2,981,651	34%	2,223,965	9%	2,037,514
Non-casino revenue:					
Rooms	1,673,696	84%	911,259	9%	833,272
Food and beverage	1,330,210	58%	841,147	11%	757,278
Entertainment, retail and other	1,098,612	58%	696,117	7%	647,702
Non-casino revenue	4,102,518	68%	2,448,523	9%	2,238,252
	7,084,169	52%	4,672,488	9%	4,275,766
Less: Promotional allowances	(602,202)	39%	(434,384)	5%	(413,023)
	$ 6,481,967	53%	$ 4,238,104	10%	$ 3,862,743

Table games revenue, including baccarat, was flat on a same-store basis in 2005. A 4% increase in table games volume was offset by a slightly lower hold percentage, though hold percentages were within our normal range for all

three years presented. In 2004, table games volume increased 9%, with particular strength in baccarat volume, up 18%. In both 2005 and 2004, key events such as New Year, Chinese New Year and other marketing events, were well-attended.

Slots revenue increased 8% on a same-store basis, following a 9% increase in 2004. Additional volume in 2005 was generated by the Spa Tower at Bellagio Bellagio s slots revenue increased over 30% and the traffic generated by *KÀ* and other amenities at MGM Grand Las Vegas, where slots revenue increased almost 10%. In both periods, we benefited from the continued success of our Players Club affinity program and marketing events targeted at repeat customers.

Hotel revenue increased 19% on a same-store basis in 2005. We had more rooms available as a result of the Bellagio expansion and 2004 room remodel activity at MGM Grand Las Vegas, and our company-wide same-store REVPAR increased 13% to $140. This was on top of a 10% increase in 2004 over 2003. The increase in REVPAR in 2005 was entirely rate-driven, as same-store occupancy was consistent at 92%. The 2004 increase was also largely rate-driven.

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Other non-gaming revenue was also up in 2005, with *KÀ* leading to a 35% increase in same-store entertainment revenue, and several new restaurants and bars at MGM Grand Las Vegas, Bellagio, TI and The Mirage leading to a 14% increase in same-store food and beverage revenue. These results followed similar trends experienced in 2004 compared to 2003. We expect these increases to continue in 2006, as we will open a new Beatles-themed Cirque du Soleil show at The Mirage, along with more new restaurants and lounges across our resort portfolio, including the recently opened Jet nightclub and several restaurants at The Mirage.

Operating Results Details of Certain Charges

Preopening and start-up expenses consisted of the following:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
Project CityCenter	$ 5,173	$	$
MGM Grand Macau	1,914		
Jet nightclub at The Mirage	1,891		
Bellagio expansion	665	3,805	
KÀ	1,871	3,655	
Borgata			19,326
New York-New York (*Zumanity*, Nine Fine Irishmen)			4,310
Players Club			3,051
Other	4,238	2,816	2,579
	$ 15,752	$ 10,276	$ 29,266

Preopening and start-up expenses at MGM Grand Macau relate to our share of the operating results of that venture prior to its opening. Preopening and start-up expenses related to Borgata represent our share of the operating results of Borgata prior to its July 2003 opening. We expect preopening and start-up expenses for Project CityCenter and MGM Grand Macau to increase in 2006. In addition, we will incur preopening and start-up expenses related to the permanent facility at MGM Grand Detroit and the new Beatles-themed show by Cirque du Soleil at The Mirage.

Restructuring costs (credit) consisted of the following:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
Contract termination costs	$	$ 3,693	$ 4,049
Siegfried & Roy show closure The Mirage			1,623
Other	(59)	1,932	925
	$ (59)	$ 5,625	$ 6,597

There were no material restructuring activities in 2005. At December 31, 2005, there were no material restructuring accruals. All material restructuring costs have been fully paid or otherwise resolved.

In 2004, restructuring costs include $3 million for contract termination costs related to the Aqua restaurant at Bellagio and $2 million of workforce reduction costs at MGM Grand Detroit as a result of our efforts to minimize the impact of a gaming tax increase in Michigan.

In 2003, restructuring costs included $2 million related to the closure of the Siegfried & Roy show, primarily for severance costs of employees involved in the show s production. Also, we terminated a restaurant lease and closed two

marketing offices, resulting in $4 million of contract termination charges. Other severance of $1 million in 2003 related primarily to restructuring of table games staffing at several resorts.

Property transactions, net consisted of the following:

	Year Ended December 31,		
	2005	**2004**	**2003**
		(In thousands)	
Impairment of assets to be disposed of	$ 22,651	$ 473	$ 7,172
Write-off of abandoned capital projects	5,971		
Demolition costs	5,362	7,057	6,614
Gain on sale of North Las Vegas land			(36,776)
Other net losses on asset sales or disposals	2,896	1,135	4,049
	$ 36,880	$ 8,665	$ (18,941)

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In 2005, recognized impairments relate primarily to assets removed from service in connection with new capital projects at several resorts, including Bellagio, TI, The Mirage and Mandalay Bay. The amount of the impairments was based on the net book value of the disposed assets. Abandoned projects included individually insignificant projects at several resorts. Demolition costs related primarily to room remodel activity at MGM Grand Las Vegas and the new showroom at The Mirage.

In 2004, there were no material unusual property transactions. In 2003, we sold 315 acres of land in North Las Vegas, Nevada near Shadow Creek for approximately $55 million, resulting in the $37 million gain reflected above. Also in 2003, we recorded write-downs and impairments of assets abandoned or replaced with new construction, primarily at MGM Grand Las Vegas in preparation for new restaurants and the *KÀ* theatre. Demolition costs in 2004 and 2003 related primarily to preparation for the Bellagio standard room remodel, Bellagio expansion and *KÀ* theatre at MGM Grand Las Vegas.

Non-operating Results

The following table summarizes information related to interest on our long-term debt:

	Year Ended December 31,		
	2005	**2004**	**2003**
		(In thousands)	
Interest cost	$ 685,686	$ 401,391	$ 352,820
Less: Capitalized interest	(29,527)	(23,005)	(15,234)
Interest expense, net	$ 656,159	$ 378,386	$ 337,586
Cash paid for interest, net of amounts capitalized	$ 588,587	$ 321,008	$ 308,198
Weighted average total debt balance	$10.1 billion	$5.5 billion	$5.2 billion
Weighted average interest rate	6.8%	7.3%	6.7%

Interest cost was higher in 2005 due to the funding of the cash consideration in the Mandalay acquisition through senior credit facility borrowings, and the assumption of debt in the Mandalay acquisition. While variable market interest rates continued to increase in 2005, our effective interest rate decreased due to a more normalized ratio of variable rate debt in 2005; our variable interest rate under our senior credit facility has been lower than the interest rates on our fixed-rate borrowings. Capitalized interest increased in 2005 as we began capitalizing interest on Project CityCenter and our investment in MGM Grand Paradise Limited. We expect capitalized interest to increase in 2006 as we will start capitalizing interest on a longer portion of the land related to Project City Center and as we spend more on the construction of Project CityCenter.

Interest cost was higher in 2004 as we had a higher average borrowing rate due to increases in variable interest rates and the issuance of significant fixed rate debt in the second half of 2004 in anticipation of the Mandalay merger. Capitalized interest increased in 2004 due to the ongoing Bellagio expansion and *KÀ* theatre projects offset partially by the cessation of interest capitalization on our investment in Borgata in July 2003.

Non-operating items from unconsolidated affiliates, primarily our share of interest expense at Borgata and Silver Legacy and state income taxes at Borgata, increased from $12 million in 2004 to $16 million in 2005. Borgata s lower interest expense was largely offset by the addition of Silver Legacy s interest expense, and the remaining decrease resulted from a reduction in state income taxes in the fourth quarter of 2004 at Borgata as a result of recording the benefit of certain investment tax credits. In 2004, non-operating items from unconsolidated affiliates was higher than 2003, $12 million versus $10 million, due to the full year of Borgata s results, offset by the reduction to state income taxes in the fourth quarter of 2004 described above.

The following table summarizes information related to our income taxes:

	Year Ended December 31,

	2005	2004 (In thousands)	2003
Income from continuing operations before income tax	$ 678,900	$ 555,815	$ 343,660
Income tax provision	235,644	205,959	113,387
Effective income tax rate	34.7%	37.1%	33.0%
Cash paid for income taxes	$ 75,776	$ 128,393	$ 94,932

The effective income tax rate in 2005 was lower than in 2004 due primarily to a tax benefit realized from the repatriation of foreign earnings from Australia as a result of the provisions of the American Jobs Creation Act of 2004 that provided for a special one-time deduction of 85 percent on certain repatriated earnings of foreign subsidiaries. Additionally, in 2004 the Company accrued additional state deferred taxes related to capital investments in New Jersey and incurred non-deductible costs related to a Michigan ballot initiative; neither of these items recurred in 2005.

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The effective income tax rate in 2004 was higher than in 2003 primarily due to the additional New Jersey taxes and non-deductible Michigan ballot initiative costs discussed above, as well as overseas development costs for which no tax benefit was provided and the reversal of a greater amount of tax reserves in 2003 compared to 2004 as a result of completion of audits and the expiration of statutes of limitations.

In 2005, taxes paid decreased from 2004, in part due to increased tax benefits from stock option exercises and one-time benefit plan deductions, partially offset by decreased accelerated tax depreciation deductions and increased pre-tax income. In addition, a federal tax overpayment from 2004 was applied to 2005, reducing the 2005 tax payments. In 2004, taxes paid increased from 2003, primarily due to increased pre-tax income and the full utilization of tax credit carryforwards in 2003. We expect cash paid for income taxes to increase significantly in 2006 due to the required payment of taxes on the gain on Mandalay s sale of MotorCity Casino, required tax payments on the income associated with Towers 1 and 2 of The Signature at MGM Grand, and continued increases in income resulting from the Mandalay merger and continued improvements in operating results.

Liquidity and Capital Resources

Cash Flows Summary

Our cash flows consisted of the following:

	Year Ended December 31,		
	2005	**2004**	**2003**
		(In thousands)	
Net cash provided by operations	$ 1,182,796	$ 829,247	$ 740,812
Investing cash flows:			
Acquisition of Mandalay Resort Group, net	(4,420,990)		
Capital expenditures	(759,949)	(702,862)	(550,232)
Proceeds from the sale of subsidiaries, net		345,730	
Investments in unconsolidated affiliates	(183,000)	(11,602)	(41,350)
Other	61,122	20,981	35,894
Net cash used in investing activities	(5,302,817)	(347,753)	(555,688)
Financing cash flows:			
Net borrowing (repayment) under bank credit facilities	4,725,000	(1,574,489)	(285,087)
Issuance of long-term debt	880,156	1,528,957	600,000
Repayment of long-term debt	(1,408,992)	(52,149)	(28,011)
Issuance of common stock	145,761	135,910	36,254
Purchase of treasury stock	(217,316)	(348,895)	(442,864)
Other	(61,783)	(15,306)	(45,527)
Net cash provided by (used in) financing activities	4,062,826	(325,972)	(165,235)
Net increase (decrease) in cash and cash equivalents	$ (57,195)	$ 155,522	$ 19,889

Cash Flows Operating Activities

Trends in our operating cash flows tend to follow trends in our operating income, excluding non-cash charges, since our business is primarily cash-based. Cash flow from operations has increased in each of the last two years due

to higher operating income offset by higher combined interest and tax payments.

At December 31, 2005 and 2004, we held cash and cash equivalents of $378 million and $435 million, respectively. We require a certain amount of cash on hand to operate our resorts. Beyond our cash on hand, we utilize a company-wide cash management system to minimize the amount of cash held in banks. Funds are swept from accounts at our resorts daily into central bank accounts, and excess funds are invested overnight or are used to repay borrowings under our bank credit facilities. Included in cash and cash equivalents at December 31, 2004 was $141 million received from the sale of MGM Grand Australia and still held in Australia. These funds, net of amounts paid for Australia taxes on the sale, were repatriated to the United States in 2005 and used to fund capital expenditures during the year.

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Cash Flows Investing Activities

The acquisition of Mandalay closed on April 25, 2005, at a cost of $4.4 billion, net of cash acquired, plus the assumption of $2.9 billion of Mandalay debt.

Capital expenditures in 2005 included maintenance capital spending at our resorts such as room remodel activity at MGM Grand Las Vegas, including the completion of the Skylofts and West Wing room enhancements and spending on the following key expansion and development projects:

- Project CityCenter;
- The permanent casino at MGM Grand Detroit, including costs of purchasing land;
- The new theatre at The Mirage for the Beatles-themed show by Cirque du Soleil, along with new restaurants and other amenities at this resort;
- Rebuilding costs at Beau Rivage.

Capital expenditures in 2004 consisted of large capital projects, such as the Bellagio expansion and the *KÀ* theatre at MGM Grand Las Vegas, and maintenance capital activities, such as room remodel projects at New York New York and MGM Grand Las Vegas and new restaurant and entertainment amenities at several resorts. Capital expenditures in 2003 included major projects at our existing resorts, including projects described above which began in 2003, the *Zumanity* theatre at New York-New York, the Bellagio room remodel and slot technology improvements.

The sale of the Golden Nugget Subsidiaries closed in January 2004 with net proceeds to the Company of $210 million. The sale of MGM Grand Australia closed in July 2004 with net proceeds to the Company of $136 million.

Investments in unconsolidated affiliates in 2005 consists primarily of our required contributions to MGM Grand Paradise Limited, which is developing MGM Grand Macau. In 2004, such investments related primarily to The Signature at MGM Grand, and in 2003 such investments related primarily to Borgata.

Cash Flows Financing Activities

Our primary financing activities in 2005 related to the Mandalay acquisition. The cash purchase price of Mandalay, $4.4 billion, was funded from borrowings under our senior credit facility. We also issued $875 million of fixed rate debt in various issuances:

- In June 2005, we issued $500 million of 6.625% senior notes due 2015;
- In September 2005, we issued $375 million of 6.625% senior notes due 2015.

In the first quarter of 2005, we repaid at their scheduled maturity two issues of senior notes due in 2005, $176.4 million of 6.625% senior notes and $300 million of 6.95% senior notes, and redeemed one issue of senior notes due in 2008, $200 million of 6.875% senior notes. The redemption of the 2008 senior notes resulted in a loss on early retirement of debt of $20 million, which is classified as Other, net in the accompanying consolidated statements of income. With the redemption of the 2008 senior notes and the repayment of the 6.95% senior notes, the Company s senior credit facility and senior notes are now unsecured.

In addition, in the second quarter of 2005 we initiated a tender offer for several issuances of Mandalay s senior notes and senior subordinated notes totaling $1.5 billion. Holders of $155 million of Mandalay s senior notes and senior subordinated notes redeemed their holdings. Holders of Mandalay s floating rate convertible senior debentures with a principal amount of $394 million had the right to redeem the debentures for $566 million through June 30, 2005. $388 million of principal of the convertible debentures were tendered for redemption and redeemed for $558 million. Since the Mandalay acquisition we have reduced net debt by $419 million.

In 2004, we issued $1.5 billion of fixed rate debt in various issuances:

- In February and March 2004, we issued $525 million of 5.875% senior notes due 2014;
- In August 2004, we issued $550 million of 6.75% senior notes due 2012;
- In September 2004, we issued $450 million of 6% senior notes due 2009 at a premium to yield 5.65%.

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In 2004, we repaid a net $1.6 billion on our bank credit facilities and repurchased $49 million of our existing senior notes for $52 million, resulting in a loss on early retirement of debt of $6 million, including the write-off of unamortized original issue discount, which is classified as Other, net in the accompanying consolidated statements of income.

In 2003, we issued $600 million of 6% senior notes, due 2009 and repaid a net $285 million on our bank credit facilities. The net proceeds of these financing activities were used to supplement operating cash flows, fund capital expenditures and repurchase shares of our common stock.

Our share repurchases are only conducted under repurchase programs approved by our Board of Directors and publicly announced. Our share repurchase activity was as follows:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
August 2001 authorization (2.8 million shares purchased)	$	$	$ 36,034
February 2003 authorization (20 million shares purchased)			335,911
November 2003 authorization (16 million and 4 million shares purchased)		348,895	70,919
July 2004 authorization (5.5 million shares purchased)	217,316		
	$ 217,316	$ 348,895	$ 442,864
Average price of shares repurchased	$ 39.51	$ 21.80	$ 16.59

At December 31, 2005, we had 14.5 million shares available for repurchase under a July 2004 authorization. We received $146 million, $136 million and $36 million in proceeds from the exercise of employee stock options in the years ended December 31, 2005, 2004 and 2003, respectively.

Principal Debt Arrangements

Our long-term debt consists of publicly held senior and subordinated notes and our senior credit facility. We pay fixed rates of interest ranging from 5.875% to 10.25% on the senior and subordinated notes. We pay variable interest based on LIBOR on our senior credit facility. Our current senior credit facility is a $7.0 billion, five-year credit facility with a syndicate of banks led by Bank of America, N.A., and consists of a $5.5 billion revolving credit facility and a $1.5 billion term loan facility. As of December 31, 2005, we had approximately $2.2 billion of available liquidity under our senior credit facility.

Other Factors Affecting Liquidity

Distributions from The Signature at MGM Grand**.** As discussed earlier, Towers 1 and 2 of The Signature at MGM Grand are expected to be completed in the second and fourth quarters of 2006, respectively. We expect to receive distributions totaling at least $100 million upon completion of these towers.

Long-term Debt Payable in 2006**.** We repaid $200 million of long-term debt at maturity in February 2006 with available borrowings under our senior credit facility. Another $245 million of long-term debt matures later in 2006.

Project CityCenter**.** In November 2004 we announced a plan to develop a multi-billion dollar urban metropolis, Project CityCenter, on 66 acres of land on the Las Vegas Strip, between Bellagio and Monte Carlo. Project CityCenter will feature a 4,000-room casino resort designed by world-famous architect Cesar Pelli; two 400-room boutique hotels, one of which will be managed by luxury hotelier Mandarin Oriental; approximately 470,000 square feet of retail shops, dining and entertainment venues; and approximately 2.3 million square feet of residential space in over 2,900 luxury condominium and condominium-hotel units in multiple towers.

As currently contemplated, we believe Project CityCenter will cost approximately $7 billion, excluding preopening and land costs. After estimated proceeds of $2.5 billion from the sale of residential units, we believe the net project cost will be approximately $4.5 billion. We expect to complete the design work for Project CityCenter in mid-2006 and expect the project to open in 2009. The design, budget and schedule of Project CityCenter are still preliminary,

and the ultimate timing, cost and scope of Project CityCenter are subject to risks attendant to large-scale projects.

Detroit Permanent Casino. MGM Grand Detroit, LLC has operated an interim casino facility in downtown Detroit since July 1999. In August 2002 the Detroit City Council approved revised development agreements with our subsidiary and two other developers. The revised development agreement released us and the City from certain of the obligations under the original agreement and significantly changed other provisions of the original agreement.

In April 2005, the 6th Circuit Court of Appeals lifted its injunction prohibiting commencement of construction of the permanent hotel and casino complexes. We have obtained land and began construction on our permanent facility, which will be located near the site of our interim facility. The permanent facility is expected to open in late 2007 at a cost of $765 million, including land and preopening costs, and will feature a 400-room hotel, 100,000-square foot casino, numerous restaurant and entertainment amenities, and spa and convention facilities. The complete design, timing and cost of the permanent facility are at a preliminary stage, and are subject to risks attendant to large-scale projects.

MGM Grand Macau. We own 50% of MGM Grand Paradise Limited, an entity which is developing, and will operate, MGM Grand Macau, a hotel-casino resort in Macau S.A.R. Pansy Ho Chiu-king owns the other 50% of MGM Grand Paradise Limited. MGM Grand Macau will be located on a prime waterfront site and will feature at least 345 table games and 1,035 slots with room for significant expansion. Other features will include a 600-room hotel, a luxurious spa, convertible convention space, a variety of dining destinations, and other attractions. Construction of MGM Grand Macau, which is estimated to cost $1.1 billion including license and land rights and preopening costs, began in the second quarter of 2005 and the resort is anticipated to open in late 2007. The complete design, timing, cost and scope of the project are at a preliminary stage and are subject to the risks attendant to large-scale projects. We have invested $180 million in the venture, and are committed to loaning the venture up to $100 million. The venture has obtained commitments from lenders for a credit facility sufficient, along with equity contributions and shareholder loans, to fund the construction of MGM Grand Macau.

Beau Rivage Rebuilding. We have already begun the process of rebuilding Beau Rivage. Damage was extensive on the main levels of the resort, largely destroying the casino floor and gaming equipment, the resort s restaurants, the retail area and a portion of the parking garage. There was also damage, though to a lesser extent, in the hotel tower. We expect to reopen the resort in stages beginning in the third quarter of 2006. When fully reopened, Beau Rivage will include 1,740 guestrooms, over 2,000 slot machines and 90 table games, new and restored restaurants, a state-of-the-art convention center, and pool and spa amenities.

We believe that a large portion of the costs to rebuild Beau Rivage will be covered under our insurance policies. However, we cannot determine the exact amount of reimbursement until we submit our claims and receive notice of approval from our insurers. It is also uncertain as to the timing of such reimbursements, and we have been funding the rebuilding costs in advance of receiving reimbursements from our insurers.

New York Racing Association. We have entered into a definitive agreement with the New York Racing Association (NYRA) to manage video lottery terminals (VLTs) at NYRA s Aqueduct horseracing facility in metropolitan New York. We will assist in the development of the approximately $170 million facility, including providing project financing, and will manage the facility for a term of five years (extended automatically if the financing provided by us is not fully repaid) for a fee. Recent legislative changes will allow us to operate the VLTs past the expiration date of the current NYRA franchise agreement.

Off Balance Sheet Arrangements

Our off balance sheet arrangements consist primarily of investments in unconsolidated affiliates, which currently consist primarily of our investments in Borgata, Grand Victoria, Silver Legacy, MGM Grand Macau and The Signature at MGM Grand. We have not entered into any transactions with special purpose entities, nor have we engaged in any derivative transactions other than straightforward interest rate swaps. Our joint venture and unconsolidated affiliate investments allow us to realize the benefits of owning a full-scale resort in a manner that minimizes our initial investment. We provided a guaranty for up to 50% of the interest and principal payment obligations on the construction financing for the first two towers of The Signature at MGM Grand. Otherwise, we have not guaranteed financing obtained by our investees, nor are there any other provisions of the venture agreements which are unusual or subject us to risks to which we would not be subjected if we had full ownership of the resort.

At December 31, 2005, we had outstanding letters of credit totaling $53 million, of which $50 million support bonds issued by the Economic Development Corporation of the City of Detroit. These bonds are recorded as a liability in our consolidated balance sheets. This obligation was undertaken to secure our right to develop a permanent casino in Detroit.

Commitments and Contractual Obligations

The following table summarizes our scheduled contractual commitments as of December 31, 2005:

	2006	2007	2008	2009	2010	Thereafter
			(In millions)			
Long-term debt	$ 445	$ 1,402	$ 377	$ 1,276	$ 5,898	$ 2,893
Estimated interest payments on long-term debt (1)	853	769	688	659	559	811
Capital leases	2	1	1			
Operating leases	13	11	9	9	8	338
Long-term liabilities (2)	61	9	9	58	8	5
Other purchase obligations:						
Construction commitments (3)	432	146	54	28	4	
Employment agreements	125	62	27	12		
Entertainment agreements (4)	124	5				
Other (5)	101	44	4	3	1	1
	$ 2,156	$ 2,449	$ 1,169	$ 2,045	$ 6,478	$ 4,048

(1) Estimated interest payments on long-term debt are based on principal amounts outstanding at December 31, 2005 and forecasted LIBOR rates for our bank credit facility.

(2) Includes our obligation to support $50 million of bonds issued by the Economic Development Corporation of the City of Detroit as part of our development agreement with the City. The bonds mature in 2009. Also includes the estimated payments of obligations under our deferred compensation and supplemental executive retirement plans, based on balances as of December 31, 2005 and assumptions of retirement based on plan provisions.

(3) Included in construction commitments is $413 million related to Project CityCenter, consisting primarily of commitments related to design work and the Bellagio employee parking garage. While we have entered into a contract with a general contractor for the construction of most of Project CityCenter, we are not committed to any component of the project until we request and approve a guaranteed maximum price (GMP) for the component with the general contractor. We expect to approve GMPs for most or all of the components of Project CityCenter in 2006.

(4) Our largest entertainment commitments consist of minimum contractual payments to Cirque du Soleil, which performs shows at several of our resorts. We are generally contractually committed for a period of 12 months based on our ability to exercise certain termination rights; however, we expect these shows to continue for longer periods.

(5) The amount for 2006 includes approximately $61 million of open purchase orders. Other commitments are for various contracts, including corporate aircraft purchases, maintenance and other service agreements and advertising commitments.

Summary of Expected Sources and Uses of Funds

In addition to the contractual obligations disclosed above, other significant operating uses of cash in 2006 include tax payments. Other significant investing uses of cash flow in 2006 include uncommitted capital expenditures, expected to be approximately $850 million, excluding capitalized interest and spending at Beau Rivage.

We plan to fund our contractual obligations and other estimated spending through a combination of operating cash flow, distributions from The Signature at MGM Grand, available borrowings under our senior credit facility and potential issuances of fixed rate long-term debt. We generated almost $1.2 billion in operating cash flow in 2005,

which included deductions for interest payments, tax payments and certain contractually committed payments reflected in the above table, including operating leases, employment agreements and entertainment agreements. We expect to generate a higher level of operating cash flow in 2006 due primarily to the continued impact of the Mandalay acquisition, as well as expected increases in operating income at other resorts.

Critical Accounting Policies and Estimates

Management s discussion and analysis of our results of operations and liquidity and capital resources are based on our consolidated financial statements. To prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, we must make estimates and assumptions that affect the amounts reported in the consolidated financial statements. We regularly evaluate these estimates and assumptions, particularly in areas we consider to be critical accounting estimates, where changes in the estimates and assumptions could have a material impact on our results of operations, financial position or cash flows. Senior management and the Audit Committee of the Board of Directors have reviewed the disclosures included herein about our critical accounting estimates, and have reviewed the processes to determine those estimates.

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Allowance for Doubtful Casino Accounts Receivable

Marker play represents a significant portion of the table games volume at Bellagio, MGM Grand Las Vegas, Mandalay Bay and The Mirage. Our other facilities do not emphasize marker play to the same extent, although we offer markers to customers at those casinos as well.

We maintain strict controls over the issuance of markers and aggressively pursue collection from those customers who fail to pay their marker balances timely. These collection efforts are similar to those used by most large corporations when dealing with overdue customer accounts, including the mailing of statements and delinquency notices, personal contacts, the use of outside collection agencies and civil litigation. Markers are generally legally enforceable instruments in the United States. At December 31, 2005 and 2004, approximately 44% and 54%, respectively, of our casino accounts receivable was owed by customers from the United States. Markers are not legally enforceable instruments in some foreign countries, but the United States assets of foreign customers may be reached to satisfy judgments entered in the United States. At December 31, 2005 and 2004, approximately 42% and 25%, respectively, of our casino accounts receivable was owed by customers from the Far East.

We maintain an allowance, or reserve, for doubtful casino accounts at all of our operating casino resorts. The provision for doubtful accounts, an operating expense, increases the allowance for doubtful accounts. We regularly evaluate the allowance for doubtful casino accounts. At resorts where marker play is not significant, the allowance is generally established by applying standard reserve percentages to aged account balances. At resorts where marker play is significant, we apply standard reserve percentages to aged account balances under a specified dollar amount and specifically analyze the collectibility of each account with a balance over the specified dollar amount, based on the age of the account, the customer s financial condition, collection history and any other known information. We also monitor regional and global economic conditions and forecasts to determine if reserve levels are adequate.

The collectibility of unpaid markers is affected by a number of factors, including changes in currency exchange rates and economic conditions in the customers home countries. Because individual customer account balances can be significant, the allowance and the provision can change significantly between periods, as information about a certain customer becomes known or as changes in a region s economy occur.

The following table shows key statistics related to our casino receivables:

	At December 31,		
	2005	2004	2003
		(In thousands)	
Casino accounts receivable	$ 221,873	$ 174,713	$ 159,569
Allowance for doubtful casino accounts receivable	68,768	57,111	75,265
Allowance as a percentage of casino accounts receivable	31%	33%	47%
Median age of casino accounts receivable	39 days	33 days	43 days
Percentage of casino accounts outstanding over 180 days	19%	15%	23%

The allowance for doubtful accounts as a percentage of casino accounts receivable has decreased in the last two years, particularly in 2004, as a result of improved collections leading to improved credit statistics. Our reserve percentages for 2004 and 2005 are consistent with the percentage before the September 11, 2001 attacks, and are representative of a more normalized collection experience and positive global economic conditions relative to the conditions in 2001 and 2002.

At December 31, 2005, a 100 basis-point change in the allowance for doubtful accounts as a percentage of casino accounts receivable would change net income by $1.5 million, or less than $0.01 per share.

Fixed asset capitalization and depreciation policies

Property and equipment are stated at cost. For the majority of our property and equipment, cost has been determined based on estimated fair values in connection with the Mandalay acquisition and the May 2000 Mirage Resorts acquisition. Maintenance and repairs that neither materially add to the value of the property nor appreciably prolong its life are charged to expense as incurred. Depreciation and amortization are provided on a straight-line basis over the estimated useful lives of the assets. We account for construction projects in accordance with Statement of

Financial Accounting Standards No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects. When we construct assets, we capitalize direct costs of the project, including fees paid to architects and contractors, property taxes, and certain costs of our design and construction subsidiaries.

We must make estimates and assumptions when accounting for capital expenditures. Whether an expenditure is considered a maintenance expense or a capital asset is a matter of judgment. When constructing or purchasing assets, we must determine whether existing assets are being replaced or otherwise impaired, which also may be a matter of judgment. Our depreciation expense is highly dependent on the assumptions we make about our assets estimated useful lives. We determine the estimated useful lives based on our experience with similar assets, engineering studies, and our estimate of the usage of the asset. Whenever events or circumstances occur which change the estimated useful life of an asset, we account for the change prospectively.

In accordance with Statement of Financial Accounting Standards No. 34, Capitalization of Interest Cost (SFAS 34), interest cost associated with major development and construction projects is capitalized as part of the cost of the project. Interest is typically capitalized on amounts expended on the project using the weighted-average cost of our outstanding borrowings, since we typically do not borrow funds directly related to a development project. Capitalization of interest starts when construction activities, as defined in SFAS 34, begin and ceases when construction is substantially complete or development activity is suspended for more than a brief period.

Whether we capitalize interest on a project depends in part on management s actions. In November 2004, we announced the development of Project CityCenter in Las Vegas. In connection with this announcement and the start of design activities, we began capitalizing interest associated with this project, including capitalizing interest on land costs for the portion of the Project CityCenter site not currently being utilized in operations. Interest capitalized on this project for the years ended December 31, 2004 and 2005 was $2 million and $12 million, respectively.

Impairment of Long-lived Assets

We evaluate our property and equipment and other long-lived assets for impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. For assets to be disposed of, we recognize the asset at the lower of carrying value or fair market value less costs of disposal, as estimated based on comparable asset sales, offers received, or a discounted cash flow model. For assets to be held and used, we review for impairment whenever indicators of impairment exist. We then compare the estimated future cash flows of the asset, on an undiscounted basis, to the carrying value of the asset. If the undiscounted cash flows exceed the carrying value, no impairment is indicated. If the undiscounted cash flows do not exceed the carrying value, then an impairment is recorded based on the fair value of the asset, typically measured using a discounted cash flow model. If an asset is still under development, future cash flows include remaining construction costs. All recognized impairment losses, whether for assets to be disposed of or assets to be held and used, are recorded as operating expenses.

There are several estimates, assumptions and decisions in measuring impairments of long-lived assets. First, management must determine the usage of the asset. To the extent management decides that an asset will be sold, it is more likely that an impairment may be recognized. Assets must be tested at the lowest level for which identifiable cash flows exist. This means that some assets must be grouped, and management has some discretion in the grouping of assets. Future cash flow estimates are, by their nature, subjective and actual results may differ materially from our estimates.

On a quarterly basis, we review our major long-lived assets to determine if events have occurred or circumstances exist that indicate a potential impairment. We estimate future cash flows using our internal budgets. When appropriate, we discount future cash flows using our weighted-average cost of capital, developed using a standard capital asset pricing model. Whenever an impairment loss is recorded, or a test for impairment is made, we discuss the facts and circumstances with the Audit Committee.

See Results of Operations for discussion of write-downs and impairments recorded in 2003, 2004 and 2005. In June 2003, we entered into an agreement to sell the Golden Nugget Subsidiaries. The fair value less costs to sell exceeds the carrying value, therefore no impairment was indicated. In February 2004, we entered into an agreement to sell MGM Grand Australia. The fair value less costs to sell exceeds the carrying value, therefore no impairment was indicated. Other than the above items, we are not aware of events or circumstances that would cause us to review any material long-lived assets for impairment.

Income taxes

We are subject to income taxes in the United States, and in several states and foreign jurisdictions in which we operate. We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). SFAS 109 requires the recognition of deferred tax assets, net of applicable reserves, related to net operating loss carryforwards and certain temporary differences. The standard requires recognition of a future tax benefit to the extent that realization of such benefit is more likely than not. Otherwise, a valuation allowance is applied.

As reflected in Note 11 to the accompanying consolidated financial statements, at December 31, 2005, we had $126 million of deferred tax assets and $3.4 billion of deferred tax liabilities. Except for certain New Jersey state net operating losses, certain other New Jersey state deferred tax assets and certain foreign deferred tax assets, we believe that it is more likely than not that our deferred tax assets are fully realizable because of the future reversal of existing taxable temporary differences and future projected taxable income. The valuation allowance at December 31, 2005 related to the New Jersey and foreign deferred tax assets were $6 million and $2 million, respectively.

Our income tax returns are subject to examination by the Internal Revenue Service (IRS) and other tax authorities. While positions taken in tax returns are sometimes subject to uncertainty in the tax laws, we do not take such positions unless we have substantial authority to do so under the Internal Revenue Code and applicable regulations. We may take positions on our tax returns based on substantial authority that are not ultimately accepted by the IRS.

We assess such potential unfavorable outcomes based on the criteria of Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (SFAS 5). We establish a tax reserve if an unfavorable outcome is probable and the amount of the unfavorable outcome can be reasonably estimated. We assess the potential outcomes of tax uncertainties on a quarterly basis. In determining whether the probable criterion of SFAS 5 is met, we presume that the taxing authority will focus on the exposure and we assess the probable outcome of a particular issue based upon the relevant legal and technical merits. We also apply our judgment regarding the potential actions by the tax authorities and resolution through the settlement process.

We maintain required tax reserves until such time as the underlying issue is resolved. When actual results differ from reserve estimates, we adjust the income tax provision and our tax reserves in the period resolved. For tax years that are examined by taxing authorities, we adjust tax reserves in the year the tax examinations are settled. For tax years that are not examined by taxing authorities, we adjust tax reserves in the year that the statute of limitations expires. Our estimate of the potential outcome for any uncertain tax issue is highly judgmental, and we believe we have adequately provided for any reasonable and foreseeable outcomes related to uncertain tax matters.

During 2003, we filed amended returns for tax years subsequent to 1996 to reflect the impact of the IRS audits of the 1993 through 1996 tax years on those subsequent years. In the fourth quarter of 2003, the statutes of limitations expired for the 1997 through 1999 tax years, resulting in a reduction of our tax reserves of $13 million and a corresponding reduction in our provision for income taxes. In the third quarter of 2004, the statute of limitations expired for our 2000 tax return, resulting in a reduction of our tax reserves of $6 million and a corresponding reduction in our provision for income taxes. The IRS is currently auditing our 2001 and 2002 tax returns, and the tax returns for years after 2002 are subject to possible future examination.

We classify reserves for tax uncertainties within Other accrued liabilities in the accompanying consolidated balance sheets, separate from any related income tax payable or deferred income taxes. Reserve amounts may relate to the deductibility of an item, as well as potential interest associated with those items.

A portion of our tax reserves was assumed in the Mirage Resorts and Mandalay acquisitions. The IRS audit of the tax returns of Mirage Resorts through the merger date was settled in August 2003, resulting in a payment to the IRS of $45 million, including interest. These matters had been previously reserved for, so the settlement had no impact on our goodwill balances. Any future adjustments to the acquired Mirage Resorts and Mandalay tax reserves will be recorded as an adjustment to goodwill.

Business Combinations

We account for business combinations in accordance with Statement of Financial Accounting Standards No, 141, Accounting for Business Combinations (SFAS 141) and Statement of Financial Accounting Standards No. 142, Accounting tor Goodwill and Other Intangible Assets (SFAS 142), and related interpretations. SFAS 141 requires that we record the net assets of acquired businesses at fair value, and we must make estimates and assumptions to determine the fair value of these acquired assets and assumed liabilities.

In determining the fair value of acquired assets and assumed liabilities in the Mandalay acquisition, we hired third-party valuation specialists to assist us with certain fair value estimates, primarily related to land, property and equipment and intangible assets. We and the third-party specialist applied significant judgment and utilized a variety of assumptions in determining the fair value of acquired assets and assumed liabilities, including market data, estimated future cash flows, growth rates, current replacement cost for similar capacity for certain fixed assets, market

rate assumptions for contractual obligations and settlement plans for contingencies and liabilities.

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The Mandalay purchase price allocation is preliminary and may be adjusted up to one year after the acquisition. In particular, the Company is still evaluating certain customer relationship intangible assets related to individual and group hotel reservations as well as gaming loyalty program members. Changes to the assumptions we used to estimate fair value could impact the recorded amounts for acquired assets and assumed liabilities and significant changes to these balances could have a material impact to our future reported results. For instance, lower or higher fair values assigned to property, plant, and equipment and certain amortizable intangible assets could result in lower or higher amounts of depreciation and amortization recorded.

Recently Issued Accounting Standards

Stock-based Compensation

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)). Under the original standard, SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), companies had the option of recording stock options issued to employees at fair value or intrinsic value, which generally leads to no expense being recorded. Most companies, including us, opted to use this intrinsic value method and make required disclosures of fair value expense. SFAS 123(R) eliminates this intrinsic value alternative. SFAS 123(R) was effective for us on January 1, 2006, and all future share-based payments must be recorded at fair value. The following are the key impacts and decisions regarding implementation of SFAS 123(R).

Valuation model. Under SFAS 123, stock options were generally valued using the Black-Scholes model. SFAS 123(R) does not specify which model must be used, but requires that certain assumptions be included in the chosen model, which may be a closed form model, such as the Black-Scholes model, or a binomial model. We have chosen to continue applying the Black-Scholes model.

Vesting patterns. Under SFAS 123(R), awards with graded vesting, as all of our awards have, may be expensed in one of two time patterns: 1) On a straight-line basis over the complete vesting period, as though the entire award was one grant; or 2) On an accelerated basis, treating each vesting layer as a separate grant and amortizing each layer on a straight-line basis. For disclosure purposes under SFAS 123, we used the accelerated basis. We will use the straight-line method for future grants under SFAS 123(R). As discussed below under transition methods, such policy will only apply to future grants. Expense recognized under SFAS 123(R) for previously granted options will continue to be recorded on the accelerated basis.

Estimating forfeitures. Under SFAS 123, we could choose whether to estimate forfeitures at the grant date or recognize actual forfeitures as they occur. Under SFAS 123(R), we must estimate forfeitures as of the grant date.

Presentation of excess tax benefits in the statement of cash flows. Under SFAS 123(R), the excess of tax benefits realized from the exercise of employee stock options over the tax benefit associated with the financial reporting expense is shown as a financing cash inflow in the statement of cash flows. Previously, these excess benefits were shown as an operating cash inflow.

Transition. There are two allowable transition alternatives the modified-prospective transition or the modified-retrospective transition. We will apply the modified-prospective transition. Under the modified-prospective transition, we will begin applying the valuation and other criteria to stock options granted beginning January 1, 2006. We will begin recognizing expense for the unvested portion of previously issued grants at the same time, based on the valuation and attribution methods originally used to calculate the disclosures.

The impact of adopting SFAS 123(R) on our operating results will depend in part on the amount of stock options or other share-based payments we grant in the future. The following table shows compensation expense, net of tax, related to options granted through December 31, 2005, based on the options vesting schedules:

	(In thousands)
2003 (Actual, included in our pro forma disclosures)	$ 43,310
2004 (Actual, included in our pro forma disclosures)	22,963
2005 (Actual, included in our pro forma disclosures)	47,934
2006 (Estimated, to be recorded as expense)	45,595

We do not believe the adoption of SFAS 123(R) will have a material impact on our cash flows or financial position.

Rental costs incurred during a construction period

In October 2005, the Financial Accounting Standards Board issued Staff Position FAS 13-1, Accounting for Rental Costs Incurred during a Construction Period (FSP FAS 13-1). FSP FAS 13-1 requires that rental costs associated with ground or building operating leases incurred during a construction period be expensed. Prevalent practice in real estate and hospitality industries had been to capitalize such rental costs during a construction period as a project cost.

FSP FAS 13-1 is effective for fiscal years beginning after December 15, 2005, with early adoption permitted. We will adopt FSP FAS 13-1 in the first quarter of 2006. We do not believe that the adoption of FSP FAS 13-1 will have a material impact on our cash flows or financial position. We have historically not had significant leases during construction. We will have some minor leases in connection with Project CityCenter, and MGM Grand Paradise Limited will have a land lease for the project site in Macau.

Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency exchange rates and commodity prices. Our primary exposure to market risk is interest rate risk associated with our long-term debt. We attempt to limit our exposure to interest rate risk by managing the mix of our long-term fixed rate borrowings and short-term borrowings under our bank credit facilities.

As of December 31, 2005, long-term fixed rate borrowings represented approximately 61% of our total borrowings. Based on December 31, 2005 debt levels, an assumed 100 basis-point change in LIBOR would cause our annual interest cost to change by approximately $48 million.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We incorporate by reference the information appearing under Market Risk in Item 7 of this Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our Consolidated Financial Statements and Notes to Consolidated Financial Statements, including the Independent Registered Public Accounting Firm s Report thereon, referred to in Item 15(a)(1) of this Form 10-K, are included at pages 49 to 75 of this Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer) have concluded that the design and operation of our disclosure controls and procedures are effective as of December 31, 2005. This conclusion is based on an evaluation conducted under the supervision and with the participation of Company management. Disclosure controls and procedures are those controls and procedures which ensure that information required to be disclosed in this filing is accumulated and communicated to management and is recorded, processed, summarized and reported in a timely manner and in accordance with Securities and Exchange Commission rules and regulations.

Management s Annual Report on Internal Control Over Financial Reporting

Management s Annual Report on Internal Control Over Financial Reporting, referred to in Item 15(a)(1) of this Form 10-K, is included at page 47 of this Form 10-K.

Attestation Report of the Independent Registered Public Accounting Firm

The Independent Registered Public Accounting Firm s Attestation Report on management s assessment of our internal control over financial reporting referred to in Item 15(a)(1) of this Form 10-K, is included at page 48 of this Form 10-K.

Changes in Internal Control over Financial Reporting

During the quarter ended December 31, 2005, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

We incorporate by reference the information appearing under Executive Officers of the Registrant in Item 1 of this Form 10-K and under Election of Directors in our definitive Proxy Statement for our 2006 Annual Meeting of Stockholders, which we expect to file with the Securities and Exchange Commission on or about April 3, 2006 (the Proxy Statement). We have adopted a code of conduct which is posted on our website, along with any amendments or waivers to the Code.

ITEM 11. EXECUTIVE COMPENSATION

We incorporate by reference the information appearing under Executive Compensation and Other Information in the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

We incorporate by reference the information appearing under Principal Stockholders in the Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

We incorporate by reference the information appearing under Certain Transactions in the Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

We incorporate by reference the information appearing under Audit Committee Report in the Proxy Statement.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

(a)(1). **Financial Statements.**

Included in Part II of this Report:
Management s Annual Report on Internal Control Over Financial Reporting
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting
Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements
Consolidated Balance Sheets December 31, 2005 and 2004
Years Ended December 31, 2005, 2004 and 2003
Consolidated Statements of Income
Consolidated Statements of Cash Flows
Consolidated Statements of Stockholders Equity
Notes to Consolidated Financial Statements

(a)(2). **Financial Statement Schedule.**

Included in Part IV of this Report:
Years Ended December 31, 2005, 2004 and 2003
Schedule II Valuation and Qualifying Accounts

We have omitted schedules other than the one listed above because they are not required or are not applicable, or the required information is shown in the financial statements or notes to the financial statements.

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(a)(3). **Exhibits.**

Exhibit Number	Description
2(1)	Agreement and Plan of Merger, dated as of June 15, 2004, among MGM MIRAGE, Mandalay Resort Group and MGM MIRAGE Acquisition Co. #61, a wholly owned subsidiary of MGM MIRAGE (incorporated by reference to Exhibit 2.01 to the Company s Current Report on Form 8-K dated June 17, 2004).
3(1)	Certificate of Incorporation of the Company, as amended through 1997 (incorporated by reference to Exhibit 3(1) to Registration Statement No. 33-3305 and to Exhibit 3(a) to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
3(2)	Certificate of Amendment to Certificate of Incorporation of the Company, dated January 7, 2000, relating to an increase in the authorized shares of common stock (incorporated by reference to Exhibit 3(2) to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 1999 (the 1999 10-K)).
3(3)	Certificate of Amendment to Certificate of Incorporation of the Company, dated January 7, 2000, relating to a 2-for-1 stock split (incorporated by reference to Exhibit 3(3) to the 1999 10-K).
3(4)	Certificate of Amendment to Certificate of Incorporation of the Company, dated August 1, 2000 (incorporated by reference to Exhibit 3(i).4 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2000 (the September 2000 10-Q)).
3(5)	Certificate of Amendment to Certificate of Incorporation of the Company, dated June 3, 2003, relating to compliance with provisions of the New Jersey Casino Control Act relating to holders of Company securities (incorporated by reference to Exhibit 3.1 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2003 (the June 2003 10-Q)).
3(6)	Certificate of Amendment to Certificate of Incorporation of the Company, dated May 3, 2005 (incorporated by reference to Exhibit 3.10 to Amendment No. 1 to the Company s Form 8-A filed with the Commission on May 11, 2005).
3(7)	Amended and Restated Bylaws of the Company, effective May 11, 2004 (incorporated by reference to Exhibit 3.1 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2004 (the June 2004 10-Q).
4(1)	Indenture by and between Mandalay and First Interstate Bank of Nevada, N.A., as Trustee with respect to Mandalay s 7.625% Senior Subordinated Debentures due 2013 (incorporated by reference to Exhibit 4(a) to Mandalay s Current Report on Form 8-K dated July 21, 1993).
4(2)	Indenture, dated February 1, 1996, by and between Mandalay and First Interstate Bank of Nevada, N.A., as Trustee (incorporated by reference to Exhibit 4(b) to Mandalay s Current Report on Form 8-K dated January 29, 1996 (the Mandalay January 1996 8-K)).
4(3)	Supplemental Indenture, dated February 1, 1996, by and between Mandalay and First Interstate Bank of Nevada, N.A., as Trustee, with respect to Mandalay s 6.45% Senior Notes due February 1, 2006 (incorporated by reference to Exhibit 4(c) to the Mandalay January 1996 8-K).

4(4)	6.45% Senior Notes due February 1, 2006 in the principal amount of $200,000,000 (incorporated by reference to Exhibit 4(d) to the Mandalay January 1996 8-K).

Exhibit Number	Description
4 (5)	Indenture, dated as October 15, 1996, between MRI and Firstar Bank of Minnesota, N.A., as trustee (the MRI 1996 Indenture) (incorporated by reference to Exhibit 4.1 to the Quarterly Report on Form 10-Q of Mirage Resorts Incorporated (MRI) (Commission File No. 01-6697) for the fiscal quarter ended September 30, 1996 (the MRI September 1996 10-Q)).
4 (6)	Supplemental Indenture, dated as October 15, 1996, to the MRI 1996 Indenture (incorporated by reference to Exhibit 4.2 to the MRI September 1996 10-Q).
4 (7)	Supplemental Indenture, dated as of November 15, 1996, to an indenture dated February 1, 1996, by and between Mandalay and Wells Fargo Bank (Colorado), N.A., as Trustee, with respect to Mandalay s 6.70% Senior Notes due November 15, 2096 (incorporated by reference to Exhibit 4(c) to Mandalay s Quarterly Report on Form 10-Q for the fiscal quarter ended October 31, 1996 (the Mandalay October 1996 10-Q)).
4 (8)	6.70% Senior Notes due February 15, 2096 in the principal amount of $150,000,000 (incorporated by reference to Exhibit 4(d) to the Mandalay October 1996 10-Q).
4 (9)	Indenture, dated November 15, 1996, by and between Mandalay and Wells Fargo Bank (Colorado), N.A., as Trustee (incorporated by reference to Exhibit 4(e) to the Mandalay October 1996 10-Q).
4 (10)	Supplemental Indenture, dated as of November 15, 1996, to an indenture dated November 15, 1996, by and between Mandalay and Wells Fargo Bank (Colorado), N.A., as Trustee, with respect to Mandalay s 7.0% Senior Notes due November 15, 2036 (incorporated by reference to the Mandalay October 1996 10-Q).
4 (11)	7.0% Senior Notes due February 15, 2036, in the principal amount of $150,000,000 (incorporated by reference to Exhibit 4(g) to the Mandalay October 1996 10-q).
4 (12)	Indenture, dated as of August 1, 1997, between MRI and First Security Bank, National Association, as trustee (the MRI 1997 Indenture) (incorporated by reference to Exhibit 4.1 to the Quarterly Report on Form 10-Q of MRI for the fiscal quarter ended June 30, 1997 (the MRI June 1997 10-Q)).
4 (13)	Supplemental Indenture, dated as of August 1, 1997, to the MRI 1997 Indenture (incorporated by reference to Exhibit 4.2 to the MRI June 1997 10-Q).
4 (14)	Indenture, dated as of February 4, 1998, between MRI and PNC Bank, National Association, as trustee (the MRI 1998 Indenture) (incorporated by reference to Exhibit 4(e) to the Annual Report on Form 10-K of MRI for the fiscal year ended December 31, 1997 (the MRI 1997 10-K)).
4 (15)	Supplemental Indenture, dated as of February 4, 1998, to the MRI 1998 Indenture (incorporated by reference to Exhibit 4(f) to the MRI 1997 10-K).
4 (16)	Indenture, dated as of May 31, 2000, among the Company, as issuer, the Subsidiary Guarantors parties thereto, as guarantors, and The Bank of New York, as trustee (incorporated by reference to

	Exhibit 4 to the Company s Current Report on Form 8-K dated May 22, 2000 (the May 2000 8-K)).
4 (17)	Indenture dated as of July 24, 2000 by and between Mandalay and The Bank of New York with respect to $500 million aggregate principal amount of 10.25% Senior Subordinated Notes due 2007 (incorporated by reference to Exhibit 4.1 to Mandalay s Form S-4 Registration Statement No. 333-44216).
4 (18)	Indenture dated as of August 16, 2000 by and between Mandalay and The Bank of New York, with respect to $200 million aggregate principal amount of 9.5% Senior Notes due 2008 (incorporated by reference to Exhibit 4.1 to Mandalay s Form S-4 Registration Statement No. 333-44838).

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Exhibit Number	Description
4(19)	Indenture, dated as of September 15, 2000, among the Company, as issuer, the Subsidiary Guarantors parties thereto, as guarantors, and U.S. Trust Company, National Association, as trustee (incorporated by reference to Exhibit 4 to the Company s Amended Current Report on Form 8-K/A dated September 12, 2000).
4(20)	First Supplemental Indenture, dated as of September 15, 2000, among the Company, Bellagio Merger Sub, LLC and U.S. Trust Company, National Association, as trustee (incorporated by reference to Exhibit 4(11) to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 (the 2000 10-K)).
4(21)	First Supplemental Indenture, dated as of September 30, 2000, among the Company, Bellagio Merger Sub, LLC and The Bank of New York, as trustee (incorporated by reference to Exhibit 4(12) to the 2000 10-K).
4(22)	Second Supplemental Indenture, dated as of October 10, 2000, to the MRI 1996 Indenture (incorporated by reference to Exhibit 4(13) to the 2000 10-K).
4(23)	Second Supplemental Indenture, dated as of October 10, 2000, to the MRI 1997 Indenture (incorporated by reference to Exhibit 4(14) to the 2000 10-K).
4(24)	Second Supplemental Indenture, dated as of October 10, 2000, to the MRI 1998 Indenture (incorporated by reference to Exhibit 4(15) to the 2000 10-K).
4(25)	Second Supplemental Indenture, dated as of December 31, 2000, among the Company, MGM Grand Hotel & Casino Merger Sub, LLC and The Bank of New York, as trustee (incorporated by reference to Exhibit 4(16) to the 2000 10-K).
4(26)	Second Supplemental Indenture, dated as of December 31, 2000, among the Company, MGM Grand Hotel & Casino Merger Sub, LLC and U.S. Trust Company, National Association, as trustee (incorporated by reference to Exhibit 4(17) to the 2000 10-K).
4(27)	Indenture, dated as of January 23, 2001, among the Company, as issuer, the Subsidiary Guarantors parties thereto, as guarantors, and United States Trust Company of New York, as trustee (incorporated by reference to Exhibit 4 to the Company s Current Report on Form 8-K dated January 18, 2001).
4(28)	Indenture dated as of December 20, 2001 by and among Mandalay and The Bank of New York, with respect to $300 million aggregate principal amount of 9.375% Senior Subordinated Notes due 2010 (incorporated by reference to Exhibit 4.1 to Mandalay s Form S-4 Registration Statement No. 333-82936).
4(29)	Indenture dated as of March 21, 2003 by and among Mandalay and The Bank of New York with respect to $400 million aggregate principal amount of Floating Rate Convertible Senior Debentures due 2033 (incorporated by reference to Exhibit 4.44 to Mandalay s Annual Report on Form 10-K for the fiscal year ended January 31, 2003).

4(30)	First Supplemental Indenture dated as of July 26, 2004, relating to Mandalay s Floating Rate Senior Convertible Debentures due 2033 (incorporated by reference to Exhibit 4 to Mandalay s Current Report on Form 8-K dated July 26, 2004).
4(31)	Indenture, dated as of July 31, 2003, by and between Mandalay and The Bank of New York with respect to $250 million aggregate principal amount of 6.5% Senior Notes due 2009 (incorporated by reference to Exhibit 4.1 to Mandalay s Quarterly Report on Form 10-Q for the fiscal quarter ended July 31, 2003).
4(32)	Indenture, dated as of September 17, 2003, among the Company, as issuer, the Subsidiary Guarantors parties thereto, as guarantors, and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K dated September 11, 2003).

Exhibit Number	Description
4 (33)	Indenture, dated as of November 25, 2003, by and between Mandalay and The Bank of New York with respect to $250 million aggregate principal amount of 6.375% Senior Notes due 2011 (incorporated by reference to Exhibit 4.1 to Mandalay s Quarterly Report on Form 10-Q for the fiscal quarter ended October 31, 2003).
4 (34)	Indenture dated as of February 27, 2004, among the Company, as issuer, the Subsidiary Guarantors, as guarantors, and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K, dated February 27, 2004).
4 (35)	Indenture dated as of August 25, 2004, among the Company, as issuer, certain subsidiaries of the Company, as guarantors, and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K dated August 25, 2004).
4 (36)	Indenture, dated June 20, 2005, among MGM MIRAGE, certain subsidiaries of MGM MIRAGE, and U.S. Bank National Association (incorporated by reference to Exhibit 99.1 to the Company s Current Report on Form 8-K dated June 20, 2005).
4 (37)	Supplemental Indenture, dated September 9, 2005, among MGM MIRAGE, certain subsidiaries of MGM MIRAGE, and U.S. Bank National Association (incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K dated September 9, 2005).
10.1(1)	Guarantee, dated as of May 31, 2000, by certain subsidiaries of the Company, in favor of The Chase Manhattan Bank, as successor in interest to PNC Bank, National Association, as trustee for the benefit of the holders of Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.4 to the May 2000 8-K).
10.1(2)	Schedule setting forth material details of the Guarantee, dated as of May 31, 2000, by certain subsidiaries of the Company, in favor of U.S. Trust Company, National Association (formerly known as U.S. Trust Company of California, N.A.), as trustee for the benefit of the holders of Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.5 to the May 2000 8-K).
10.1(3)	Guarantee (Mirage Resorts, Incorporated 7.25% Senior Notes Due October 15, 2006), dated as of May 31, 2000, by the Company and certain of its subsidiaries, in favor of Firstar Bank of Minnesota, N.A., as trustee for the benefit of the holders of Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.6 to the May 2000 8-K).
10.1(4)	Schedule setting forth material details of the Guarantee (Mirage Resorts, Incorporated 6.75% Notes Due February 1, 2008), dated as of May 31, 2000, by the Company and certain of its subsidiaries, in favor of The Chase Manhattan Bank, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.7 to the May 2000 8-K).

10.1(5)	Schedule setting forth material details of the Guarantee (Mirage Resorts, Incorporated 6.75% Notes Due August 1, 2007 and 7.25% Debentures Due August 1, 2017), dated as of May 31, 2000, by the Company and certain of its subsidiaries, in favor of First Security Bank, National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.8 to the May 2000 8-K).
10.1(6)	Instrument of Joinder, dated as of May 31, 2000, by MRI and certain of its wholly owned subsidiaries, in favor of the beneficiaries of the Guarantees referred to therein (incorporated by reference to Exhibit 10.9 to the May 2000 8-K).
10.1(7)	Guarantee (MGM MIRAGE 9.75% Senior Subordinated Notes due 2007) dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York N.A., as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.6 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2005 (the September 2005 10-Q)).

Exhibit Number	Description
10.1(8)	Guarantee (MGM MIRAGE 8.5% Senior Notes due 2010), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York N.A., as successor to U.S. Trust Company, National Association, for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.7 to the September 2005 10-Q).
10.1(9)	Guarantee (Mirage Resorts, Incorporated 7.25% Senior Notes due 2006), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of U.S. Bank National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.8 to the September 2005 10-Q).
10.1(10)	Guarantee (Mandalay Resort Group 7.625% Senior Subordinated Notes due 2013), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.9 to the September 2005 10-Q).
10.1(11)	Guarantee (Mandalay Resort Group 6.45% Senior Notes due 2006), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of Wells Fargo Bank (Colorado), N.A., as successor in interest to First Interstate Bank of Nevada, N.A., as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.10 to the September 2005 10-Q).
10.1(12)	Guarantee (MGM MIRAGE 8.375% Senior Subordinated Notes due 2011), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York N.A., successor to the United States Trust Company of New York, as trustee for the benefit of holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.11 to the September 2005 10-Q).
10.1(13)	Guarantee (MGM MIRAGE 6.0% Senior Notes due 2009), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of U.S. Bank National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.12 to the September 2005 10-Q).
10.1(14)	Guarantee (MGM MIRAGE 6.0% Senior Notes due 2009 (Exchange Notes)), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of U.S. Bank National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.13 to the September 2005 10-Q).
10.1(15)	Guarantee (MGM MIRAGE 5.875% Senior Notes due 2014), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of U.S. Bank National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.14 to the September 2005 10-Q).
10.1(16)	Guarantee (MGM MIRAGE 5.875% Senior Notes due 2014 (Exchange Notes)), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of U.S. Bank National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture

	referred to therein (incorporated by reference to Exhibit 10.15 to the September 2005 10-Q).
10.1(17)	Guarantee (MGM MIRAGE 6.75% Senior Notes due 2012), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of U.S. Bank National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.16 to the September 2005 10-Q).
10.1(18)	Guarantee (Mirage Resorts, Incorporated 6.75% Senior Notes due 2007 and 7.25% Debentures due 2017), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of Wells Fargo Bank Northwest, National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.17 to the September 2005 10-Q).

Exhibit Number	Description
10.1(19)	Guarantee (Mirage Resorts, Incorporated 6.75% Senior Notes due 2008), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of JPMorgan Chase Bank, N.A., successor in interest to PNC Bank, National Association, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.18 to the September 2005 10-Q).
10.1(20)	Guarantee (Mandalay Resort Group 10.25% Senior Subordinated Notes due 2007), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.19 to the September 2005 10-Q).
10.1(21)	Guarantee (Mandalay Resort Group 9.375% Senior Subordinated Notes due 2010), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.20 to the September 2005 10-Q).
10.1(22)	Guarantee (Mandalay Resort Group 6.70% Senior Notes due 2096), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as successor in interest to First Interstate Bank of Nevada, N.A., as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.21 to the September 2005 10-Q).
10.1(23)	Guarantee (Mandalay Resort Group 7.0% Senior Notes due 2036), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.22 to the September 2005 10-Q).
10.1(24)	Guarantee (Mandalay Resort Group 9.5% Senior Notes due 2008), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.23 to the September 2005 10-Q).
10.1(25)	Guarantee (Mandalay Resort Group Floating Rate Convertible Senior Debentures due 2033), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.24 to the September 2005 10-Q).
10.1(26)	Guarantee (Mandalay Resort Group 6.5% Senior Notes due 2009), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.25 to the September 2005 10-Q).
10.1(27)	Guarantee (Mandalay Resort Group 6.375% Senior Notes due 2011), dated as of April 25, 2005, by certain subsidiaries of MGM MIRAGE, in favor of The Bank of New York, as trustee for the benefit of the holders of the Notes pursuant to the Indenture referred to therein (incorporated by reference to Exhibit 10.26 to the September 2005 10-Q).

10.1(28)	Fourth Amended and Restated Loan Agreement, dated November 22, 2004, by and among the Company, as Borrower, MGM Grand Detroit, LLC, as a Co-Borrower, the Lenders and Co-Documentation Agents therein named, Bank of America, N.A., as the Administrative Agent, The Royal Bank of Scotland PLC, as the Syndication Agent, and Bank of America Securities LLC and The Royal Bank of Scotland PLC, as Joint Lead Arrangers and Joint Book Managers (incorporated by reference to Exhibit 10.1(10) to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004).

Exhibit Number	Description
10.1(29)	Guaranty Agreement, dated August 16, 2004, by MGM MIRAGE in favor of Bank of America, N.A., as Administrative Agent for the benefit of the Lenders from time to time party to a Construction Loan Agreement with the Borrower, Turnberry/MGM Grand Towers, LLC (incorporated by reference to Exhibit 10.2 of the September 2004 10-Q).
10.1(30)	Guaranty Agreement, dated September 21, 2005, by MGM MIRAGE in favor of Bank of America, N.A., as Administrative Agent for the benefit of the Lenders from time to time party to a Construction Loan Agreement with the Borrower, Turnberry/MGM Grand Tower B, LLC.
10.2(1)	Lease, dated August 3, 1977, by and between B&D Properties, Inc., as lessor, and Mandalay, as lessee; Amendment of Lease, dated May 6, 1983 (incorporated by reference to Exhibit 10(h) to Mandalay s Registration Statement (No. 2-85794) on Form S-1).
10.2(2)	Lease by and between Robert Lewis Uccelli, guardian, as lessor, and Nevada Greens, a limited partnership, William N. Pennington, as trustee, and William G. Bennett, as trustee, and related Assignment of Lease (incorporated by reference to Exhibit 10(p) to Mandalay s Registration Statement (No. 33-4475) on Form S-1).
10.2(3)	Amended and Restated Ground Lease Agreement, dated July 1, 1993, between Primm South Real Estate Company and The Primadonna Corporation (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q of Primadonna Resorts, Inc. (Commission File No. 0-21732) for the fiscal quarter ended September 30, 1993).
10.2(4)	First Amendment to the Amended and Restated Ground Lease Agreement and Consent and Waiver, dated as of August 25, 1997, between The Primadonna Corporation and Primm South Real Estate Company (incorporated by reference to Exhibit 10.31 to the Annual Report on Form 10-K of Primadonna Resorts, Inc. for the fiscal year ended December 31, 1997).
10.2(5)	Public Trust Tidelands Lease, dated February 4, 1999, between the State of Mississippi and Beau Rivage Resorts, Inc. (without exhibits) (incorporated by reference to Exhibit 10.73 to the Annual Report on Form 10-K of MRI for the fiscal year ended December 31, 1999).
*10.3(1)	Nonqualified Stock Option Plan (incorporated by reference to Exhibit 10(1) to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 1996).
*10.3(2)	1997 Nonqualified Stock Option Plan, Amended and Restated February 2, 2004 (incorporated by reference to Exhibit 10.1 of the June 2004 10-Q).
*10.3(3)	MGM MIRAGE 2005 Omnibus Incentive Plan (incorporated by reference to Exhibit 10 to the Company s Registration Statement on Form S-8 filed May 12, 2005).
*10.3(4)	Amended and Restated Annual Performance Based Incentive Plan for Executive Officers, giving effect to amendment approved by the Company s shareholders on May 13, 2003 (incorporated by reference to Appendix B to the Company s 2003 Proxy Statement).
*10.3(5)	

Non-Qualified Deferred Compensation Plan, dated as of January 1, 2001 (incorporated by reference to Exhibit 10.3(12) to the 2000 10-K).

*10.3(6) Supplemental Executive Retirement Plan, dated as of January 1, 2001 (incorporated by reference to Exhibit 10.3(13) to the 2000 10-K).

*10.3(7) Deferred Compensation Plan II, dated as of December 30, 2004 (incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K dated January 10, 2005 (the January 2005 8-K).

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Exhibit Number	Description
*10.3(8)	Supplemental Executive Retirement Plan II, dated as of December 30, 2004 (incorporated by reference to Exhibit 10.1 to the January 2005 8-K).
*10.3(9)	Amendment to Deferred Compensation Plan II, dated as of December 21, 2005.
*10.3(10)	Employment Agreement, dated September 16, 2005 between the Company and J. Terrence Lanni (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K dated September 16, 2005 (the September 16, 2005 8-K)).
*10.3(11)	Employment Agreement, dated September 16, 2005 between the Company and Robert H. Baldwin (incorporated by reference to Exhibit 10.2 to the September 16, 2005 8-K).
*10.3(12)	Employment Agreement, dated September 16, 2005 between the Company and John Redmond (incorporated by reference to Exhibit 10.3 to the September 16, 2005 8-K).
*10.3(13)	Employment Agreement, dated September 16, 2005 between the Company and James J. Murren (incorporated by reference to Exhibit 10.4 to the September 16, 2005 8-K).
*10.3(14)	Employment Agreement, dated September 16, 2005 between the Company and Gary N. Jacobs (incorporated by reference to Exhibit 10.5 to the September 16, 2005 8-K).
10.4(1)	Second Amended and Restated Joint Venture Agreement of Marina District Development Company, dated as of August 31, 2000, between MAC, CORP. and Boyd Atlantic City, Inc. (without exhibits) (incorporated by reference to Exhibit 10.2 to the September 2000 10-Q).
10.4(2)	Contribution and Adoption Agreement, dated as of December 13, 2000, among Marina District Development Holding Co., LLC, MAC, CORP. and Boyd Atlantic City, Inc. (incorporated by reference to Exhibit 10.4(15) to the 2000 10-K).
10.4(3)	Amended and Restated Agreement of Joint Venture of Circus and Eldorado Joint Venture by and between Eldorado Limited Liability Company and Galleon, Inc. (incorporated by reference to Exhibit 3.3 to the Form S-4 Registration Statement of Circus and Eldorado Joint Venture and Silver Legacy Capital Corp. Commission File No. 333-87202).
10.4(4)	Amended and Restated Joint Venture Agreement, dated as of June 25, 2002, between Nevada Landing Partnership and RBG, L.P. (incorporated by reference to Exhibit 10.1 to Mandalay s Quarterly Report on Form 10-Q for the fiscal quarter ended July 31, 2004.)
10.4(5)	Amendment No.1 to Amended and Restated Joint Venture Agreement, dated as of April 25, 2005, by and among Nevada Landing Partnership, an Illinois general partnership, and RBG, L.P., an Illinois limited partnership.
10.4(6)	Amended and Restated Subscription and Shareholders Agreement, dated June 19, 2004, among Pansy Ho, Grand Paradise Macau Limited, MGMM Macau, Ltd., MGM MIRAGE Macau, Ltd., MGM MIRAGE and MGM Grand Paradise Limited (formerly N.V. Limited) (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K dated

April 19, 2005).

10.5(1)	Revised Development Agreement among the City of Detroit, The Economic Development Corporation of the City of Detroit and MGM Grand Detroit, LLC (incorporated by reference to Exhibit 10.10 to the June 2002 10-Q).
10.5(2)	Revised Development Agreement effective August 2, 2002, by and among the City of Detroit, The Economic Development Corporation of the City of Detroit and Detroit Entertainment, L.L.C. (incorporated by reference to Exhibit 10.61 of Mandalay s Annual Report on Form 10-K for the year ended January 31, 2005).
10.6(1)	Agreement and Plan of Merger dated as of March 22, 2005 among Mandalay Resort Group, MGM MIRAGE, Circus Circus Michigan, Inc., CCM Merger Inc., and CCM Merger Sub., Inc. (incorporated by reference to Exhibit 2.01 to Mandalay s Current Report on Form 8-K dated March 22, 2005).

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Exhibit Number	Description
10.6 (2)	Letter Agreement, dated March 22, 2005, between MGM MIRAGE and CCM Merger Inc. (incorporated by reference to Exhibit 10.2 of the Company s Current Report on Form 8-K dated March 22, 2005).
21	List of subsidiaries of the Company.
23	Consent of Deloitte & Touche LLP.
31.1	Certification of Chief Executive Officer of Periodic Report Pursuant to Rule 13a 14(a) and Rule 15d 14(a).
31.2	Certification of Chief Financial Officer of Periodic Report Pursuant to Rule 13a 14(a) and Rule 15d 14(a).
**32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.
**32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.
99	Description of Regulation and Licensing.

* Management contract or compensatory plan or arrangement.

** Exhibits 32.1 and 32.2 shall not be deemed filed with the Securities and Exchange Commission, nor shall they be deemed incorporated by reference in any filing with the Securities and Exchange Commission under the Securities Exchange Act of 1934 or the Securities Act of 1933, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

MANAGEMENT S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management s Responsibilities

Management is responsible for establishing and maintaining adequate internal control over financial reporting for MGM MIRAGE and subsidiaries (the Company).

Objective of Internal Control Over Financial Reporting

In establishing adequate internal control over financial reporting, management has developed and maintained a system of internal control, policies and procedures designed to provide reasonable assurance that information contained in the accompanying consolidated financial statements and other information presented in this annual report is reliable, does not contain any untrue statement of a material fact or omit to state a material fact, and fairly presents in all material respects the financial condition, results of operations and cash flows of the Company as of and for the periods presented in this annual report. Significant elements of the Company s internal control over financial reporting include, for example:

Hiring skilled accounting personnel and training them appropriately;

Written accounting policies;

Written documentation of accounting systems and procedures;

Segregation of incompatible duties;

Internal audit function to monitor the effectiveness of the system of internal control;

Oversight by an independent Audit Committee of the Board of Directors.

Management s Evaluation

Management has evaluated the Company s internal control over financial reporting using the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. As permitted by the Securities and Exchange Commission, management s evaluation as of December 31, 2005 excludes Mandalay Resort Group (Mandalay) and the business units acquired in the merger with Mandalay which closed on April 25, 2005. Such businesses represent approximately 47% of the Company s total assets as of December 31, 2005 and 29% of the Company s total revenues for the year ended December 31, 2005. Based on its evaluation as of December 31, 2005, management believes that the Company s internal control over financial reporting, excluding Mandalay, is effective in achieving the objectives described above.

Report of Independent Registered Public Accounting Firm

Deloitte & Touche LLP audited the Company s consolidated financial statements as of and for the period ended December 31, 2005 and issued their report thereon, which is included in this annual report. Deloitte & Touche LLP has also issued an attestation report on management s assessment and on the effectiveness of the Company s internal control over financial reporting, excluding Mandalay, and such report is also included in this annual report.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
of MGM MIRAGE

We have audited management s assessment, included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting, that MGM MIRAGE and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management s Annual Report on Internal Control Over Financial Reporting, management excluded from their assessment the internal control over financial reporting of Mandalay Resort Group (Mandalay) and the business units acquired in the merger which closed on April 25, 2005. Such businesses represent approximately 47% of the Company s total assets as of December 31, 2005 and 29% of the Company s total revenues for the year ended December 31, 2005. Accordingly, our audit did not include the internal control over financial reporting of Mandalay and the business units acquired in the merger. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2005 of the Company and our report dated March 10, 2006 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

Las Vegas, Nevada
March 10, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
of MGM MIRAGE

We have audited the accompanying consolidated balance sheets of MGM MIRAGE and subsidiaries (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule of Valuation and Qualifying Accounts included in Item 15(a)(2). These financial statements and the financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 10, 2006 expressed an unqualified opinion on management s assessment of the effectiveness of the Company s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Las Vegas, Nevada
March 10, 2006

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MGM MIRAGE AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	At December 31, 2005	At December 31, 2004
ASSETS		
Current assets		
Cash and cash equivalents	$ 377,933	$ 435,128
Accounts receivable, net	352,673	204,151
Inventories	111,825	70,333
Deferred income taxes	65,518	28,928
Prepaid expenses and other	110,634	81,662
Total current assets	1,018,583	820,202
Property and equipment, net	16,541,651	8,914,142
Other assets		
Investments in unconsolidated affiliates	931,154	842,640
Goodwill and other intangible assets, net	1,692,040	233,335
Deposits and other assets, net	515,992	304,710
Total other assets	3,139,186	1,380,685
	$ 20,699,420	$ 11,115,029
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 265,601	$ 198,050
Income taxes payable	125,503	4,991
Current portion of long-term debt	14	14
Accrued interest on long-term debt	229,930	116,997
Other accrued liabilities	913,520	607,925
Total current liabilities	1,534,568	927,977
Deferred income taxes	3,378,371	1,802,008
Long-term debt	12,355,433	5,458,848
Other long-term obligations	195,976	154,492
Commitments and contingencies (Note 12)		
Stockholders equity		
	3,573	3,472

Common stock, $.01 par value: authorized 600,000,000 shares, issued 357,262,405 and 347,147,868 shares; outstanding 285,069,516 and 280,739,868 shares		
Capital in excess of par value	2,586,587	2,346,329
Deferred compensation	(3,618)	(10,878)
Treasury stock, at cost (72,192,889 and 66,408,000 shares)	(1,338,394)	(1,110,551)
Retained earnings	1,987,725	1,544,499
Accumulated other comprehensive loss	(801)	(1,167)
Total stockholders equity	3,235,072	2,771,704
	$ 20,699,420	$ 11,115,029

The accompanying notes are an integral part of these consolidated financial statements.

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MGM MIRAGE AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)

	Year Ended December 31,		
	2005	**2004**	**2003**
Revenues			
Casino	$ 2,981,651	$ 2,223,965	$ 2,037,514
Rooms	1,673,696	911,259	833,272
Food and beverage	1,330,210	841,147	757,278
Entertainment	428,606	270,799	255,995
Retail	260,182	184,438	180,935
Other	409,824	240,880	210,772
	7,084,169	4,672,488	4,275,766
Less: Promotional allowances	(602,202)	(434,384)	(413,023)
	6,481,967	4,238,104	3,862,743
Expenses			
Casino	1,536,611	1,101,892	1,050,397
Rooms	472,592	248,166	235,899
Food and beverage	816,570	482,079	436,929
Entertainment	307,596	192,465	183,056
Retail	169,667	118,470	115,235
Other	244,023	146,177	130,720
General and administrative	958,263	612,632	585,161
Corporate expense	130,633	77,910	61,541
Preopening and start-up expenses	15,752	10,276	29,266
Restructuring costs (credit)	(59)	5,625	6,597
Property transactions, net	36,880	8,665	(18,941)
Depreciation and amortization	588,102	402,545	400,766
	5,276,630	3,406,902	3,216,626
Income from unconsolidated affiliates	151,871	119,658	53,612
Operating income	1,357,208	950,860	699,729
Non-operating income (expense)			
Interest income	12,110	5,664	4,078
Interest expense, net	(656,159)	(378,386)	(337,586)
Non-operating items from unconsolidated affiliates	(15,825)	(12,298)	(10,401)
Other, net	(18,434)	(10,025)	(12,160)

	(678,308)	(395,045)	(356,069)
Income from continuing operations before income taxes	678,900	555,815	343,660
Provision for income taxes	(235,644)	(205,959)	(113,387)
Income from continuing operations	443,256	349,856	230,273
Discontinued operations			
Income from discontinued operations, including gain (loss) on disposal of $82,538 (2004) and $(6,735) (2003)		94,207	16,075
Provision for income taxes		(31,731)	(2,651)
		62,476	13,424
Net income	$ 443,256	$ 412,332	$ 243,697
Basic income per share of common stock			
Income from continuing operations	$ 1.56	$ 1.25	$ 0.77
Discontinued operations		0.23	0.05
Net income per share	$ 1.56	$ 1.48	$ 0.82
Diluted income per share of common stock			
Income from continuing operations	$ 1.50	$ 1.21	$ 0.76
Discontinued operations		0.22	0.04
Net income per share	$ 1.50	$ 1.43	$ 0.80

The accompanying notes are an integral part of these consolidated financial statements.

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MGM MIRAGE AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2005	**2004**	**2003**
Cash flows from operating activities			
Net income	$ 443,256	$ 412,332	$ 243,697
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	588,102	403,039	412,937
Amortizational debt discounts, premiums and issuance costs	5,791	31,217	35,826
Provision for doubtful accounts	25,846	(3,522)	13,668
Property transactions, net	36,880	8,661	(18,336)
Loss on early retirements of debt	18,139	5,527	3,244
(Gain) loss on disposal of discontinued operations		(82,538)	6,735
Income from unconsolidated affiliates	(134,132)	(107,360)	(23,885)
Distributions from unconsolidated affiliates	89,857	51,500	38,000
Deferred income taxes	51,759	55,647	28,362
Tax benefit from stock option exercises	94,083	38,911	9,505
Changes in current assets and liabilities:			
Accounts receivable	(68,159)	(48,533)	(14,330)
Inventories	(7,017)	(8,557)	(2,205)
Income taxes receivable and payable	8,058	14,891	(10,538)
Prepaid expenses and other	10,830	1,109	(8,500)
Accounts payable and accrued liabilities	75,404	72,392	53,971
Change in Hurricane Katrina insurance receivable	(46,275)		
Other	(9,626)	(15,469)	(27,339)
Net cash provided by operating activities	1,182,796	829,247	740,812
Cash flows from investing activities			
Acquisition of Mandalay Resort Group, net of cash acquired	(4,420,990)		
Capital expenditures	(759,949)	(702,862)	(550,232)
Proceeds from the sale of the Golden Nugget Subsidiaries and MGM Grand Australia, net		345,730	
Hurricane Katrina insurance proceeds	46,250		
Dispositions of property and equipment	7,828	32,978	56,614
Investments in unconsolidated affiliates	(183,000)	(11,602)	(41,350)
Change in construction payable	40,803	17,329	12,953
Other	(33,759)	(29,326)	(33,673)
Net cash used in investing activities	(5,302,817)	(347,753)	(555,688)
Cash flows from financing activities			
Net borrowings (repayments) under bank credit facilities with maturities of	325,000	(1,574,489)	(285,087)

90 days of less			
Borrowings under bank credit facilities with maturities longer than 90 days	4,400,000		
Issuance of long-term debt	880,156	1,528,957	600,000
Repayment of long-term debt	(1,408,992)	(52,149)	(28,011)
Debt issuance costs	(50,331)	(13,349)	(25,374)
Issuance of common stock	145,761	135,910	36,254
Purchases of treasury stock	(217,316)	(348,895)	(442,864)
Other	(11,452)	(1,957)	(20,153)
Net cash provided by (used in) financing activities	4,062,826	(325,972)	(165,235)
Cash and cash equivalents			
Net increase (decrease) for the year	(57,195)	155,522	19,889
Cash related to discontinued operations			(15,230)
Balance, beginning of year	435,128	279,606	274,947
Balance, end of year	$ 377,933	$ 435,128	$ 279,606
Supplemental cash flow disclosures			
Interest paid, net of amounts capitalized	$ 588,587	$ 321,008	$ 308,198
State, federal and foreign income taxes paid	75,776	128,393	94,932

The accompanying notes are an integral part of these consolidated financial statements.

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MGM MIRAGE AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(In thousands)
For the Years Ended December 31, 2005, 2004 and 2003

	Common Stock Shares Outstanding	Common Stock Par Value	Capital in Excess of Par Value	Deferred Compensation	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balances, January 1, 2003	309,148	$ 3,328	$ 2,125,626	$ (27,034)	$ (317,432)	$ 888,542	$ (8,886)	$ 2,664,144
Net income						243,697		243,697
Currency translation adjustment							12,313	12,313
Derivative income from unconsolidated affiliate, net							2,918	2,918
Total comprehensive income								258,928
Cancellation of restricted stock	(20)		(54)	352	(298)			
Issuance of stock options to non-employees			313	(313)				
Amortization of deferred compensation				7,821				7,821
Issuance of common stock upon exercise of stock options	3,750	38	36,235			(19)		36,254
Purchases of treasury stock	(26,686)				(442,864)			(442,864)
Tax benefit from stock option exercises			9,505					9,505
Balances, December 31, 2003	286,192	3,366	2,171,625	(19,174)	(760,594)	1,132,220	6,345	2,533,788

Net income						412,332		412,332
Currency translation adjustment							(10,336)	(10,336)
Derivative income from unconsolidated affiliate, net							2,824	2,824
Total comprehensive income								404,820
Cancellation of restricted stock	(64)		(64)	1,126	(1,062)			
Amortization of deferred compensation				7,170				7,170
Issuance of common stock upon exercise of stock options	10,612	106	135,857			(53)		135,910
Purchases of treasury stock	(16,000)				(348,895)			(348,895)
Tax benefit from stock option exercises			38,911					38,911
Balances, December 31, 2004	280,740	3,472	2,346,329	(10,878)	(1,110,551)	1,544,499	(1,167)	2,771,704
Net income						443,256		443,256
Currency translation adjustment							(1,631)	(1,631)
Derivative income from unconsolidated affiliate, net							1,997	1,997
Total comprehensive income								443,622
Cancellation of restricted stock	(24)			422	(422)			
Issuance of stock options to non-employees			485	(485)				

Amortization of deferred compensation				7,323				7,323
Issuance of common stock upon exercise of stock options	10,115	101	145,690			(30)		145,761
Purchases of treasury stock	(5,500)				(217,316)			(217,316)
Restricted shares turned in for tax withholding	(261)				(10,105)			(10,105)
Tax benefit from stock option exercises			94,083					94,083
Balances, December 31, 2005	285,070	$ 3,573	$ 2,586,587	$ (3,618)	$ (1,338,394)	$ 1,987,725	$ (801)	$ 3,235,072

The accompanying notes are an integral part of these consolidated financial statements.

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MGM MIRAGE AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION

MGM MIRAGE (the Company) is a Delaware corporation, incorporated on January 29, 1986. As of December 31, 2005, approximately 56% of the outstanding shares of the Company s common stock were owned by Tracinda Corporation, a Nevada corporation wholly owned by Kirk Kerkorian. MGM MIRAGE acts largely as a holding company and, through wholly-owned subsidiaries, owns and/or operates casino resorts. On April 25, 2005, the Company completed its merger with Mandalay Resort Group (Mandalay) see Note 3.

The Company owns and operates the following casino resorts in Las Vegas, Nevada: Bellagio, MGM Grand Las Vegas, Mandalay Bay, The Mirage, Luxor, Treasure Island (TI), New York-New York, Excalibur, Monte Carlo, Circus Circus Las Vegas and Slots-A-Fun. The Boardwalk was closed in early 2006 in preparation for Project CityCenter (see below). The Company owns three resorts in Primm, Nevada, at the California/Nevada state line Whiskey Pete s, Buffalo Bill s and the Primm Valley Resort as well as two championship golf courses located near the resorts. Other Nevada operations include Circus Circus Reno, Colorado Belle and Edgewater in Laughlin, Gold Strike and Nevada Landing in Jean, and Railroad Pass in Henderson. The Company has a 50% investment in Silver Legacy in Reno, which is adjacent to Circus Circus Reno. In addition, the Company owns a 50% interest in The Signature at MGM Grand, which is adjacent to MGM Grand Las Vegas. The Signature at MGM Grand is a condominium-hotel development, with three towers currently under construction. The Company also owns Shadow Creek, an exclusive world-class golf course located approximately ten miles north of its Las Vegas Strip resorts.

The Company and its local partners own MGM Grand Detroit, LLC, which operates a casino in an interim facility located in downtown Detroit, Michigan. The Company also owns and operates two resorts in Mississippi Beau Rivage in Biloxi and Gold Strike Tunica. Beau Rivage sustained significant damage in late August 2005 as a result of Hurricane Katrina and has been closed since. The Company expects to reopen Beau Rivage in stages beginning in the third quarter of 2006. The Company has 50% interests in two resorts outside of Nevada Borgata and Grand Victoria. Borgata is a casino resort located on Renaissance Point in the Marina area of Atlantic City, New Jersey. Boyd Gaming Corporation owns the other 50% of Borgata and also operates the resort. The Company owns additional land adjacent to Borgata, a portion of which consists of common roads, landscaping and master plan improvements, a portion of which is being utilized for an expansion of Borgata, and a portion of which is available for future development. Grand Victoria is a riverboat in Elgin, Illinois that was previously owned by Mandalay. An affiliate of Hyatt Gaming owns the other 50% of Grand Victoria and also operates the resort.

The Company owns 50% of MGM Grand Paradise Limited, a joint venture with Pansy Ho Chiu-king formed to develop, build and operate a hotel-casino resort, MGM Grand Macau, in Macau S.A.R. In April 2005, MGM Grand Paradise Limited obtained a subconcession allowing it to conduct gaming operations. Construction of MGM Grand Macau, which is estimated to cost approximately $1.1 billion including land and license rights and preopening costs, began in the second quarter of 2005 and the resort is anticipated to open in late 2007.

The Company owns 66 acres adjacent to Bellagio on which it is developing Project CityCenter. Project CityCenter will feature a 4,000-room casino resort designed by world-famous architect Cesar Pelli; two 400-room non-gaming boutique hotels, one of which will be managed by luxury hotelier Mandarin Oriental; approximately 470,000 square feet of retail shops, dining and entertainment venues; and approximately 2.3 million square feet of residential space in over 2,900 luxury condominium and condominium-hotel units in multiple towers. The overall cost of Project CityCenter is estimated at approximately $7 billion, excluding preopening and land costs. After estimated proceeds of $2.5 billion from the sale of residential units, net project cost is estimated at approximately $4.5 billion. Project City Center is expected to open in 2009.

Until July 2004, the Company owned and operated MGM Grand Australia and until January 2004, the Company owned and operated the Golden Nugget Las Vegas in downtown Las Vegas and the Golden Nugget Laughlin in Laughlin, Nevada. Until June 2003, the Company operated PLAYMGMMIRAGE.com, the Company s online gaming website based in the Isle of Man. See Note 4 for further information regarding these discontinued operations.

Until 2005, the Company held an indirect interest in Triangle Casino in Bristol through its 25% ownership of Metro Casinos Limited, a United Kingdom gaming company. Metro Casinos Limited sold the Triangle Casino in

2005.

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NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Principles of consolidation. The consolidated financial statements include the accounts of the Company and its subsidiaries. Investments in unconsolidated affiliates which are 50% or less owned are accounted for under the equity method. All significant intercompany balances and transactions have been eliminated in consolidation. The Company s operations are primarily in one segment operation of casino resorts. Other operations, and foreign operations, are not material.

Management s use of estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Those principles require the Company s management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Financial statement impact of Hurricane Katrina. The Company maintains insurance covering both property damage and business interruption as a result of wind and flood damage sustained at Beau Rivage. The deductible under this coverage is approximately $15 million, based on the amount of damage incurred. Based on current estimates, insurance proceeds are expected to exceed the net book value of damaged assets; therefore, the Company will not record an impairment charge related to the storm and upon ultimate settlement of the claim will likely record a gain. Damaged assets with a net book value of $121 million have been written off, and a corresponding insurance receivable has been recorded.

Business interruption coverage covers lost profits and other costs incurred during the closure period and up to six months following the reopening of the facility. Expected costs during the interruption period are less than the anticipated business interruption proceeds; therefore, post-storm costs of $50 million through December 31, 2005 were offset by the expected recoveries and a corresponding insurance receivable was recorded. Post-storm costs and expected recoveries are recorded net with General and administrative expenses in the accompanying consolidated statements of income, except for depreciation of non-damaged assets, which is classified as Depreciation and amortization.

The insurance receivable is recorded within Deposits and other assets, net in the accompanying consolidated balance sheets. Through December 31, 2005, the Company received $46 million from its insurers, leaving a net receivable of $125 million at December 31, 2005.

Cash and cash equivalents. Cash and cash equivalents include investments and interest bearing instruments with maturities of three months or less at the date of acquisition. Such investments are carried at cost which approximates market value. Book overdraft balances resulting from the Company s cash management program are recorded as accounts payable.

Accounts receivable and credit risk. Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of casino accounts receivable. The Company issues markers to approved casino customers following background checks and investigations of creditworthiness. At December 31, 2005, a substantial portion of the Company s receivables were due from customers residing in foreign countries. Business or economic conditions or other significant events in these countries could affect the collectibility of such receivables.

Trade receivables, including casino and hotel receivables, are typically non-interest bearing and are initially recorded at cost. Accounts are written off when management deems the account to be uncollectible. Recoveries of accounts previously written off are recorded when received. An estimated allowance for doubtful accounts is maintained to reduce the Company s receivables to their carrying amount, which approximates fair value. The allowance is estimated based on specific review of customer accounts as well as historical collection experience and current economic and business conditions. Management believes that as of December 31, 2005, no significant concentrations of credit risk existed for which an allowance had not already been recorded.

Inventories. Inventories consist of food and beverage, retail merchandise and operating supplies, and are stated at the lower of cost or market. Cost is determined primarily by the average cost method for food and beverage and supplies and the retail inventory or specific identification methods for retail merchandise.

Property and equipment. Property and equipment are stated at cost. Gains or losses on dispositions of property and equipment are included in the determination of income. Maintenance costs are expensed as incurred. Property and

equipment are generally depreciated over the following estimated useful lives on a straight-line basis:

Buildings and improvements	30 to 45 years
Land improvements	10 to 20 years
Furniture and fixtures	3 to 10 years
Equipment	3 to 20 years

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We evaluate our property and equipment and other long-lived assets for impairment in accordance with the Financial Accounting Standards Board s Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. For assets to be disposed of, we recognize the asset to be sold at the lower of carrying value or fair value less costs of disposal. Fair value for assets to be disposed of is estimated based on comparable asset sales, offers received, or a discounted cash flow model.

For assets to be held and used, we review fixed assets for impairment whenever indicators of impairment exist. If an indicator of impairment exists, we compare the estimated future cash flows of the asset, on an undiscounted basis, to the carrying value of the asset. If the undiscounted cash flows exceed the carrying value, no impairment is indicated. If the undiscounted cash flows do not exceed the carrying value, then an impairment is measured based on fair value compared to carrying value, with fair value typically based on a discounted cash flow model. If an asset is still under development, future cash flows include remaining construction costs. For a discussion of recognized impairment losses, see Note 16.

Capitalized interest. The interest cost associated with major development and construction projects is capitalized and included in the cost of the project. When no debt is incurred specifically for a project, interest is capitalized on amounts expended on the project using the weighted-average cost of the Company s outstanding borrowings. Capitalization of interest ceases when the project is substantially complete or development activity is suspended for more than a brief period.

Goodwill and other intangible assets. Goodwill represents the excess of purchase price over fair market value of net assets acquired in business combinations. Goodwill and indefinite-lived intangible assets must be reviewed for impairment at least annually and between annual test dates in certain circumstances. The Company performs its annual impairment test for goodwill and indefinite-lived intangible assets in the fourth quarter of each fiscal year. No impairments were indicated as a result of the annual impairment reviews for goodwill and indefinite-lived intangible assets in 2005, 2004 or 2003.

Revenue recognition and promotional allowances. Casino revenue is the aggregate net difference between gaming wins and losses, with liabilities recognized for funds deposited by customers before gaming play occurs (casino front money) and for chips in the customers possession (outstanding chip liability). Hotel, food and beverage, entertainment and other operating revenues are recognized as services are performed. Advance deposits on rooms and advance ticket sales are recorded as accrued liabilities until services are provided to the customer.

Gaming revenues are recognized net of certain sales incentives, including discounts and points earned in point-loyalty programs. The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenue and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in casino expenses as follows:

	Year Ended December 31,		
	2005	**2004**	**2003**
		(In thousands)	
Rooms	$ 82,009	$ 63,652	$ 64,103
Food and beverage	255,201	191,695	178,399
Other	35,242	25,213	21,560
	$ 372,452	$ 280,560	$ 264,062

Advertising. The Company expenses advertising costs the first time the advertising takes place. Advertising expense, which is generally included in general and administrative expenses, was $99 million, $57 million and $54 million for 2005, 2004 and 2003, respectively.

Corporate expense. Corporate expense represents unallocated payroll and aircraft costs, professional fees and various other expenses not directly related to the Company s casino resort operations. In addition, corporate expense includes the costs associated with the Company s evaluation and pursuit of new business opportunities, which are

expensed as incurred until development of a specific project has become probable.

Preopening and start-up expenses. The Company accounts for costs incurred during the preopening and start-up phases of operations in accordance with Statement of Position 98-5, Reporting on the Costs of Start-up Activities. Preopening and start-up costs, including organizational costs, are expensed as incurred. Costs classified as preopening and start-up expenses include payroll, outside services, advertising, and other expenses related to new or start-up operations and new customer initiatives.

Income per share of common stock. The weighted-average number of common and common equivalent shares used in the calculation of basic and diluted earnings per share consisted of the following:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
Weighted-average common shares outstanding used in the calculation of basic earnings per share	284,943	279,325	297,861
Potential dilution from stock options and restricted stock	11,391	10,008	5,323
Weighted-average common and common equivalent shares used in the calculation of diluted earnings per share	296,334	289,333	303,184

Stock-based compensation. The Company has accounted for stock-based compensation, including employee stock option plans, in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and the Financial Accounting Standards Board s Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25, and has disclosed supplemental information in accordance with Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), as amended by Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148). The Company has not incurred compensation expense for employee stock options when the exercise price is at least 100% of the market value of the Company s common stock on the date of grant. For disclosure purposes, employee stock options have been measured at fair value using the Black-Scholes option-pricing model and compensation has been assumed to be amortized over the vesting periods of the options.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)). Under the original standard, SFAS No. 123, companies had the option of recording stock options issued to employees at fair value or intrinsic value, which generally leads to no expense being recorded. The Company opted to use this intrinsic value method and make required disclosures of fair value expense. SFAS 123(R) eliminates this intrinsic value alternative. SFAS 123(R) was effective for the Company on January 1, 2006, and all future share-based payments must be recorded at fair value.

The Company has adopted nonqualified stock option plans and incentive stock option plans which provide for the granting of stock options to eligible directors, officers and employees. The plans are administered by the Compensation and Stock Option Committee of the Board of Directors. Salaried officers, directors and other key employees of the Company and its subsidiaries are eligible to receive options. The exercise price in each instance is 100% of the fair market value of the Company s common stock on the date of grant. The options have either 7-year or 10-year terms and in most cases are exercisable in either four or five equal annual installments.

As of December 31, 2005, the aggregate number of stock options available for grant was 6.5 million. A summary of the status of the Company s stock option plans is presented below:

	2005		2004		2003	
	Shares (000 s)	Weighted Average Exercise Price	Shares (000 s)	Weighted Average Exercise Price	Shares (000 s)	Weighted Average Exercise Price
Outstanding at beginning of year	30,728	$ 14.16	41,735	$ 13.69	28,646	$ 13.59
Granted	14,625	35.26	551	22.93	17,382	13.05
Exercised	(10,115)	14.43	(10,612)	12.79	(3,750)	9.67

Terminated	(631)	22.28	(946)	13.85	(543)	16.39
Outstanding at end of year	34,607	22.85	30,728	14.16	41,735	13.68
Exercisable at end of year	9,291	14.33	14,979	14.50	17,671	13.50

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The following table summarizes information about stock options outstanding at December 31, 2005:

Range of Exercise Prices	Options Outstanding Number Outstanding (000 s)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Options Exercisable Number Exercisable (000 s)	Weighted Average Exercise Price
$5.49 - $6.66	826	2.5	$ 6.65	826	$ 6.65
$8.30 - $12.35	732	3.6	11.32	732	11.32
$12.58 - $18.87	18,111	6.8	14.20	7,596	15.31
$20.08 - $27.22	578	8.0	22.89	137	22.03
$34.05 - $45.64	14,360	6.7	35.27		
	34,607	6.6	22.85	9,291	14.33

Had the Company accounted for these plans under the fair value method allowed by SFAS 123, the Company s net income and earnings per share would have been reduced to recognize the fair value of employee stock options. The following are required disclosures under SFAS 123 and SFAS 148:

	Year Ended December 31, 2005	2004	2003
	(In thousands, except per share amounts)		
Net income			
As reported	$ 443,256	$ 412,332	$ 243,697
Stock-based compensation under SFAS 123	(47,934)	(22,963)	(43,310)
Pro forma	$ 395,322	$ 389,369	$ 200,387
Basic earnings per share			
As reported	$ 1.56	$ 1.48	$ 0.82
Stock-based compensation under SFAS 123	(0.17)	(0.09)	(0.15)
Pro forma	$ 1.39	$ 1.39	$ 0.67
Diluted earnings per share			
As reported	$ 1.50	$ 1.43	$ 0.80
Stock-based compensation under SFAS 123	(0.17)	(0.08)	(0.14)
Pro forma	$ 1.33	$ 1.35	$ 0.66
Weighted-average assumptions used in the Black-Scholes model:			
Expected volatility	37%	42%	42%
Expected life	4.3 years	5.0 years	5.0 years
Expected dividend yield	0%	0%	0%
Risk-free interest rate	3.8%	3.4%	3.2%
Weighted average fair value of options granted	$ 12.73	$ 9.55	$ 5.32

Reported net income includes $5 million, net of tax, of amortization of restricted stock and non-employee stock option compensation for each of the years ended December 31, 2005, 2004 and 2003.

Currency translation. The Company accounts for currency translation in accordance with Statement of Financial Accounting Standards No. 52, Foreign Currency Translation. Balance sheet accounts are translated at the exchange rate in effect at each balance sheet date. Income statement accounts are translated at the average rate of exchange prevailing during the period. Translation adjustments resulting from this process are charged or credited to other comprehensive loss.

Comprehensive income. Comprehensive income includes net income and all other non-stockholder changes in equity, or other comprehensive income. Elements of the Company s other comprehensive income are reported in the accompanying consolidated statement of stockholders equity, and the cumulative balance of these elements consisted of the following:

	At December 31,	
	2005	2004
	(In thousands)	
Derivative loss from unconsolidated affiliate, net	$ 134	$ (1,863)
Foreign currency translation adjustments	(935)	696
	$ (801)	$ (1,167)

Reclassifications. The consolidated financial statements for prior years reflect certain reclassifications, which have no effect on previously reported net income, to conform to the current year presentation.

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NOTE 3 ACQUISITION

On April 25, 2005, the Company closed its merger with Mandalay under which the Company acquired 100% of the outstanding common stock of Mandalay for $71 in cash for each share of Mandalay s common stock. The acquisition expands the Company s portfolio of resorts on the Las Vegas Strip, provides additional sites for future development and expands the Company s employee and customer bases significantly. These factors result in the recognition of certain intangible assets, discussed below, and significant goodwill. The total acquisition cost included (in thousands):

Cash consideration for Mandalay s outstanding shares and stock options	$ 4,831,944
Estimated fair value of Mandalay s long-term debt	2,849,225
Transaction costs and expenses and other	111,944
	7,793,113
Less: Net proceeds from the sale of MotorCity Casino	(526,597)
	$ 7,266,516

Cash paid, net of cash acquired, was $4.4 billion. The transaction was accounted for as a purchase and, accordingly, the purchase price was allocated to the underlying assets acquired and liabilities assumed based upon their estimated fair values at the date of the acquisition. The purchase price allocation is preliminary and may be adjusted up to one year after the acquisition. In particular, the Company is still evaluating certain customer relationship intangible assets related to individual and group hotel reservations as well as gaming loyalty program members.

The following table sets forth the preliminary allocation of purchase price (in thousands):

Current assets (including cash of $134,245)	$ 414,326
Property and equipment	7,180,936
Goodwill	1,230,804
Other intangible assets	245,940
Other assets	283,931
Assumed liabilities, excluding long-term debt	(602,338)
Deferred taxes	(1,487,083)
	$ 7,266,516

The amount allocated to intangible assets includes the recognition of customer lists with an estimated value of $12 million and an estimated useful life of five years and trade names and trademarks with an estimated value of $234 million and an indefinite life. Goodwill and indefinite-lived intangible assets are not amortized.

The operating results for Mandalay are included in the accompanying consolidated statements of income from the date of the acquisition. The following unaudited pro forma consolidated financial information for the Company has been prepared assuming the Mandalay acquisition had occurred on January 1, 2004.

	Year Ended December 31, 2005	Year Ended December 31, 2004
	(In thousands, except per share amounts)	
Net revenues	$ 7,384,626	$ 6,903,004
Operating income	1,519,500	1,423,324
Income from continuing operations	465,087	415,625
Net income	465,087	478,101

Basic earnings per share:		
Income from continuing operations	$ 1.63	$ 1.49
Net income	1.63	1.71
Diluted earnings per share:		
Income from continuing operations	$ 1.57	$ 1.44
Net income	1.57	1.65

NOTE 4 DISCONTINUED OPERATIONS

In June 2003, the Company ceased operations of PLAYMGMMIRAGE.com, its online gaming website (Online). In January 2004, the Company completed the sale of the Golden Nugget Las Vegas in downtown Las Vegas and the Golden Nugget Laughlin in Laughlin, Nevada (the Golden Nugget Subsidiaries), with net proceeds to the Company of $210 million. In July 2004, the Company completed the sale of the subsidiaries that owned and operated MGM Grand Australia with net proceeds to the Company of $136 million.

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The results of the Golden Nugget Subsidiaries, Online and MGM Grand Australia are classified as discontinued operations in the accompanying consolidated statements of income for all periods presented. Net revenues of discontinued operations were $45 million and $231 million, respectively, for the years ended December 31, 2004 and 2003. Included in income from discontinued operations is an allocation of interest expense based on the ratio of the net assets of the discontinued operations to the total consolidated net assets and debt of the Company. Interest allocated to discontinued operations was $2 million and $9 million for the years ended December 31, 2004 and 2003, respectively. Included in discontinued operations for the year ended December 31, 2003 is a loss on disposal of Online of $7 million relating primarily to unrecoverable costs of computer hardware and software. Included in the tax benefit from discontinued operations for the year ended December 31, 2003 is $2 million of previously unrecognized tax benefits relating to prior year operating losses of Online. Included in discontinued operations for the year ended December 31, 2004 is a gain on the sale of the Golden Nugget Subsidiaries of $8 million and a gain on sale of MGM Grand Australia of $74 million.

NOTE 5 ACCOUNTS RECEIVABLE, NET

Accounts receivable consisted of the following:

	At December 31,	
	2005	2004
	(In thousands)	
Casino	$ 221,873	$ 174,713
Hotel	173,049	61,084
Other	35,021	28,114
	429,943	263,911
Less: Allowance for doubtful accounts	(77,270)	(59,760)
	$ 352,673	$ 204,151

NOTE 6 PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following:

	At December 31,	
	2005	2004
	(In thousands)	
Land	$ 8,018,301	$ 4,089,106
Buildings, building improvements and land improvements	7,595,257	4,228,138
Furniture, fixtures and equipment	2,695,746	2,235,766
Construction in progress	607,447	299,148
	18,916,751	10,852,158
Less: Accumulated depreciation and amortization	(2,375,100)	(1,938,016)
	$ 16,541,651	$ 8,914,142

NOTE 7 INVESTMENTS IN UNCONSOLIDATED AFFILIATES

The Company has investments in unconsolidated affiliates accounted for under the equity method. Under the equity method, carrying value is adjusted for the Company s share of the investees earnings and losses, as well as capital contributions to and distributions from these companies. Investments in unconsolidated affiliates consisted of the following:

	At December 31,	
	2005	2004
	(In thousands)	
Marina District Development Company Borgata (50%)	$ 461,211	$ 405,322
Elgin Riverboat Resort-Riverboat Casino-Grand Victoria (50%)	241,279	
MGM Grand Paradise Limited Macau (50%)	187,568	3,002
Circus and Eldorado Joint Venture Silver Legacy (50%)	26,492	
Victoria Partners Monte Carlo (50% in 2004)		424,683
Other	14,604	9,633
	931,154	842,640
Turnberry/MGM Grand Towers The Signature at MGM Grand (50%)	(7,400)	(3,231)
	$ 923,754	$ 839,409

The negative investment balances in The Signature at MGM Grand, which represents cumulative losses of the venture, are classified as Other long-term liabilities in the accompanying consolidated balance sheets along with deferred income of $16 million related to the excess of equity credit over carrying value of land the Company contributed to the venture. The income will be recognized when the venture recognizes the profits on the sale of each tower s units.

Differences between the Company s venture-level equity and investment balances are as follows:

	At December 31,	
	2005	2004
	(In thousands)	
Venture-level equity	$ 603,015	$ 419,035
Fair value adjustments	264,814	361,102
Capitalized interest	52,689	45,099
Other adjustments	3,236	14,173
	$ 923,754	$ 839,409

The fair value adjustments at December 31, 2005 include $90 million related to Borgata, which was assigned to land, $210 million related to Grand Victoria, which has been assigned to goodwill on a preliminary basis, and a $35 million credit related to Silver Legacy, which was assigned to long-term assets and long-term debt and is being amortized accordingly. The amount related to Grand Victoria is subject to adjustment as the Mandalay purchase price allocation is preliminary. See Note 3 for further information. At December 31, 2004, fair value adjustments included the amount related to Borgata and an amount related to Monte Carlo which was assigned to land. Amounts related to capitalized interest are amortized over the life of the related building.

The Company recorded its share of the results of operations of the unconsolidated affiliates as follows:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
Income from unconsolidated affiliates	$ 151,871	$ 119,658	$ 53,612
Preopening and start-up expenses	(1,914)		(19,326)
Non-operating items from unconsolidated affiliates	(15,825)	(12,298)	(10,401)
	$ 134,132	$ 107,360	$ 23,885

Summarized balance sheet information of the unconsolidated affiliates is as follows:

	At December 31,	
	2005	2004
	(In thousands)	
Current assets	$ 220,708	$ 129,009
Property and other assets, net	2,008,912	1,392,436
Current liabilities	213,135	106,111
Long-term debt and other liabilities	871,173	530,458
Equity	1,145,312	884,876

Summarized results of operations of the unconsolidated affiliates are as follows:

	Year Ended December 31,		
	2005	2004	2003

	(In thousands)		
Net revenues	$ 1,243,465	$ 966,642	$ 551,669
Operating expenses, except preopening expenses	(938,972)	(721,998)	(441,526)
Preopening and start-up expenses	(3,829)		(39,186)
Operating income	300,664	244,644	70,957
Interest expense	(35,034)	(34,698)	(21,700)
Other non-operating income (expense)	1,435	9,789	4,297
Net income	$ 267,065	$ 219,735	$ 53,554

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NOTE 8 GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets consisted of the following:

	At December 31,	
	2005	2004
	(In thousands)	
Goodwill:		
Mandalay acquisition (2005)	$ 1,230,804	$
Mirage Resorts acquisition (2000)	76,342	76,342
Other	7,415	7,415
	1,314,561	83,757
Indefinite-lived intangible assets:		
Detroit development rights	100,056	115,056
Trademarks, license rights and other	251,754	17,554
	351,810	132,610
Other intangible assets, net	25,669	16,968
	$ 1,692,040	$ 233,335

Goodwill related to the Mandalay acquisition was primarily assigned to Mandalay Bay, Luxor, Excalibur and Gold Strike Tunica. Goodwill related to the Mirage Resorts acquisition was assigned to Bellagio, The Mirage and TI. Other goodwill relates to the Company s 2003 acquisition of majority interests in the entities that operate the nightclubs Light and Caramel, located in Bellagio, and Mist, located in TI. Changes in the recorded balances of goodwill are as follows:

	Year Ended December 31,	
	2005	2004
	(In thousands)	
Balance, beginning of period	$ 83,757	$ 118,434
Goodwill acquired during the period	1,230,804	
Currency translation adjustment		(992)
Goodwill assigned to discontinued operations		(33,267)
Other		(418)
Balance, end of the period	$ 1,314,561	$ 83,757

The Company s indefinite-lived intangible assets consist primarily of development rights in Detroit and trademarks. The Company s finite lived intangible assets consist primarily of customer lists amortized over five years, lease acquisition costs amortized over the life of the related leases, and certain license rights amortized over their contractual life.

NOTE 9 OTHER ACCRUED LIABILITIES

Other accrued liabilities consisted of the following:

At December 31,

	2005	2004
	(In thousands)	
Payroll and related	$ 297,946	$ 162,943
Advance deposits and ticket sales	120,830	65,810
Casino outstanding chip liability	100,621	85,086
Casino front money deposits	71,768	67,621
Other gaming related accruals	78,921	50,186
Taxes, other than income taxes	68,632	47,311
Other	174,802	128,968
	$ 913,520	$ 607,925

NOTE 10 LONG-TERM DEBT

Long-term debt consisted of the following:

	At December 31,	
	2005	2004
	(In thousands)	
Senior credit facility	$ 4,775,000	$ 50,000
$300 million 6.95% senior notes, repaid at maturity in 2005		300,087
$176.4 million 6.625% senior notes, repaid at maturity in 2005		176,096
$200 million 6.45% senior notes, repaid at maturity in February 2006	200,223	
$244.5 million 7.25% senior notes, due 2006, net	240,353	235,511
$710 million 9.75% senior subordinated notes, due 2007, net	708,223	706,968
$200 million 6.75% senior notes, due 2007, net	192,977	189,115
$492.2 million 10.25% senior subordinated notes, due 2007, net	527,879	
$180.4 million 6.75% senior notes, due 2008, net	172,238	168,908
$196.2 million 9.5% senior notes, due 2008, net	212,895	
$200 million 6.875% senior notes, redeemed in 2005		199,095
$226.3 million 6.5% senior notes, due 2009, net	228,518	
$1.05 billion 6% senior notes, due 2009, net	1,055,232	1,056,453
$297.6 million 9.375% senior subordinated notes, due 2010, net	325,332	
$825 million 8.5% senior notes, due 2010, net	822,705	822,214
$400 million 8.375% senior subordinated notes, due 2011	400,000	400,000
$132.4 million 6.375% senior notes, due 2011, net	133,725	
$550 million 6.75% senior notes, due 2012	550,000	550,000
$150 million 7.625% senior subordinated debentures, due 2013, net	155,978	
$525 million 5.875% senior notes, due 2014, net	522,604	522,301
$875 million 6.625% senior notes, due 2015, net	879,989	
$100 million 7.25% senior debentures, due 2017, net	82,699	81,919
Floating rate convertible senior debentures due 2033	8,472	
$150 million 7% debentures due 2036, net	155,961	
$4.3 million 6.7% debentures, due 2096	4,265	
Other notes	179	195
	12,355,447	5,458,862
Less: Current portion	(14)	(14)
	$ 12,355,433	$ 5,458,848

Total interest incurred during 2005, 2004 and 2003 was $686 million, $401 million and $353 million, respectively, of which $30 million, $23 million and $15 million, respectively, was capitalized.

At December 31, 2005, the senior credit facility had total capacity of $7.0 billion. The senior credit facility matures in 2010 and consists of a $5.5 billion revolving credit facility and $1.5 billion term loan facility. The current senior credit facility was made available upon the closing of the Mandalay merger, and replaced the Company s previous $2.5 billion senior credit facility.

Interest on the senior credit facility is based on the bank reference rate or Eurodollar rate. The Company s borrowing rate on the senior credit facility was approximately 5.3% at December 31, 2005 and 3.3% at December 31, 2004. Stand-by letters of credit totaling $53 million were outstanding as of December 31, 2005, thereby reducing the availability under the senior credit facility. At December 31, 2005, the Company had approximately $2.2 billion of available borrowings under the senior credit facility.

In June 2005, the Company issued $500 million of 6.625% senior notes due 2015 and in September 2005, the Company issued an additional $375 million of 6.625% senior notes due 2015. In 2004, the Company issued $525 million of 5.875% senior notes due 2014, $550 million of 6.75% senior notes due 2012, and $450 million of 6% senior notes due 2009. The proceeds of the above offerings were used to reduce outstanding borrowings under the Company s senior credit facility.

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In May 2005, the Company initiated a tender offer for several issuances of Mandalay s senior notes and senior subordinated notes totaling $1.5 billion, as required by the change of control provisions contained in the respective indentures. Holders of $155 million of Mandalay s senior notes and senior subordinated notes redeemed their holdings, resulting in a gain on early retirement of debt of $1 million, classified as Other, net in the accompanying consolidated statements of income. Holders of Mandalay s floating rate convertible senior debentures with a principal amount of $394 million had the right to redeem the debentures for $566 million through June 30, 2005. $388 million of principal of the convertible senior debentures were tendered for redemption and redeemed for $558 million.

In February 2005, the Company redeemed all of its outstanding 6.875% senior notes due February 2008 at the present value of future interest payments plus accrued interest at the date of redemption. The Company recorded a loss on retirement of debt of $20 million in the first quarter of 2005, classified as Other, net in the accompanying consolidated statements of income. As a result of the redemption of the February 2008 senior notes and the repayment of the $300 million 6.95% senior notes that matured in February 2005, the Company applied for, and received, release of collateral under its senior credit facility and all of its senior notes. Therefore, the Company s senior credit facility and senior notes are now unsecured.

In August 2003, the Company s Board of Directors authorized the repurchase of up to $100 million of the Company s public debt securities. Subsequently, the Company repurchased $25 million of its senior notes and recorded a loss on early retirement of debt of $3 million related to repurchase premiums and unamortized debt issue costs. In 2004, the Company repurchased an additional $49 million of its senior notes for $52 million. This resulted in a loss on early retirement of debt of $6 million related to repurchase premiums and unamortized debt issuance costs. The losses in both periods are classified as Other, net in the accompanying consolidated statements of income. In December 2004, the Company s Board of Directors renewed its authorization for up to $100 million of additional debt securities.

The Company attempts to limit its exposure to interest rate risk by managing the mix of its long-term fixed rate borrowings and short-term borrowings under its bank credit facilities. In the past, the Company has also utilized interest rate swap agreements to manage this risk. At December 31, 2005, the Company had no outstanding interest rate swaps. All of the Company s interest rate swaps have met the criteria for using the shortcut method allowed under Statement of Financial Accounting Standards No. 133. The amounts received for the termination of past interest rate swaps, including the last $100 million swap terminated in May 2005, have been added to the carrying value of the related debt obligations and are being amortized and recorded as a reduction of interest expense over the remaining life of that debt.

The Company and each of its material subsidiaries, excluding MGM Grand Detroit, LLC and the Company s foreign subsidiaries, are directly liable for or unconditionally guarantee the senior credit facility, senior notes, senior debentures, and senior subordinated notes. MGM Grand Detroit, LLC is a guarantor under the senior credit facility, but only to the extent that the proceeds of borrowings under such facilities are made available to MGM Grand Detroit, LLC. See Note 18 for consolidating condensed financial information of the subsidiary guarantors and non-guarantors.

The Company s long-term debt obligations contain customary covenants requiring the Company to maintain certain financial ratios. At December 31, 2005, the Company was required to maintain a maximum leverage ratio (debt to EBITDA, as defined) of 7.25:1 and a maximum senior leverage ratio of 5.75:1. Also at December 31, 2005, the Company was required to maintain a minimum coverage ratio (EBITDA to interest charges, as defined) of 2.0:1. As of December 31, 2005, the Company s leverage, senior leverage and interest coverage ratios were 5.4:1, 4.5:1 and 2.9:1, respectively.

Maturities of the Company s long-term debt as of December 31, 2005 are as follows:

		(In thousands)
Years ending December 31,		
2006	$	444,526
2007		1,402,260
2008		376,649
2009		1,276,358

2010	5,897,584
Thereafter	2,892,571
	12,289,948
Debt premiums	63,315
Swap deferred gain	2,184
	$ 12,355,447

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Amounts due in 2006 that were refinanced, or are intended to be refinanced, through available capacity under the Company s senior credit facility have been excluded from current liabilities in the accompanying consolidated balance sheet.

The estimated fair value of the Company s long-term debt at December 31, 2005 was approximately $12.5 billion, versus its book value of $12.4 billion. At December 31, 2004, the estimated fair value of the Company s long-term debt was approximately $5.9 billion, versus its book value of $5.5 billion. The estimated fair value of the Company s public debt securities was based on quoted market prices on or about December 31, 2005 and 2004. The estimated fair value of the Company s senior credit facility was assumed to approximate book value due to the short-term nature of the borrowings.

NOTE 11 INCOME TAXES

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). SFAS 109 requires the recognition of deferred income tax assets, net of applicable reserves, related to net operating loss carryforwards and certain temporary differences. The standard requires recognition of a future tax benefit to the extent that realization of such benefit is more likely than not. Otherwise, a valuation allowance is applied.

The income tax provision attributable to continuing operations and discontinued operations is as follows:

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
Continuing operations	$ 235,644	$ 205,959	$ 113,387
Discontinued operations		31,731	2,651
	$ 235,644	$ 237,690	$ 116,038

The income tax provision attributable to income from continuing operations before income taxes is as follows:

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
Current federal	$ 224,850	$ 200,419	$ 68,760
Deferred federal	2,140	(9,155)	40,142
Provision for federal income taxes	226,990	191,264	108,902
Current state	5,252	2,851	5,167
Deferred state	6,811	11,420	(682)
Provision for state income taxes	12,063	14,271	4,485
Current foreign	(2,979)	424	
Deferred foreign	(430)		
Provision for foreign income taxes	(3,409)	424	
	$ 235,644	$ 205,959	$ 113,387

A reconciliation of the federal income tax statutory rate and the Company s effective tax rate is as follows:

	Year Ended December 31,		
	2005	2004	2003
Federal income tax statutory rate	35.0%	35.0%	35.0%
State income tax (net of federal benefit)	1.2	1.7	0.8
Reversal of reserves for prior tax years		(1.0)	(3.9)
Foreign earnings repatriation benefit of American Job Creation Act of 2004	(1.5)		
Tax credits	(1.2)	(0.6)	(0.8)
Permanent and other items, net	1.2	2.0	1.9
	34.7%	37.1%	33.0%

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The major tax effected components of the Company s net deferred tax liability are as follows:

	At December 31, 2005	At December 31, 2004
	(In thousands)	
Deferred tax assets federal and state		
Bad debt reserve	$ 32,490	$ 25,168
Deferred compensation	31,230	25,131
Net operating loss carryforward	7,253	8,569
Preopening and start-up costs	3,801	4,305
Accruals, reserves and other	35,675	37,152
Investments in unconsolidated affiliates	265	(130,059)
Long-term debt	20,902	(18,548)
	131,616	(48,282)
Less: Valuation allowance	(5,734)	(5,608)
	125,882	(53,890)
Deferred tax liabilities federal and state		
Property and equipment	(3,350,365)	(1,710,006)
Intangibles	(88,800)	1,966
Unremitted earnings of foreign subsidiary		(11,150)
	(3,439,165)	(1,719,190)
Deferred taxes foreign	2,027	1,660
Less: Valuation allowance	(1,597)	(1,660)
	430	
Net deferred tax liability	$ (3,312,853)	$ (1,773,080)

For U.S. federal income tax return purposes, the Company has a net operating loss carryforward of $2 million, which will begin to expire in 2012. For state income tax purposes, the Company has a New Jersey net operating loss carryforward of $112 million, which equates to a deferred tax asset of $7 million, after federal tax effect, and before valuation allowance. The New Jersey net operating loss carryforwards began to expire in 2005.

At December 31, 2005, there is a $6 million valuation allowance provided on certain New Jersey state net operating loss carryforwards and other New Jersey state deferred tax assets and a $2 million valuation allowance related to certain foreign deferred tax assets because management believes these assets do not meet the more likely than not criteria for recognition under SFAS 109. Management believes all other deferred tax assets are more likely than not to be realized because of the future reversal of existing taxable temporary differences and expected future taxable income. Accordingly, there are no other valuation allowances provided at December 31, 2005.

As anticipated, the United States Treasury issued guidance during 2005 that clarified provisions of the American Job Creation Act of 2004 (the Act) that provide for a special one-time deduction of 85 percent on certain repatriated earnings of foreign subsidiaries. This guidance clarified for the Company that the planned repatriation of the net proceeds of its Australia operations would qualify for the one-time deduction. Consequently, the Company repatriated the net proceeds during 2005 and secured the benefits of the deduction. Since the Company provided deferred taxes in

2004 on the basis that the net proceeds would be repatriated without the benefit of the one-time deduction, a tax benefit of $10 million was recorded in 2005 to reflect the benefit of the Act. The Company considered the earnings of its Australia operations permanently reinvested prior to the sale of such operations in 2004.

NOTE 12 COMMITMENTS AND CONTINGENCIES

Leases. The Company leases real estate and various equipment under operating and, to a lesser extent, capital lease arrangements. Certain real estate leases provide for escalation of rent based upon a specified price index and/or based upon periodic appraisals.

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At December 31, 2005, the Company was obligated under non-cancelable operating leases and capital leases to make future minimum lease payments as follows:

	Operating Leases	Capital Leases
	(In thousands)	
Years ending December 31,		
2006	$ 13,462	$ 1,979
2007	11,370	1,448
2008	9,447	512
2009	8,728	126
2010	8,263	
Thereafter	337,989	
Total minimum lease payments	$ 389,259	4,065
Less: Amounts representing interest		(683)
Total obligations under capital leases		3,382
Less: Amounts due within one year		(1,584)
Amounts due after one year		$ 1,798

The current and long-term obligations under capital leases are included in Other accrued liabilities and Other long-term obligations, respectively, in the accompanying consolidated balance sheets. Rental expense for operating leases was $23 million, $19 million and $19 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Detroit Development Agreement. Under the August 2002 revised development agreement with the City of Detroit, MGM Grand Detroit, LLC and the Company are subject to certain obligations in exchange for the ability to develop a permanent casino complex. The Company recorded an intangible asset (development rights, deemed to have an indefinite life) in connection with its obligations under the revised development agreement. Outstanding obligations include continued letter of credit support for $50 million of bonds issued by the Economic Development Corporation of the City of Detroit, which mature in 2009. In addition, the City required an indemnification of up to $20 million related to the Lac Vieux and certain other litigation, of which $2.5 million had been paid as of December 31, 2005. In addition to the above obligations, the Company will pay the City of Detroit 2% of gaming revenues (1% if annual revenues do not exceed $400 million) beginning January 1, 2006.

Until April 2005, the ability to construct the permanent casino facility was subject to resolution of the Lac Vieux litigation. In April 2005, the 6th Circuit Court of Appeals ruled on the three pending appeals, approved the settlement agreement between Lac Vieux and the two other Detroit casino developers, dismissed Lac Vieux s request for a reselection process for our subsidiary s casino franchise and lifted the injunction prohibiting the City and the Detroit developers from commencing construction of the permanent hotel and casino complexes. As a result of the resolution of the Lac Vieux litigation and the current status of the other litigation to which the indemnification relates, the Company determined that the necessary accrual for the indemnification to the City was $2.5 million, and recorded a reduction in accrued liabilities and a corresponding reduction in the development rights intangible asset.

The Company has acquired the land and begun construction on the permanent casino facility. The permanent facility is expected to open in late 2007 at a cost of $765 million, including land and preopening costs, and will feature a 400-room hotel, 100,000-square foot casino, numerous restaurant and entertainment amenities, and spa and convention facilities. The complete design, timing and cost of the permanent facility are at a preliminary stage, and are subject to risks attendant to large-scale projects.

Macau. In connection with its investment in MGM Grand Paradise Limited, the Company has committed to loan the entity up to $100 million, which will be accounted for as an additional element of the Company s investment in the venture.

New York Racing Association. The Company has entered into a definitive agreement with the New York Racing Association (NYRA) to manage video lottery terminals (VLTs) at NYRA s Aqueduct horseracing facility in metropolitan New York. The Company will assist in the development of the approximately $170 million facility, including providing project financing, and will manage the facility for a term of five years (extended automatically if the financing provided by the Company is not fully repaid) for a fee. Recent legislative changes will allow the Company to operate the VLTs past the expiration date of the current NYRA franchise agreement.

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United Kingdom. In November 2003, the Company entered into an agreement with Newcastle United PLC to create a 50-50 joint venture, which would build a major new mixed-use development, including a regional casino, on a site adjacent to Newcastle United s football stadium. The Company made an equity investment of £5 million ($8.6 million based on exchange rates at December 31, 2005). The agreement is cancelable, and the equity investment is refundable, if certain conditions are not met within specified time frames, including obtaining a regional casino license and regulatory approvals, and the implementation of an acceptable tax regime.

The Company had an agreement with the Earls Court and Olympia Group, which operates large trade show facilities in London, to develop an entertainment and gaming facility. In 2005, the agreement was terminated and the Company received a refund of its £1.75 million deposit ($3.2 million).

The Signature at MGM Grand. In 2004, the venture obtained construction financing for up to $210 million for the development of Tower 1. The Company has provided a guaranty for up to 50% of the interest and principal obligations on the construction financing. The remaining 50% of interest and principal obligations is guaranteed by affiliates of the venture s other member. These affiliates and the Company have also jointly and severally provided a completion guaranty.

In 2005, the venture obtained construction financing for up to $230 million for the development of Tower 2. The Company has provided a guaranty for up to 50% of the interest and principal obligations on the construction financing, with such guaranty decreasing by 50% relative to the principal when construction is 50% complete. The remaining 50% of interest and principal obligations is guaranteed by affiliates of the venture s other investor. These affiliates and the Company have also jointly and severally provided a completion guaranty. The Company recorded the value of its guaranty obligations for Towers 1 and 2, approximately $3 million, in Other long-term liabilities in the accompanying consolidated balance sheets.

Other guarantees. The Company is party to various guarantee contracts in the normal course of business, which are generally supported by letters of credit issued by financial institutions. The Company s senior credit facility limits the amount of letters of credit that can be issued to $250 million, and the amount of available borrowings under the senior credit facility is reduced by any outstanding letters of credit. At December 31, 2005, the Company had provided a $50 million letter of credit to support the Economic Development Corporation of the City of Detroit bonds referred to above, which are a liability of the Company.

Litigation. The Company is a party to various legal proceedings, most of which relate to routine matters incidental to its business. Management does not believe that the outcome of such proceedings will have a material adverse effect on the Company s financial position or results of operations.

NOTE 13 STOCKHOLDERS EQUITY

Stock split. In May 2005, the Company completed a 2-for-1 stock split effected in the form of a 100% stock dividend. The additional shares were issued on May 18, 2005 to stockholders of record on May 4, 2005. All share and per share data in the accompanying financial statements and notes thereto have been restated for all periods presented to reflect the 100% stock dividend.

Stock repurchases. Share repurchases are only conducted under repurchase programs approved by the Board of Directors and publicly announced. Share repurchase activity was as follows:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
August 2001 authorization (2.8 million shares purchased)	$	$	$ 36,034
February 2003 authorization (20 million shares purchased)			335,911
November 2003 authorization (16 million and 4 million shares purchased)		348,895	70,919
July 2004 authorization (5.5 million shares purchased)	217,316		
	$ 217,316	$ 348,895	$ 442,864

Average price of shares repurchased	$ 39.51	$ 21.80	$ 16.59

At December 31, 2005, we had 14.5 million shares available for repurchase under the July 2004 authorization.

Restricted stock. In May 2002, the Board of Directors approved a restricted stock plan. The plan allowed for the issuance of up to 2 million shares of Company common stock to certain key employees. The restrictions on selling 50% of these shares lapsed on the third anniversary date from the grant date and the restrictions lapse on the remaining 50% on the fourth anniversary date after the grant date. Through December 31, 2005, 1,806,000 shares were issued, with an aggregate value of $32 million. This amount was recorded as deferred compensation in the accompanying consolidated balance sheets and is being amortized to operating expenses on a straight-line basis through the period in which the restrictions fully lapse. Amortization of deferred compensation was $7 million, $7 million and $8 million for the years ended December 31, 2005, 2004 and 2003, respectively. In November 2002, the Board of Directors determined that no more awards would be granted under the plan.

Through December 31, 2005, restrictions on 852,000 shares have lapsed and 120,000 shares were cancelled before the restrictions had lapsed, leaving 834,000 restricted shares outstanding, all of which will become unrestricted in 2006. In 2005, certain recipients of restricted shares elected to use a portion of the shares on which restrictions lapsed in 2005 to pay required withholding taxes. Approximately 261,000 shares were surrendered, and became treasury shares, as a result of these elections.

NOTE 14 EMPLOYEE BENEFIT PLANS

Employees of the Company who are members of various unions are covered by union-sponsored, collectively bargained, multi-employer health and welfare and defined benefit pension plans. The Company recorded an expense of $161 million in 2005, $86 million in 2004 and $77 million in 2003 under such plans. The plans sponsors have not provided sufficient information to permit the Company to determine its share of unfunded vested benefits, if any.

The Company is self-insured for most health care benefits for its non-union employees. The liability for claims filed and estimates of claims incurred but not reported is included in Other accrued liabilities in the accompanying consolidated balance sheets.

The Company has retirement savings plans under Section 401(k) of the Internal Revenue Code for eligible employees. The plans allow employees to defer, within prescribed limits, up to 30% of their income on a pre-tax basis through contributions to the plans. The Company matches, within prescribed limits, a portion of eligible employees contributions. In the case of certain union employees, the Company contributions to the plan are based on hours worked. The Company recorded charges for 401(k) contributions of $19 million in 2005, $12 million in 2004 and $10 million in 2003.

The Company maintains a nonqualified deferred retirement plan for certain key employees. The plan allows participants to defer, on a pre-tax basis, a portion of their salary and bonus and accumulate tax deferred earnings, plus investment earnings on the deferred balances, as a retirement fund. Participants receive a Company match of up to 4% of salary, net of any Company match received under the Company s 401(k) plan. All employee deferrals vest immediately. The Company matching contributions vest ratably over a three-year period. The Company recorded charges for matching contributions of $2 million in 2005, $1 million in 2004 and $2 million in 2003.

The Company implemented a supplemental executive retirement plan (SERP) for certain key employees effective January 1, 2001. The SERP is a nonqualified plan under which the Company makes quarterly contributions which are intended to provide a retirement benefit that is a fixed percentage of a participant s estimated final five-year average annual salary, up to a maximum of 65%. Company contributions and investment earnings on the contributions are tax-deferred and accumulate as a retirement fund. Employees do not make contributions under this plan. A portion of the Company contributions and investment earnings thereon vests after three years of SERP participation and the remaining portion vests after both five years of SERP participation and 10 years of continuous service. The Company recorded expense under this plan of $6 million in 2005, $5 million in 2004 and $5 million in 2003.

Mandalay sponsored a defined benefit pension plan (the Mandalay SERP) under which certain key employees earned supplemental pension benefits based upon their respective years of service, compensation and tier category set out in the plan document. The Mandalay SERP was terminated in July 2005 and lump-sum payouts to the plan participants in the aggregate amount of $145 million were made. In purchase accounting, all previously recognized amounts related to the SERP were eliminated and a liability was recorded at the value of the lump-sum payouts as of the date of the merger, approximately $146 million. Related investments intended to fund the Mandalay SERP of $96 million were liquidated in July 2005 and used to fund a portion of the lump-sum payouts.

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NOTE 15 RESTRUCTURING COSTS

Restructuring costs (credit) consisted of the following:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
Contract termination costs	$	$ 3,693	$ 4,049
Siegfried & Roy show closure The Mirage			1,623
Other	(59)	1,932	925
	$ (59)	$ 5,625	$ 6,597

There were no material restructuring activities in 2005. At December 31, 2005, there were no material restructuring accruals. All material restructuring costs have been fully paid or otherwise resolved.

In 2004, restructuring costs include $3 million for contract termination costs related to the Aqua restaurant at Bellagio and $2 million of workforce reduction costs at MGM Grand Detroit as a result of the Company s efforts to minimize the impact of a gaming tax increase in Michigan.

In 2003, restructuring costs included $2 million related to the closure of the Siegfried & Roy show, primarily for severance costs of employees involved in the show s production. Also, the Company terminated a restaurant lease and closed two marketing offices, resulting in $4 million of contract termination charges. Other severance of $1 million in 2003 related primarily to restructuring of table games staffing at several resorts.

NOTE 16 PROPERTY TRANSACTIONS, NET

Property transactions, net consisted of the following:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
Impairment of assets to be disposed of	$ 22,651	$ 473	$ 7,172
Write-off of abandoned capital projects	5,971		
Demolition costs	5,362	7,057	6,614
Gain on sale of North Las Vegas land			(36,776)
Other net losses on asset sales or disposals	2,896	1,135	4,049
	$ 36,880	$ 8,665	$ (18,941)

In 2005, recognized impairments relate primarily to assets removed from service in connection with new capital projects at several resorts, including Bellagio, TI, The Mirage and Mandalay Bay. The amount of the impairments was based on the net book value of the disposed assets. Abandoned projects included individually insignificant projects at several resorts. Demolition costs related primarily to room remodel activity at MGM Grand Las Vegas and the new showroom at The Mirage.

In 2004, there were no material unusual property transactions. In 2003, the Company sold 315 acres of land in North Las Vegas, Nevada near Shadow Creek for approximately $55 million, which resulted in a pretax gain of approximately $37 million. Also in 2003, the Company recorded write-downs and impairments of assets abandoned or replaced with new construction, primarily at MGM Grand Las Vegas in preparation for new restaurants and the *KÀ* theatre. Demolition costs in 2004 and 2003 relate primarily to preparation for the Bellagio standard room remodel, Bellagio expansion and the *KÀ* theatre at MGM Grand Las Vegas.

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NOTE 17 RELATED PARTY TRANSACTIONS

The Company s related party transactions consisted of the following:

	Year Ended December 31,		
	2005	2004	2003
		(In thousands)	
Revenue from related parties	$ 1,081	$ 635	$ 871
Related party payments:			
Professional fees	$ 12,757	$ 4,084	$ 1,551
License payments		1,000	1,000
Other	1,866	248	469
	$ 14,623	$ 5,332	$ 3,020
Transactions with unconsolidated affiliates:			
Rent payments from Borgata	$ 3,620	$ 1,208	$ 1,060
Net reimbursements from Borgata Renaissance Pointe costs	$ 522	$ 575	$ 9,969
Rent payments from The Signature at MGM Grand	$ 770	$ 785	$
Rent payments from Silver Legacy	$ 40	$	$
Tram payments to Monte Carlo	$ 1,021	$ 3,950	$ 3,876

Borgata leases 10 acres from the Company on a long-term basis for use in its current operations and for its expansion. Additionally Borgata leases nine acres from the Company on a short-term basis for surface parking. The net reimbursements from Borgata are related to Borgata s responsibility for a portion of the master plan improvements at Renaissance Pointe and the Company s responsibility for environmental cleanup costs incurred by Borgata. The rent payments from The Signature of MGM Grand are for the sales office, which is located inside MGM Grand Las Vegas. The tram payments to Monte Carlo were compensation for lost business as a result of closing the tram between Bellagio and Monte Carlo in preparation for the Bellagio expansion.

Primarily all of the professional fees paid to related parties were for legal fees to a firm affiliated with the Company s general counsel and a former director of the Company. At December 31, 2005, the Company owed the firm $3.1 million.

NOTE 18 CONSOLIDATING CONDENSED FINANCIAL INFORMATION

The Company s subsidiaries (excluding MGM Grand Detroit, LLC and certain minor subsidiaries) have fully and unconditionally guaranteed, on a joint and several basis, payment of the senior credit facility, and the senior and senior subordinated notes of the Company and its subsidiaries. Separate condensed financial statement information for the subsidiary guarantors and non-guarantors as of December 31, 2005 and 2004 and for the years ended December 31, 2005, 2004 and 2003 is as follows:

As of and for the Year Ended December 31, 2005

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
	(In thousands)				
Balance Sheet	in-top:0pt;margin-left:0pt;;text-indent:0pt;;color:#000000;font-size:7.5pt;font-family:Times New Roman;font-weight:normal;font-style:normal;text-transform:none;font-variant: normal;">				

1,613,481

1,664,179

Other borrowings

251,584

247,883

248,898

Operating lease liabilities

114,040

—

—

Accrued expenses and other liabilities

150,200

195,123

157,277

Total liabilities

17,332,548

17,038,865

15,317,169

Shareholders' Equity

Preferred stock, 2,000 shares authorized, no shares issued or outstanding

—

—

—

Common stock, $1.00 per share stated value, 300,000 shares authorized,

173,979; 175,141; and 152,172 shares issued and outstanding, respectively

173,979

175,141

152,172

Capital surplus

2,007,962

2,031,695

1,640,776

Retained earnings

567,311

527,684

447,696

Accumulated other comprehensive income (loss), net of tax

2,620

(44,950

)

(61,526

)

Total shareholders' equity

2,751,872

2,689,570

2,179,118

Total liabilities and shareholders' equity

$

20,084,420

$

19,728,435

$

17,496,287

The accompanying notes to consolidated financial statements are an integral part of these statements.

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OLD NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Three Months Ended March 31,	
(dollars and shares in thousands, except per share data)	2019	2018
Interest Income		
Loans including fees:		
Taxable	$138,972	$118,389
Nontaxable	4,223	3,874
Investment securities:		
Taxable	28,037	18,804
Nontaxable	7,408	6,549
Money market and other interest-earning investments	278	90
Total interest income	178,918	147,706
Interest Expense		
Deposits	16,444	7,255
Federal funds purchased and interbank borrowings	1,918	1,017
Securities sold under agreements to repurchase	662	359
Federal Home Loan Bank advances	9,931	7,780
Other borrowings	2,915	2,723
Total interest expense	31,870	19,134
Net interest income	147,048	128,572
Provision for loan losses	1,043	380
Net interest income after provision for loan losses	146,005	128,192
Noninterest Income		
Wealth management fees	8,535	9,026
Service charges on deposit accounts	10,826	10,759
Debit card and ATM fees	5,503	4,865
Mortgage banking revenue	5,011	4,192
Investment product fees	5,271	5,031
Capital markets income	2,517	498
Company-owned life insurance	3,188	2,605
Net debt securities gains (losses)	(103)	788
Other income	5,668	4,141
Total noninterest income	46,416	41,905
Noninterest Expense		
Salaries and employee benefits	71,183	64,179
Occupancy	14,578	13,280
Equipment	4,474	3,565
Marketing	3,723	3,697
Data processing	9,341	8,400
Communication	3,054	3,064
Professional fees	2,910	2,730
Loan expenses	1,912	1,744
Supplies	755	722
FDIC assessment	2,087	2,645
Other real estate owned expense	36	349
Amortization of intangibles	4,472	3,609
Amortization of tax credit investments	260	716

Other expense	4,256	8,457
Total noninterest expense	123,041	117,157
Income before income taxes	69,380	52,940
Income tax expense	13,104	4,957
Net income	$56,276	$47,983
Net income per common share - basic	$0.32	$0.32
Net income per common share - diluted	0.32	0.31
Weighted average number of common shares outstanding - basic	174,734	151,721
Weighted average number of common shares outstanding - diluted	175,368	152,370
Dividends per common share	$0.13	$0.13

The accompanying notes to consolidated financial statements are an integral part of these statements.

OLD NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

	Three Months Ended March 31,	
(dollars in thousands)	2019	2018
Net income	$56,276	$47,983
Other comprehensive income (loss):		
Change in debt securities available-for-sale:		
Unrealized holding gains (losses) for the period	62,265	(25,794)
Reclassification for securities transferred to held-to-maturity	—	14,007
Reclassification adjustment for securities (gains) losses realized in income	103	(788)
Income tax effect	(14,578)	3,110
Unrealized gains (losses) on available-for-sale debt securities	47,790	(9,465)
Change in securities held-to-maturity:		
Adjustment for securities transferred to available-for-sale	—	19,412
Adjustment for securities transferred from available-for-sale	—	(14,007)
Amortization of unrealized losses on securities transferred from available-for-sale	457	591
Income tax effect	(106)	(1,026)
Changes from securities held-to-maturity	351	4,970
Cash flow hedges:		
Net unrealized derivative gains (losses) on cash flow hedges	(392)	4,563
Reclassification adjustment for (gains) losses realized in net income	(385)	769
Income tax effect	191	(1,308)
Changes from cash flow hedges	(586)	4,024
Defined benefit pension plans:		
Amortization of net loss recognized in income	20	51
Income tax effect	(5)	(31)
Changes from defined benefit pension plans	15	20
Other comprehensive income (loss), net of tax	47,570	(451)
Comprehensive income	$103,846	$47,532

The accompanying notes to consolidated financial statements are an integral part of these statements.

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OLD NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

(dollars in thousands)	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2017	$ 152,040	$ 1,639,499	$ 413,130	$ (50,272)	$ 2,154,397
Cumulative effect of change in accounting principles	—	—	(4,127)	(52)	(4,179)
Balance, January 1, 2018	152,040	1,639,499	409,003	(50,324)	2,150,218
Reclassification of certain tax effects related to the Tax Cuts and Jobs Act of 2017	—	—	10,751	(10,751)	—
Net income	—	—	47,983	—	47,983
Other comprehensive income (loss)	—	—	—	(451)	(451)
Dividends - common stock ($0.13 per share)	—	—	(19,782)	—	(19,782)
Common stock issued	6	99	—	—	105
Common stock repurchased	(64)	(1,051)	—	—	(1,115)
Share-based compensation expense	—	1,931	—	—	1,931
Stock activity under incentive compensation plans	190	298	(259)	—	229
Balance at March 31, 2018	$ 152,172	$ 1,640,776	$ 447,696	$ (61,526)	$ 2,179,118
Balance at December 31, 2018	$ 175,141	$ 2,031,695	$ 527,684	$ (44,950)	$ 2,689,570
Cumulative effect of change in accounting principles (Note 2)	—	—	6,322	—	6,322
Balance, January 1, 2019	175,141	2,031,695	534,006	(44,950)	2,695,892
Net income	—	—	56,276	—	56,276
Other comprehensive income (loss)	—	—	—	47,570	47,570
Dividends - common stock ($0.13 per share)	—	—	(22,812)	—	(22,812)
Common stock issued	9	121	—	—	130
Common stock repurchased	(1,655)	(25,642)	—	—	(27,297)
Share-based compensation expense	—	1,800	—	—	1,800
Stock activity under incentive compensation plans	484	(12)	(159)	—	313
Balance at March 31, 2019	$ 173,979	$ 2,007,962	$ 567,311	$ 2,620	$ 2,751,872

The accompanying notes to consolidated financial statements are an integral part of these statements.

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OLD NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(dollars in thousands)	Three Months Ended March 31, 2019	2018
Cash Flows From Operating Activities		
Net income	$56,276	$47,983
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	6,443	5,833
Amortization of other intangible assets	4,472	3,609
Amortization of tax credit investments	260	716
Net premium amortization on investment securities	3,154	3,845
Accretion income related to acquired loans	(8,668)	(10,914)
Share-based compensation expense	1,800	1,931
Excess tax (benefit) expense on share-based compensation	(1,013)	536
Provision for loan losses	1,043	380
Net debt securities (gains) losses	103	(788)
Net (gains) losses on sales of loans and other assets	(1,564)	5,365
Increase in cash surrender value of company-owned life insurance	(3,188)	(2,605)
Residential real estate loans originated for sale	(94,632)	(92,377)
Proceeds from sales of residential real estate loans	97,010	93,686
(Increase) decrease in interest receivable	3,184	5,481
(Increase) decrease in other real estate owned	(47)	2,075
(Increase) decrease in other assets	13,665	9,211
Increase (decrease) in accrued expenses and other liabilities	(34,376)	(22,567)
Total adjustments	(12,354)	3,417
Net cash flows provided by (used in) operating activities	43,922	51,400
Cash Flows From Investing Activities		
Purchases of investment securities available-for-sale	(541,589)	(113,525)
Purchases of Federal Home Loan Bank/Federal Reserve Bank stock	(14,439)	(16,520)
Proceeds from maturities, prepayments, and calls of investment securities available-for-sale	145,356	118,694
Proceeds from sales of investment securities available-for-sale	8,681	84,257
Proceeds from maturities, prepayments, and calls of investment securities held-to-maturity	21,689	26,117
Proceeds from sales of Federal Home Loan Bank/Federal Reserve Bank stock	19	—
Proceeds from sales of equity securities	130	128
Net principal collected from (loans made to) loan customers	182,638	(110,027)
Proceeds from settlements on company-owned life insurance	2,861	1,797
Proceeds from sales of premises and equipment and other assets	84	2,578
Purchases of premises and equipment and other assets	(11,684)	(9,593)
Net cash flows provided by (used in) investing activities	(206,254)	(16,094)
Cash Flows From Financing Activities		
Net increase (decrease) in:		
Deposits	79,321	182,697
Federal funds purchased and interbank borrowings	54,895	(185,007)
Securities sold under agreements to repurchase	(19,814)	(76,621)
Other borrowings	3,650	(32)
Payments for maturities of Federal Home Loan Bank advances	(325,070)	(772,928)
Proceeds from Federal Home Loan Bank advances	425,000	825,000
Cash dividends paid on common stock	(22,812)	(19,782)

Common stock repurchased	(27,297)	(1,115)
Proceeds from exercise of stock options	280	186
Common stock issued	130	105
Net cash flows provided by (used in) financing activities	168,283	(47,497)
Net increase (decrease) in cash and cash equivalents	5,951	(12,191)
Cash and cash equivalents at beginning of period	317,165	290,432
Cash and cash equivalents at end of period	$323,116	$278,241
Supplemental cash flow information:		
Total interest paid	$33,779	$20,775
Total taxes paid (net of refunds)	$150	$(183)
Securities transferred from held-to-maturity to available-for-sale	$—	$447,026
Securities transferred from available-for-sale to held-to-maturity	$—	$323,990

See Note 10 for additional supplemental cash flow information related to leases.

The accompanying notes to consolidated financial statements are an integral part of these statements.

OLD NATIONAL BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of Old National Bancorp and its wholly-owned affiliates (hereinafter collectively referred to as "Old National") and have been prepared in conformity with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. Such principles require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and the disclosures of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, the consolidated financial statements contain all the normal and recurring adjustments necessary for a fair statement of the financial position of Old National as of March 31, 2019 and 2018, and December 31, 2018, and the results of its operations for the three months ended March 31, 2019 and 2018. Interim results do not necessarily represent annual results. These financial statements should be read in conjunction with Old National's Annual Report for the year ended December 31, 2018.

All significant intercompany transactions and balances have been eliminated. Certain prior year amounts have been reclassified to conform to the 2019 presentation. Such reclassifications had no effect on net income or shareholders' equity and were insignificant amounts.

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Guidance Adopted in 2019

FASB ASC 842 – In February 2016, the FASB issued its new lease accounting guidance in ASU No. 2016-02, Leases (Topic 842). Under the new guidance, lessees will be required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged.

In July 2018, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases* and ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*. ASU No. 2018-10 provides improvements related to ASU No. 2016-02 to increase stakeholders' awareness of the amendments and to expedite the improvements. The amendments affect narrow aspects of the guidance issued in ASU No. 2016-02. ASU No. 2018-11 allows entities adopting ASU No. 2016-02 to choose an additional (and optional) transition method, under which an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. ASU No. 2018-11 also allows lessors to not separate non-lease components from the associated lease component if certain conditions are met. The amendments in these updates became effective for annual periods and interim periods within those annual periods beginning after December 15, 2018.

Old National elected the optional transition method permitted by ASU No. 2018-11. Under this method, an entity shall recognize and measure leases that exist at the application date and prior comparative periods are not adjusted. In addition, Old National elected the package of practical expedients to leases that commenced before the effective date:

1. An entity need not reassess whether any expired or existing contracts contain leases.
2. An entity need not reassess the lease classification for any expired or existing leases.
3. An entity need not reassess initial direct costs for any existing leases.

Old National also elected the practical expedient, which must be applied consistently to all leases, to use hindsight in determining the lease term and in assessing impairment of our right-of-use assets. We also elected a practical expedient to not assess whether existing or expired land easements that were not previously accounted for as leases under Topic 840 contain a lease under this Topic. Both of these practical expedients may be elected separately or in conjunction with each other or the package noted above.

Based on both operating and finance leases outstanding at December 31, 2018, the impact of adoption on January 1, 2019 was recording a lease liability of $122.9 million, a right-of-use asset of $118.7 million, and a cumulative-effect adjustment of $6.3 million to increase retained earnings.

FASB ASC 310 – In March 2017, the FASB issued ASU No. 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. This update amends the amortization period for certain purchased callable debt securities held at a premium. FASB is shortening the amortization period for the premium to the earliest call date. Under current GAAP, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. Concerns were raised that current GAAP excludes certain callable debt securities from consideration of early repayment of principal even if the holder is certain that the call will be exercised. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. There is diversity in practice (1) in the amortization period for premiums of callable debt securities and (2) in how the potential for exercise of a call is factored into current impairment assessments. The amendments in this update became effective for annual reporting periods beginning after December 15, 2018, including interim reporting periods within those annual reporting periods and did not have a material impact on the consolidated financial statements.

FASB ASC 718 – In June 2018, the FASB issued ASU No. 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. The amendments in this update expand the scope of Topic 718, Compensation—Stock Compensation (which currently only includes share-based payments to employees) to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. The ASU supersedes Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees. The amendments in this update became effective for annual periods beginning after December 15, 2018, including interim periods within that fiscal year and did not have a material impact on the consolidated financial statements.

FASB ASC 958 – In June 2018, the FASB issued ASU No. 2018-08, Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made. The amendments in this update clarify and improve the scope and accounting guidance around contributions of cash and other assets received and made by not-for-profit organizations and business enterprises. The ASU clarifies and improves current guidance about whether a transfer of assets, or the reduction, settlement, or cancellation of liabilities, is a contribution or an exchange transaction. It provides criteria for determining whether the resource provider is receiving commensurate value in return for the resources transferred which, depending on the outcome, determines whether the organization follows contribution guidance or exchange transaction guidance in the revenue recognition and other applicable standards. It also provides a more robust framework for determining whether a contribution is conditional or unconditional, and for distinguishing a donor-imposed condition from a donor-imposed restriction. This is important because such classification affects the timing of contribution revenue and expense recognition. The new ASU does not apply to transfers of assets from governments to businesses. The amendments in this update became effective for a public business entity for transactions in which the entity serves as a resource recipient to annual periods beginning after June 15, 2018, including interim periods within those annual periods. The amendments in this update became effective for a public business entity for transactions in which the entity serves as a resource provider to annual periods beginning after December 15, 2018, including interim periods within those annual periods and there was no impact.

FASB ASC 815 – In October 2018, the FASB issued ASU No. 2018-16, Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting. In the United States, eligible benchmark interest rates under Topic 815 are

interest rates on direct Treasury obligations of the U.S. government ("UST"), the London Interbank Offered Rate ("LIBOR") swap rate, and the Overnight Index Swap ("OIS") Rate based on the Fed Funds Effective Rate. When the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, in August 2017, it introduced the Securities Industry and Financial Markets Association ("SIFMA") Municipal Swap Rate as the fourth permissible U.S. benchmark rate.

The new ASU adds the OIS rate based on SOFR as a U.S. benchmark interest rate to facilitate the LIBOR to SOFR transition and provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes. The amendments in this update became effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years and the financial statement impact immediately upon adoption was immaterial. The future financial statement impact will depend on

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any new contracts entered into using new benchmark rates, as well as any existing contracts that get migrated from LIBOR to new benchmark interest rates. The Company has formed a working group who is developing a transition plan for all exposed contracts migrating from LIBOR to SOFR. Additionally, the working group is monitoring industry specific transition guidance around a LIBOR contract's "fallback" language with the industry goal to minimize or eliminate value transfers resulting from the transition.

Accounting Guidance Issued But Not Yet Adopted

FASB ASC 326 – In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("CECL"). The main objective of this amendment is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendment requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to enhance their credit loss estimates. The amendment requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The current expected credit loss measurement will be used to estimate the allowance for credit losses ("ACL") over the life of the financial assets. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2019. Early adoption will be permitted beginning after December 15, 2018.

As previously disclosed, Old National formed a cross functional committee to oversee the adoption of the ASU at the effective date. A working group was also formed and has developed a project plan focused on understanding the ASU, researching issues, identifying data needs for modeling inputs, technology requirements, modeling considerations, and ensuring overarching governance has been achieved for each objective and milestone. The project plan is targeting data and model validation completion during the first half of 2019, with parallel processing of our existing allowance for loan losses model with the CECL prior to implementation. Currently, the working group has identified seven distinct loan portfolios for which a model has been developed. For all seven loan portfolios, the data sets have been identified, populated, and internally validated.

Currently, our measurements for estimating the current expected life-time credit losses for loans and debt securities (as well as certain beneficial interests classified as held-to-maturity) includes the following major items:

- Initial forecast – use a period of one year for all portfolio segments and off-balance-sheet credit exposures, using forward-looking economic scenarios of expected losses.
- Historical loss forecast – for a period incorporating the remaining contractual life, adjusted for prepayments, and the changes in various economic variables during representative historical and recessionary periods.
- Reversion period – use a range from 1 to 2 years, which links the initial loss forecast to the historical loss forecast based on economic conditions at the measurement date.
- Discounted cash flow ("DCF") aggregator – using the items above to estimate the life-time credit losses for all portfolios and losses for loans modified in a TDR.

During 2019, Old National is focused on refining assumptions and evaluation/analysis of the parallel processing results. Concurrent with this, Old National is also focused on researching and resolving interpretive accounting issues in the ASU contemplating various related accounting policies, developing processes and related controls, and considering various reporting disclosures.

As of the beginning of the first reporting period in which the new standard is effective, Old National expects to recognize a one-time cumulative effect adjustment increasing the allowance for loan losses, since the ASU covers credit losses over the expected life of a loan as well as considering future changes in macroeconomic conditions. The magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements cannot yet be reasonably estimated, however, we expect to identify a range in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2019.

In December 2018, the OCC, the Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard.

FASB ASC 350 – In January 2017, the FASB issued ASU No. 2017-04, Intangibles: Goodwill and Other: Simplifying the Test for Goodwill Impairment. To simplify the subsequent measurement of goodwill, the amendments eliminate Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, the income tax effects of tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the qualitative impairment test is necessary. The amendments should be applied on a prospective basis. The nature of and reason for the change in accounting principle should be disclosed upon transition. The amendments in this update should be adopted for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted on testing dates after January 1, 2017. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but it is not expected to have a material impact.

FASB ASC 820 – In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. The updated guidance improves the disclosure requirements on fair value measurements. The ASU removes certain disclosures required by Topic 820 related to transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for timing of transfers between levels; the valuation processes for Level 3 fair value measurements; and for nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. The ASU modifies certain disclosures required by Topic 820 related to disclosure of transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities for nonpublic entities; the requirement to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly for investments in certain entities that calculate net asset value; and clarification that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The ASU adds certain disclosure requirements related to changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. The amendments in this update become effective for fiscal years, and interim periods within those fiscal years beginning after December 15, 2019. Early adoption is permitted. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but it is not expected to have a material impact.

FASB ASC 715 – In August 2018, the FASB issued ASU No. 2018-14, Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans. The amendments in this update modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The amendments in this update become effective for fiscal years ending after December 15, 2020 and will not have a material impact on the consolidated financial statements.

FASB ASC 350 – In August 2018, the FASB issued ASU No. 2018-15, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract. The amendments in this update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments in this update become effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal

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years. Early adoption is permitted. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

FASB ASC 842 – In March 2019, the FASB issued ASU No. 2019-01, Leases (Topic 842): Codification Improvements. The amendments in ASU No. 2019-01 align the guidance for fair value of the underlying asset by lessors that are not manufacturers or dealers in Topic 842 with that of existing guidance. As a result, the fair value of the underlying asset at lease commencement is its cost, reflecting any volume or trade discounts that may apply. However, if there has been a significant lapse of time between when the underlying asset is acquired and when the lease commences, the definition of fair value in Topic 820, Fair Value Measurement should be applied. ASU No. 2019-01 also requires lessors within the scope of Topic 942, Financial Services—Depository and Lending, to present all "principal payments received under leases" within investing activities. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2019. Early adoption is permitted. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but it is not expected to have a material impact.

NOTE 3 – ACQUISITION AND DIVESTITURE ACTIVITY

Acquisition

Klein Financial, Inc.

Effective November 1, 2018, Old National completed the acquisition of Minnesota-based Klein through a 100% stock merger. Klein was a bank holding company with KleinBank as its wholly-owned subsidiary. Founded in 1907 and headquartered in Chaska, Minnesota with 18 full-service branches, KleinBank was the largest family-owned community bank serving the Twin Cities and its western communities. Old National believes that it will be able to achieve cost savings by integrating the two companies and combining accounting, data processing, retail and lending support, and other administrative functions, which will enable Old National to achieve economies of scale in these areas.

Pursuant to the merger agreement, each holder of Klein common stock received 7.92 shares of Old National Common Stock per share of Klein common stock such holder owned. The total fair value of consideration for Klein was $406.5 million, consisting of 22.8 million shares of Old National Common Stock valued at $406.5 million. Through March 31, 2019, transaction and integration costs of $15.5 million associated with this acquisition have been expensed and remaining integration costs will be expensed as incurred.

The following table reflects management's preliminary valuation of the assets acquired and liabilities assumed (in thousands):

Cash and cash equivalents	$60,759
Investment securities	697,951
FHLB/Federal Reserve Bank stock	2,637
Loans held for sale	3,371
Loans	1,049,073
Premises and equipment	33,391
Accrued interest receivable	7,896
Company-owned life insurance	36,380
Net deferred tax assets	6,500

Other real estate owned	954
Other assets	10,299
Deposits	(1,713,086)
Securities sold under agreements to repurchase	(19,481)
Accrued expenses and other liabilities	(17,506)
Net tangible assets acquired	159,138
Definite-lived intangible assets acquired	39,017
Loan servicing rights	285
Goodwill	208,034
Total consideration	$406,474

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Certain loans and premises and equipment measurements have not been finalized and are subject to change. As Old National receives the information related to facts and circumstances that existed as of the acquisition date, we will finalize the provisional measurements recorded as of March 31, 2019. Such adjustments will be included in the allocation in the reporting period in which the final amounts are determined, not to exceed one year from the acquisition date.

Goodwill related to this acquisition will not be deductible for tax purposes.

The estimated fair value of the core deposit intangible was $39.0 million and is being amortized over an estimated useful life of 12 years.

Acquired loan data for Klein can be found in the table below:

(in thousands)	Fair Value of Acquired Loans at Acquisition Date	Gross Contractual Cash Flows at Acquisition Date	Best Estimate at Acquisition Date of Contractual Cash Flows Not Expected to be Collected
Acquired receivables subject to ASC 310-30	$ 11,663	$ 18,568	$ 4,521
Acquired receivables not subject to ASC 310-30	$ 1,037,410	$ 1,252,954	$ 76,534

NOTE 4 – NET INCOME PER SHARE

Basic and diluted net income per share are calculated using the two-class method. Net income is divided by the weighted-average number of common shares outstanding during the period. Adjustments to the weighted average number of common shares outstanding are made only when such adjustments will dilute net income per common share. Net income is then divided by the weighted-average number of common shares and common share equivalents during the period.

The following table reconciles basic and diluted net income per share for the three months ended March 31, 2019 and 2018:

(dollars and shares in thousands, except per share data)	Three Months Ended March 31, 2019	2018
Basic Net Income Per Share		
Net income	$56,276	$47,983
Weighted average common shares outstanding	174,734	151,721

Basic Net Income Per Share	$0.32	$0.32
Diluted Net Income Per Share		
Net income	$56,276	$47,983
Weighted average common shares outstanding	174,734	151,721
Effect of dilutive securities:		
Restricted stock	582	569
Stock options (1)	52	80
Weighted average shares outstanding	175,368	152,370
Diluted Net Income Per Share	$0.32	$0.31

(1) Options to purchase 14 thousand shares and 15 thousand shares outstanding at March 31, 2019 and 2018, respectively, were not included in the computation of net income per diluted share because the exercise price of these options was greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

NOTE 5 – INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale and held-to-maturity investment securities portfolio at March 31, 2019 and December 31, 2018 and the corresponding amounts of unrealized gains and losses therein:

(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
March 31, 2019				
Available-for-Sale				
U.S. Treasury	$9,739	$ 51	$ (13)	$9,777
U.S. government-sponsored entities and agencies	703,398	172	(5,056)	698,514
Mortgage-backed securities - Agency	2,557,848	25,070	(22,215)	2,560,703
States and political subdivisions	944,149	21,883	(596)	965,436
Pooled trust preferred securities	13,850	—	(5,727)	8,123
Other securities	327,621	2,573	(2,975)	327,219
Total available-for-sale securities	$4,556,605	$ 49,749	$ (36,582)	$4,569,772

Held-to-Maturity				
U.S. government-sponsored entities and agencies	$74,195	$30	$(39)	$74,186
Mortgage-backed securities - Agency	123,627	366	(135)	123,858
States and political subdivisions	287,012	8,880	(59)	295,833
Total held-to-maturity securities	$484,834	$9,276	$(233)	$493,877

December 31, 2018				
Available-for-Sale				
U.S. Treasury	$5,332	$—	$(31)	$5,301
U.S. government-sponsored entities and agencies	639,458	35	(11,342)	628,151
Mortgage-backed securities - Agency	2,243,774	9,738	(44,217)	2,209,295
States and political subdivisions	932,757	11,113	(3,441)	940,429
Pooled trust preferred securities	13,861	—	(5,366)	8,495
Other securities	337,435	486	(6,176)	331,745
Total available-for-sale securities	$4,172,617	$21,372	$(70,573)	$4,123,416

Held-to-Maturity				
U.S. government-sponsored entities and agencies	$73,986	$—	$(1,627)	$72,359
Mortgage-backed securities - Agency	127,120	39	(2,750)	124,409
States and political subdivisions	305,228	6,208	(2,101)	309,335
Total held-to-maturity securities	$506,334	$6,247	$(6,478)	$506,103

Proceeds from sales or calls of available-for-sale investment securities and the resulting realized gains and realized losses were as follows for the three months ended March 31, 2019 and 2018:

(dollars in thousands)	Three Months Ended March 31, 2019	2018
Proceeds from sales of available-for-sale securities	$8,681	$84,257
Proceeds from calls of available-for-sale securities	23,685	17,436
Total	$32,366	$101,693
Realized gains on sales of available-for-sale securities	$71	$2,008
Realized gains on calls of available-for-sale securities	3	1
Realized losses on sales of available-for-sale securities	(148)	(1,257)
Realized losses on calls of available-for-sale securities	(29)	(49)
Other securities gains (losses) (1)	—	85
Net debt securities gains (losses)	$(103)	$788

(1) For the three months ended March 31, 2018, other securities gains (losses) included realized gains and losses of equity securities previously classified as trading securities. For the three months ended March 31, 2019, gains (losses) on equity securities are included in other income.

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All of the mortgage-backed securities in the investment portfolio are residential mortgage-backed securities. The amortized cost and fair value of the investment securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Weighted average yield is based on amortized cost.

(dollars in thousands) Maturity	At March 31, 2019 Amortized Cost	Fair Value	Weighted Average Yield	
Available-for-Sale				
Within one year	$105,019	$105,091	2.49	%
One to five years	518,087	518,110	2.46	
Five to ten years	583,312	590,229	3.28	
Beyond ten years	3,350,187	3,356,342	2.97	
Total	$4,556,605	$4,569,772	2.94	%
Held-to-Maturity				
Within one year	$18,069	$18,179	4.32	%
One to five years	34,127	35,080	3.95	
Five to ten years	76,905	79,823	4.49	
Beyond ten years	355,733	360,795	3.58	
Total	$484,834	$493,877	3.78	%

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The following table summarizes the available-for-sale investment securities with unrealized losses at March 31, 2019 and December 31, 2018 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2019						
Available-for-Sale						
U.S. Treasury	$4,395	$ (2)	$1,481	$ (11)	$5,876	$ (13)
U.S. government-sponsored entities						
and agencies	—	—	536,114	(5,056)	536,114	(5,056)
Mortgage-backed securities - Agency	37,689	(179)	1,130,333	(22,036)	1,168,022	(22,215)
States and political subdivisions	544	—	109,859	(596)	110,403	(596)
Pooled trust preferred securities	—	—	8,123	(5,727)	8,123	(5,727)
Other securities	27,648	(128)	155,906	(2,847)	183,554	(2,975)
Total available-for-sale	$70,276	$ (309)	$1,941,816	$ (36,273)	$2,012,092	$ (36,582)
December 31, 2018						
Available-for-Sale						
U.S. Treasury	$3,829	$ (12)	$1,472	$ (19)	$5,301	$ (31)
U.S. government-sponsored entities						
and agencies	54,701	(594)	519,911	(10,748)	574,612	(11,342)
Mortgage-backed securities - Agency	82,289	(742)	1,172,984	(43,475)	1,255,273	(44,217)
States and political subdivisions	99,162	(1,340)	151,097	(2,101)	250,259	(3,441)
Pooled trust preferred securities	—	—	8,495	(5,366)	8,495	(5,366)
Other securities	94,607	(1,965)	143,842	(4,211)	238,449	(6,176)
Total available-for-sale	$334,588	$ (4,653)	$1,997,801	$ (65,920)	$2,332,389	$ (70,573)

The following table summarizes the held-to-maturity investment securities with unrecognized losses at March 31, 2019 and December 31, 2018 by aggregated major security type and length of time in a continuous unrecognized loss position:

	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
March 31, 2019						
Held-to-Maturity						
U.S. government-sponsored entities						
and agencies	$—	$ —	$41,036	$ (964)	$41,036	$ (964)
Mortgage-backed securities - Agency	—	—	44,719	(2,190)	44,719	(2,190)
States and political subdivisions	—	—	7,433	(214)	7,433	(214)
Total held-to-maturity	$—	$ —	$93,188	$ (3,368)	$93,188	$ (3,368)

December 31, 2018
Held-to-Maturity
U.S. government-sponsored entities

and agencies	$—	$ —	$72,359	$ (4,642)	$72,359	$ (4,642)
Mortgage-backed securities - Agency	4,335	(24)	119,207	(8,006)	123,542	(8,030)
States and political subdivisions	24,533	(983)	70,022	(3,556)	94,555	(4,539)
Total held-to-maturity	$28,868	$ (1,007)	$261,588	$ (16,204)	$290,456	$ (17,211)

The unrecognized losses on held-to-maturity investment securities presented in the table above include unrecognized losses on securities that were transferred from available-for-sale to held-to-maturity totaling $3.1 million at March 31, 2019 and $10.7 million at December 31, 2018.

Management evaluates debt securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management considers many factors, including: (1) the length of

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time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment’s amortized cost basis and its fair value at the balance sheet date. Otherwise, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors shall be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings shall become the new amortized cost basis of the investment.

There was no OTTI recorded during the three months ended March 31, 2019 or 2018.

At March 31, 2019, Old National’s securities portfolio consisted of 2,057 securities, 532 of which were in an unrealized loss position. The unrealized losses attributable to our U.S. Treasury, U.S. government-sponsored entities and agencies, agency mortgage-backed securities, states and political subdivisions, and other securities are the result of fluctuations in interest rates. Our pooled trust preferred securities are discussed below. At March 31, 2019, we had no intent to sell any securities that were in an unrealized loss position nor is it expected that we would be required to sell any securities.

Pooled Trust Preferred Securities

At March 31, 2019, our securities portfolio contained two pooled trust preferred securities with a fair value of $8.1 million and unrealized losses of $5.7 million. These securities are not subject to FASB ASC 325-10 and are evaluated using collateral-specific assumptions to estimate the expected future interest and principal cash flows. For the three months ended March 31, 2019 and 2018, our analysis indicated no OTTI on these securities.

The table below summarizes the relevant characteristics of our pooled trust preferred securities as well as our single issuer trust preferred securities that are included in the “other securities” category in this footnote. Each of the pooled trust preferred securities support a more senior tranche of security holders. Both pooled trust preferred securities have experienced credit defaults. However, these securities have excess subordination and are not other-than-temporarily impaired as a result of their class hierarchy, which provides more loss protection.

Trust preferred securities March 31, 2019 (dollars in thousands)	Class	Lowest Credit	Amortized Cost	Fair Value	Unrealized Gain/ (Loss)	Realized Losses 2019	# of Issuers Currently Performing/ Remaining	Actual Deferrals and Defaults as a % of Original Collateral	Expected Defaults as a % of Remaining Performing Collateral	Excess Subordination as a % of Current Performing Collateral

		Rating (1)									
Pooled trust preferred securities:											
Pretsl XXVII LTD	B	B	$ 4,334	$ 2,298	$ (2,036)	$ —	33/43	17.2%	4.5%	36.2%
Trapeza Ser 13A	A2A	BBB	9,516	5,825	(3,691)	—	44/49	4.5%	4.5%	55.7%
			13,850	8,123	(5,727)	—				
Single Issuer trust preferred securities:										
JP Morgan Chase & Co		BBB-	4,790	4,375	(415)	—				
Total			$ 18,640	$ 12,498	$ (6,142)	$ —				

(1)Lowest rating for the security provided by any nationally recognized credit rating agency.

Equity securities are recorded at fair value and totaled $6.2 million at March 31, 2019 and $5.6 million at December 31, 2018. There were gains on equity securities of $0.2 million during the three months ended March 31, 2019 and $0.1 million during the three months ended March 31, 2018. Old National also has equity securities without readily determinable fair values that are included in other assets that totaled $76.6 million at March 31, 2019 and $79.2 million at December 31, 2018. These are illiquid investments that consist of partnerships, limited liability companies, and other ownership interests that support affordable housing, economic development, and community

revitalization initiatives in low-to-moderate income neighborhoods. There have been no impairments or downward adjustments on these securities in the three months ended March 31, 2019 or 2018.

NOTE 6 – LOANS HELD FOR SALE

Mortgage loans held for immediate sale in the secondary market were $14.1 million at March 31, 2019, compared to $14.9 million at December 31, 2018. Residential loans that Old National has originated with the intent to sell are recorded at fair value in accordance with FASB ASC 825-10, *Financial Instruments*. Conventional mortgage production is sold on a servicing retained basis. Certain loans, such as government guaranteed mortgage loans are sold on servicing released basis.

NOTE 7 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Old National's loans consist primarily of loans made to consumers and commercial clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling, and retailing. Most of Old National's lending activity occurs within our principal geographic markets of Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. Old National manages concentrations of credit exposure by industry, product, geography, customer relationship, and loan size. While loans to lessors of both residential and non-residential real estate exceed 10% of total loans, no individual sub-segment category within those broader categories reaches the 10% threshold.

The composition of loans by lending classification was as follows:

(dollars in thousands)	March 31, 2019	December 31, 2018
Commercial (1)	$3,042,790	$3,232,970
Commercial real estate:		
Construction	552,825	504,625
Other	4,470,795	4,454,226
Residential real estate	2,243,885	2,248,404
Consumer credit:		
Home equity	553,264	589,322
Auto	1,034,347	1,059,633
Other	171,071	154,712
Total loans	12,068,977	12,243,892
Allowance for loan losses	(55,559)	(55,461)
Net loans	$12,013,418	$12,188,431

(1) Includes direct finance leases of $57.6 million at March 31, 2019 and $60.0 million at December 31, 2018.

The risk characteristics of each loan portfolio segment are as follows:

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other

business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate

These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. The properties securing Old National's commercial real estate portfolio are diverse in terms of type and geographic location. Management monitors and evaluates commercial real estate loans based on

collateral, geography and risk grade criteria. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Included with commercial real estate are construction loans, which are underwritten utilizing independent appraisal reviews, sensitivity analysis of absorption and lease rates, financial analysis of the developers and property owners, and feasibility studies, if available. Construction loans are generally based on estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders (including Old National), sales of developed property, or an interim loan commitment from Old National until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long-term financing.

At 194%, Old National Bank's commercial real estate loans as a percentage of its risk-based capital remained well below the regulatory guideline limit of 300% at March 31, 2019.

Residential

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, Old National typically establishes a maximum loan-to-value ratio and generally requires private mortgage insurance if that ratio is exceeded. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Consumer

Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property or other collateral values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses incurred in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience. The allowance is increased through a provision charged to operating expense. Loans deemed to be uncollectible are charged to the allowance. Recoveries of loans previously charged-off are added to the allowance.

We utilize a PD and LGD model as a tool to determine the adequacy of the allowance for loan losses for performing commercial and commercial real estate loans. The PD is forecast using a transition matrix to determine the likelihood of a customer's AQR migrating from its current AQR to any other status within the time horizon. Transition rates are measured using Old National's own historical experience. The model assumes that recent historical transition rates will continue into the future. The LGD is defined as credit loss incurred when an obligor of the bank defaults. The sum of all net charge-offs for a particular portfolio segment are divided by all loans that have defaulted over a given period of time. The expected loss derived from the model considers the PD, LGD, and exposure at

default. Additionally, qualitative factors, such as changes in lending policies or procedures, and economic business conditions are also considered.

We use historic loss ratios adjusted for economic conditions to determine the appropriate level of allowance for residential real estate and consumer loans.

No allowance was brought forward on any of the acquired loans as any credit deterioration evident in the loans was included in the determination of the fair value of the loans at the acquisition date. An allowance for loan losses will be established for any subsequent credit deterioration or adverse changes in expected cash flows.

Old National’s activity in the allowance for loan losses for the three months ended March 31, 2019 and 2018 was as follows:

(dollars in thousands)	Commercial	Commercial Real Estate	Residential	Consumer	Total
Three Months Ended March 31, 2019					
Balance at beginning of period	$ 21,742	$ 23,470	$ 2,277	$ 7,972	$55,461
Charge-offs	(160)	(235)	(178)	(2,319)	(2,892)
Recoveries	375	570	72	930	1,947
Provision	(1,551)	1,364	131	1,099	1,043
Balance at end of period	$ 20,406	$ 25,169	$ 2,302	$ 7,682	$55,559
Three Months Ended March 31, 2018					
Balance at beginning of period	$ 19,246	$ 21,436	$ 1,763	$ 7,936	$50,381
Charge-offs	(245)	(3)	(362)	(2,075)	(2,685)
Recoveries	511	484	148	1,162	2,305
Provision	79	(1,121)	214	1,208	380
Balance at end of period	$ 19,591	$ 20,796	$ 1,763	$ 8,231	$50,381

The following table provides Old National’s recorded investment in loans by portfolio segment at March 31, 2019 and December 31, 2018 and other information regarding the allowance:

(dollars in thousands)	Commercial	Commercial Real Estate	Residential	Consumer	Total
March 31, 2019					
Allowance for loan losses:					
Individually evaluated for impairment	$4,534	$6,336	$—	$—	$10,870
Collectively evaluated for impairment	15,867	18,680	2,301	7,528	44,376
Loans acquired with deteriorated credit quality	5	153	1	154	313
Total allowance for loan losses	$20,406	$25,169	$2,302	$7,682	$55,559
Loans and leases outstanding:					
Individually evaluated for impairment	$34,660	$78,055	$—	$—	$112,715
Collectively evaluated for impairment	3,002,256	4,921,352	2,234,966	1,755,393	11,913,967
Loans acquired with deteriorated credit quality	5,874	24,213	8,919	3,289	42,295
Total loans and leases outstanding	$3,042,790	$5,023,620	$2,243,885	$1,758,682	$12,068,977
December 31, 2018					
Allowance for loan losses:					

Individually evaluated for impairment	$ 6,035	$ 8,306	$—	$—	$ 14,341
Collectively evaluated for impairment	15,700	14,845	2,276	7,821	40,642
Loans acquired with deteriorated credit quality	7	319	1	151	478
Total allowance for loan losses	$ 21,742	$ 23,470	$ 2,277	$ 7,972	$ 55,461
Loans and leases outstanding:					
Individually evaluated for impairment	$ 35,410	$ 83,104	$—	$—	$ 118,514
Collectively evaluated for impairment	3,191,367	4,850,356	2,239,147	1,800,115	12,080,985
Loans acquired with deteriorated credit quality	6,193	25,391	9,257	3,552	44,393
Total loans and leases outstanding	$ 3,232,970	$ 4,958,851	$ 2,248,404	$ 1,803,667	$ 12,243,892

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Credit Quality

Old National's management monitors the credit quality of its loans in an on-going manner. Internally, management assigns an AQR to each non-homogeneous commercial and commercial real estate loan in the portfolio, with the exception of certain FICO-scored small business loans. The primary determinants of the AQR are based upon the reliability of the primary source of repayment and the past, present, and projected financial condition of the borrower. The AQR will also consider current industry conditions. Major factors used in determining the AQR can vary based on the nature of the loan, but commonly include factors such as debt service coverage, internal cash flow, liquidity, leverage, operating performance, debt burden, FICO scores, occupancy, interest rate sensitivity, and expense burden. Old National uses the following definitions for risk ratings:

Criticized. Special mention loans that have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Classified – Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Classified – Nonaccrual. Loans classified as nonaccrual have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, in doubt.

Classified – Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as nonaccrual, with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Pass rated loans are those loans that are other than criticized, classified – substandard, classified – nonaccrual, or classified – doubtful.

The risk category of commercial and commercial real estate loans by class of loans at March 31, 2019 and December 31, 2018 was as follows:

(dollars in thousands)			Commercial Real Estate - Construction		Commercial Real Estate - Other	
Corporate Credit Exposure	Commercial					
Credit Risk Profile by Internally Assigned Grade	March 31, 2019	December 31, 2018	March 31, 2019	December 31, 2018	March 31, 2019	December 31, 2018
Grade:						
Pass	$2,837,646	$3,029,130	$494,410	$460,158	$4,140,815	$4,167,902
Criticized	106,501	98,798	43,161	29,368	119,173	110,586
Classified - substandard	64,597	66,394	746	1,275	141,357	102,961
Classified - nonaccrual	22,982	29,003	14,508	13,824	33,870	37,441
Classified - doubtful	11,064	9,645	—	—	35,580	35,336
Total	$3,042,790	$3,232,970	$552,825	$504,625	$4,470,795	$4,454,226

Old National considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, Old National also evaluates credit quality based on the aging status of the loan and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity at March 31, 2019 and December 31, 2018:

(dollars in thousands)	Residential	Consumer Home Equity	Auto	Other
March 31, 2019				
Performing	$2,218,094	$548,501	$1,031,049	$170,046
Nonperforming	25,791	4,763	3,298	1,025
Total	$2,243,885	$553,264	$1,034,347	$171,071
December 31, 2018				
Performing	$2,223,450	$586,235	$1,057,038	$153,113
Nonperforming	24,954	3,087	2,595	1,599
Total	$2,248,404	$589,322	$1,059,633	$154,712

Impaired Loans

Large commercial credits are subject to individual evaluation for impairment. Retail credits and other small balance credits that are part of a homogeneous group are not tested for individual impairment unless they are modified as a TDR. A loan is considered impaired when it is probable that contractual interest and principal payments will not be collected either for the amounts or by the dates as scheduled in the loan agreement. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Old National's policy, for all but PCI loans, is to recognize interest income on impaired loans unless the loan is placed on nonaccrual status.

The following table shows Old National's impaired loans at March 31, 2019 and December 31, 2018, respectively. Only purchased loans that have experienced subsequent impairment since the date acquired (excluding loans acquired with deteriorated credit quality) are included in the table below.

(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
March 31, 2019			
With no related allowance recorded:			
Commercial	$ 25,345	$25,552	$ —
Commercial Real Estate - Construction	10,953	10,953	—
Commercial Real Estate - Other	39,143	40,043	—
Residential	2,302	2,323	—
Consumer	958	1,130	—
With an allowance recorded:			
Commercial	9,315	9,368	4,534
Commercial Real Estate - Construction	3,555	3,555	1,634
Commercial Real Estate - Other	24,404	24,404	4,702
Residential	873	873	44
Consumer	1,373	1,373	69
Total	$ 118,221	$119,574	$ 10,983
December 31, 2018			
With no related allowance recorded:			
Commercial	$ 22,031	$22,292	$ —
Commercial Real Estate - Other	41,126	41,914	—
Residential	2,276	2,296	—
Consumer	362	535	—
With an allowance recorded:			
Commercial	13,379	13,432	6,035
Commercial Real Estate - Construction	13,824	13,824	1,830
Commercial Real Estate - Other	28,154	28,154	6,476
Residential	889	889	44
Consumer	2,013	2,013	101
Total	$ 124,054	$125,349	$ 14,486

The average balance of impaired loans during the three months ended March 31, 2019 and 2018 are included in the table below.

(dollars in thousands)	Three Months Ended March 31, 2019	2018
Average Recorded Investment		
With no related allowance recorded:		
Commercial	$23,688	$20,714
Commercial Real Estate - Construction	5,477	—

Commercial Real Estate - Other	40,135	40,801
Residential	2,289	2,275
Consumer	660	1,842
With an allowance recorded:		
Commercial	11,347	7,468
Commercial Real Estate - Construction	8,690	905
Commercial Real Estate - Other	26,279	23,672
Residential	881	910
Consumer	1,693	2,117
Total	$121,139	$100,704

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Old National does not record interest on nonaccrual loans until principal is recovered. Interest income recognized on impaired loans during the three months ended March 31, 2019 and 2018 was immaterial.

For all loan classes, a loan is generally placed on nonaccrual status when principal or interest becomes 90 days past due unless it is well secured and in the process of collection, or earlier when concern exists as to the ultimate collectibility of principal or interest. Interest accrued during the current year on such loans is reversed against interest income. Interest accrued in the prior year, if any, is charged to the allowance for loan losses. Cash interest received on these loans is applied to the principal balance until the principal is recovered or until the loan returns to accrual status. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current, remain current for a prescribed period, and future payments are reasonably assured.

Loans accounted for under FASB ASC Topic 310-30 accrue interest, even though they may be contractually past due, as any nonpayment of contractual principal or interest is considered in the periodic re-estimation of expected cash flows and is included in the resulting recognition of current period loan loss provision or prospective yield adjustments.

Old National's past due loans at March 31, 2019 and December 31, 2018 were as follows:

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More and Accruing	Nonaccrual (1)	Total Past Due	Current
March 31, 2019						
Commercial	$1,308	$888	$ 98	$ 34,046	$36,340	$3,006,450
Commercial Real Estate:						
Construction	—	—	—	14,508	14,508	538,317
Other	1,656	1,858	140	69,450	73,104	4,397,691
Residential	25,297	855	49	25,791	51,992	2,191,893
Consumer:						
Home equity	786	310	158	4,763	6,017	547,247
Auto	4,667	790	89	3,298	8,844	1,025,503
Other	494	110	26	1,025	1,655	169,416
Total loans	$34,208	$4,811	$ 560	$ 152,881	$192,460	$11,876,517
December 31, 2018						
Commercial	$3,627	$279	$ 52	$ 38,648	$42,606	$3,190,364
Commercial Real Estate:						
Construction	—	—	—	13,824	13,824	490,801
Other	1,633	500	40	72,777	74,950	4,379,276
Residential	25,947	3,437	258	24,954	54,596	2,193,808
Consumer:						
Home equity	1,434	960	456	3,087	5,937	583,385
Auto	7,091	1,903	377	2,595	11,966	1,047,667
Other	711	210	170	1,599	2,690	152,022
Total loans	$40,443	$7,289	$ 1,353	$ 157,484	$206,569	$12,037,323

(1) Includes purchased credit impaired loans of $19.6 million at March 31, 2019 and $20.5 million at December 31, 2018 that are categorized as nonaccrual for credit analysis purposes because the collection of principal or interest is doubtful. However, these loans are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.

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Loan Participations

Old National has loan participations, which qualify as participating interests, with other financial institutions. At March 31, 2019, these loans totaled $952.5 million, of which $471.6 million had been sold to other financial institutions and $480.9 million was retained by Old National. The loan participations convey proportionate ownership rights with equal priority to each participating interest holder; involve no recourse (other than ordinary representations and warranties) to, or subordination by, any participating interest holder; all cash flows are divided among the participating interest holders in proportion to each holder's share of ownership; and no holder has the right to pledge the entire financial asset unless all participating interest holders agree.

Troubled Debt Restructurings

Old National may choose to restructure the contractual terms of certain loans. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit Old National by increasing the ultimate probability of collection.

Any loans that are modified are reviewed by Old National to identify if a TDR has occurred, which is when for economic or legal reasons related to a borrower's financial difficulties, Old National Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status. The modification of the terms of such loans include one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate of new debt with similar risk, or a permanent reduction of the recorded investment of the loan.

Loans modified in a TDR are typically placed on nonaccrual status until we determine the future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate a period of performance according to the restructured terms for six months.

If we are unable to resolve a nonperforming loan issue, the credit will be charged off when it is apparent there will be a loss. For large commercial type loans, each relationship is individually analyzed for evidence of apparent loss based on quantitative benchmarks or subjectively based upon certain events or particular circumstances. Generally, Old National charges off small commercial loans scored through our small business credit center with contractual balances under $250,000 that are 90 days or more delinquent and do not have adequate collateral support. For residential and consumer loans, a charge off is recorded at the time foreclosure is initiated or when the loan becomes 120 to 180 days past due, whichever is earlier.

For commercial TDRs, an allocated reserve is established within the allowance for loan losses for the difference between the carrying value of the loan and its computed value. To determine the value of the loan, one of the following methods is selected: (1) the present value of expected cash flows discounted at the loan's original effective interest rate, (2) the loan's observable market price, or (3) the fair value of the collateral value, if the loan is collateral dependent. The allocated reserve is established as the difference between the carrying value of the loan and the collectable value. If there are significant changes in the amount or timing of the loan's expected future cash flows, impairment is recalculated and the valuation allowance is adjusted accordingly.

When a residential or consumer loan is identified as a TDR, the loan is typically written down to its collateral value less selling costs.

The following table presents activity in TDRs for the three months ended March 31, 2019 and 2018:

(dollars in thousands)	Commercial	Commercial Real Estate	Residential	Consumer	Total
Three Months Ended March 31, 2019					
Balance at beginning of period	$ 10,275	$ 27,671	$ 3,390	$ 2,374	$ 43,710
(Charge-offs)/recoveries	(7)	(75)	—	(3)	(85)
(Payments)/disbursements	(1,029)	(1,562)	(143)	(58)	(2,792)
Additions	2,407	3,103	—	—	5,510
Balance at end of period	$ 11,646	$ 29,137	$ 3,247	$ 2,313	$ 46,343
Three Months Ended March 31, 2018					
Balance at beginning of period	$ 12,088	$ 34,705	$ 3,315	$ 3,895	$ 54,003
(Charge-offs)/recoveries	(129)	(10)	23	298	182
(Payments)/disbursements	(580)	(773)	(280)	(605)	(2,238)
Additions	539	566	—	432	1,537
Balance at end of period	$ 11,918	$ 34,488	$ 3,058	$ 4,020	$ 53,484

TDRs included with nonaccrual loans totaled $27.0 million at March 31, 2019 and $26.3 million at December 31, 2018. Old National has allocated specific reserves to customers whose loan terms have been modified in TDRs totaling $3.8 million at March 31, 2019 and $3.0 million at December 31, 2018. At March 31, 2019, Old National had committed to lend an additional $5.0 million to customers with outstanding loans that are classified as TDRs.

The pre-modification and post-modification outstanding recorded investments of loans modified as TDRs during the three months ended March 31, 2019 and 2018 are the same except for when the loan modifications involve the forgiveness of principal. The following table presents loans by class modified as TDRs that occurred during the three months ended March 31, 2019 and 2018:

(dollars in thousands)	Number of Loans	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Three Months Ended March 31, 2019			
TDR:			
Commercial	3	$ 2,407	$ 2,407
Commercial Real Estate - Other	1	3,103	3,103
Total	4	$ 5,510	$ 5,510
Three Months Ended March 31, 2018			
TDR:			
Commercial	1	$ 539	$ 539
Commercial Real Estate - Other	1	566	566
Consumer	1	432	432
Total	3	$ 1,537	$ 1,537

The TDRs that occurred during the three months ended March 31, 2019 and 2018 did not have a material impact on the allowance for loan losses and resulted in no charge-offs during the three months ended March 31, 2019 or 2018.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

TDRs for which there was a payment default within twelve months following the modification were insignificant during the three months ended March 31, 2019 and 2018.

The terms of certain other loans were modified during 2019 and 2018 that did not meet the definition of a TDR. It is our process to review all classified and criticized loans that, during the period, have been renewed, have entered into a forbearance agreement, have gone from principal and interest to interest only, or have extended the maturity date. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on its debt in the foreseeable future without the

modification. The evaluation is performed under our internal underwriting policy. We also evaluate whether a concession has been granted or if we were adequately compensated through a market interest rate, additional collateral or a bona fide guarantee. We also consider whether the modification was insignificant relative to the other terms of the agreement or the delay in a payment.

PCI loans are not considered impaired until after the point at which there has been a degradation of cash flows below our expected cash flows at acquisition. If a PCI loan is subsequently modified, and meets the definition of a TDR, it will be removed from PCI accounting and accounted for as a TDR only if the PCI loan was being accounted for individually. If the PCI loan is being accounted for as part of a pool, it will not be removed from the pool. As of March 31, 2019, it has not been necessary to remove any loans from PCI accounting.

In general, once a modified loan is considered a TDR, the loan will always be considered a TDR, and therefore impaired, until it is paid in full, otherwise settled, sold or charged off. However, guidance also permits for loans to be removed from TDR status when subsequently restructured under these circumstances: (1) at the time of the subsequent restructuring, the borrower is not experiencing financial difficulties, and this is documented by a current credit evaluation at the time of the restructuring, (2) under the terms of the subsequent restructuring agreement, the institution has granted no concession to the borrower; and (3) the subsequent restructuring agreement includes market terms that are no less favorable than those that would be offered for a comparable new loan. For loans subsequently restructured that have cumulative principal forgiveness, the loan should continue to be measured in accordance with ASC 310-10, *Receivables – Overall*. However, consistent with ASC 310-40-50-2, *Troubled Debt Restructurings by Creditors, Creditor Disclosure of Troubled Debt Restructurings*, the loan would not be required to be reported in the years following the restructuring if the subsequent restructuring meets both of these criteria: (1) has an interest rate at the time of the subsequent restructuring that is not less than a market interest rate; and (2) is performing in compliance with its modified terms after the subsequent restructuring.

Purchased Credit Impaired Loans

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan and lease losses. In determining the estimated fair value of purchased loans, management considers a number of factors including, among others, the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, and net present value of cash flows expected to be received. Purchased loans are accounted for in accordance with guidance for certain loans acquired in a transfer (ASC 310-30), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan and lease losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income prospectively.

Old National has purchased loans for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. For these loans that meet the criteria of ASC 310-30 treatment, the carrying amount was as follows:

(dollars in thousands)	March 31, 2019	December 31, 2018
Commercial	$5,874	$ 6,193
Commercial real estate	24,213	25,391

Residential	8,919	9,257
Consumer	3,289	3,552
Carrying amount	42,295	44,393
Allowance for loan losses	(313)	(478)
Carrying amount, net of allowance	$41,982	$ 43,915

The outstanding balance of loans accounted for under ASC 310-30, including contractual principal, interest, fees and penalties, was $243.7 million at March 31, 2019 and $246.9 million at December 31, 2018.

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The accretable difference on PCI loans is the difference between the expected cash flows and the net present value of expected cash flows with such difference accreted into earnings using the effective yield method over the term of the loans. Accretion recorded as loan interest income totaled $2.0 million during the three months ended March 31, 2019 and $4.5 million during the three months ended March 31, 2018. Improvement in cash flow expectations has resulted in a reclassification from nonaccretable difference to accretable yield as shown in the table below.

Accretable yield of PCI loans, or income expected to be collected, was as follows:

	Three Months Ended March 31,	
(dollars in thousands)	2019	2018
Balance at beginning of period	$25,051	$27,835
Accretion of income	(1,968)	(4,526)
Reclassifications from (to) nonaccretable difference	1,306	1,379
Disposals/other adjustments	—	4
Balance at end of period	$24,389	$24,692

Included in Old National's allowance for loan losses is $0.3 million related to the purchased loans disclosed above at March 31, 2019 and $0.5 million at December 31, 2018.

PCI loans purchased during 2018 for which it was probable at acquisition that all contractually required payments would not be collected were as follows:

(dollars in thousands)	Klein (1)
Contractually required payments	$18,568
Nonaccretable difference	(4,521)
Cash flows expected to be collected at acquisition	14,047
Accretable yield	(2,384)
Fair value of acquired loans at acquisition	$11,663

(1) Old National acquired Klein effective November 1, 2018.

Income would not be recognized on certain purchased loans if Old National could not reasonably estimate cash flows to be collected. Old National had no purchased loans for which it could not reasonably estimate cash flows to be collected.

NOTE 8 – OTHER REAL ESTATE OWNED

The following table presents activity in other real estate owned for the three months ended March 31, 2019 and 2018:

(dollars in thousands)	Three Months Ended March 31, 2019	2018
Balance at beginning of period	$3,232	$8,810
Additions	394	550
Sales	(272)	(2,351)
Impairments	(75)	(274)
Balance at end of period (1)	$3,279	$6,735

(1) Includes repossessed personal property of $0.4 million at March 31, 2019 and $0.3 million at March 31, 2018. Foreclosed residential real estate property included in the table above totaled $1.2 million at March 31, 2019 and $1.3 million at December 31, 2018. Consumer mortgage loans collateralized by residential real property that were in the process of foreclosure totaled $3.7 million at March 31, 2019 and $4.9 million at December 31, 2018.

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NOTE 9 – PREMISES AND EQUIPMENT

The composition of premises and equipment at March 31, 2019 and December 31, 2018 was as follows:

(dollars in thousands)	March 31, 2019	December 31, 2018
Land	$79,314	$79,231
Buildings	372,231	365,102
Furniture, fixtures, and equipment	108,457	107,862
Leasehold improvements	43,153	42,288
Total	603,155	594,483
Accumulated depreciation	(112,939)	(108,571)
Premises and equipment, net	$490,216	$485,912

Depreciation expense was $6.4 million for the three months ended March 31, 2019, compared to $5.8 million for the three months ended March 31, 2018.

Finance Leases

Old National leases three branch buildings and certain equipment under finance leases that are included in premises and equipment. See Notes 10 and 16 to the consolidated financial statements for detail regarding these leases.

NOTE 10 – LEASES

Old National adopted FASB Topic 842 as of January 1, 2019. See Note 2 to the consolidated financial statements regarding transition guidance related to the new standard.

Old National determines if an arrangement is or contains a lease at contract inception. Operating leases are included in operating lease right-of-use assets and operating lease liabilities in our consolidated balance sheet at March 31, 2019. Finance leases are included in premises and equipment and other borrowings in our consolidated balance sheets at March 31, 2019 and 2018, and December 31, 2018.

Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. In determining the present value of lease payments, we use the implicit lease rate when readily determinable. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date. The incremental borrowing rate is the rate of interest that we would have to pay to borrow on a collateralized basis over a similar term in an amount equal to the lease payments in a similar economic environment.

Old National has operating and finance leases for land, office space, banking centers, and equipment. These leases are generally for periods of 10 to 20 years with various renewal options. We include certain renewal options in the measurement of our right-of-use assets and lease liabilities if they are reasonably certain to be exercised. Variable lease payments that are dependent on an index or a rate are initially measured using the index or rate at the commencement date and are included in the measurement of the lease liability. Variable lease payments that are not dependent on an index or a rate are excluded from the measurement of the lease liability and are recognized in profit and loss in accordance with Topic 842. Variable lease payments are defined as payments made for the right to use an asset that vary because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

We have made a policy election to exclude the recognition requirements of Topic 842 to all classes of leases with original terms of 12 months or less. Instead, the short-term lease payments are recognized in profit or loss on a straight-line basis over the lease term.

Old National has lease agreements with lease and non-lease components, which are generally accounted for separately. For real estate leases, non-lease components and other non-components, such as common area maintenance charges, real estate taxes, and insurance are not included in the measurement of the lease liability since

they are generally able to be segregated. For certain equipment leases, Old National accounts for the lease and non-lease components as a single lease component using the practical expedient available for that class of assets. Additionally, for certain equipment leases, Old National applies a portfolio approach to effectively account for the operating lease right-of-use assets and liabilities.

Old National does not have any material sub-lease agreements.

The components of lease expense were as follows:

(dollars in thousands)	Three Months Ended March 31, 2019
Operating lease cost	$ 4,402
Finance lease cost:	
Amortization of right-of-use assets	158
Interest on lease liabilities	81
Short-term lease cost	1
Sub-lease income	(179)
Total	$ 4,463

Lease expense for operating leases for the three months ended March 31, 2018 was $4.4 million.

Supplemental balance sheet information related to leases was as follows:

(dollars in thousands)	March 31, 2019
Operating Leases	
Operating lease right-of-use assets	$109,916
Operating lease liabilities	114,040
Finance Leases	
Premises and equipment, net	7,335
Other borrowings	7,432
Weighted-Average Remaining Lease Term	
Operating leases	11.0 years
Finance leases	12.1 years
Weighted-Average Discount Rate	

Operating leases	3.45	%
Finance leases	4.48	%

Supplemental cash flow information related to leases was as follows:

(dollars in thousands)	Three Months Ended March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$ 4,436
Operating cash flows from finance leases	81
Financing cash flows from finance leases	111
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	117,739
Finance leases	7,542

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The following table presents a maturity analysis of the Company's lease liability by lease classification at March 31, 2019:

(dollars in thousands)	Operating Leases	Finance Leases
2019	$13,094	$573
2020	16,764	768
2021	15,690	772
2022	14,131	778
2023	9,674	791
Thereafter	68,974	6,030
Total undiscounted lease payments	138,327	9,712
Less amounts representing interest	(24,287)	(2,280)
Lease liability	$114,040	$7,432

Old National leases certain office space and buildings to unrelated parties in exchange for consideration. All of these tenant leases are classified as operating leases. The following table presents a maturity analysis of the Company's tenant leases at March 31, 2019:

(dollars in thousands)	Tenant Leases
2019	$1,457
2020	1,473
2021	1,200
2022	831
2023	690
Thereafter	2,538
Total undiscounted lease payments	$8,189

NOTE 11 – GOODWILL AND OTHER INTANGIBLE ASSETS

The following table shows the changes in the carrying amount of goodwill for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,	
(dollars in thousands)	2019	2018
Balance at beginning of period	$1,036,258	$828,051
Acquisition adjustments	—	753
Balance at end of period	$1,036,258	$828,804

Goodwill is reviewed annually for impairment. No events or circumstances since the August 31, 2018 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists. See Note 3 to the consolidated financial statements for detail regarding changes in goodwill recorded in 2018 associated with acquisitions.

The gross carrying amount and accumulated amortization of other intangible assets at March 31, 2019 and December 31, 2018 were as follows:

(dollars in thousands)	Gross Carrying Amount	Accumulated Amortization and Impairment	Net Carrying Amount
March 31, 2019			
Core deposit	$119,051	$ (51,588)	$67,463
Customer trust relationships	16,547	(11,466)	5,081
Total intangible assets	$135,598	$ (63,054)	$72,544
December 31, 2018			
Core deposit	$129,100	$ (57,524)	$71,576
Customer trust relationships	16,547	(11,107)	5,440
Total intangible assets	$145,647	$ (68,631)	$77,016

Other intangible assets consist of core deposit intangibles and customer relationship intangibles and are being amortized primarily on an accelerated basis over their estimated useful lives, generally over a period of 5 to 15 years.

Old National reviews other intangible assets for possible impairment whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. No impairment charges were recorded during the three months ended March 31, 2019 or 2018. Total amortization expense associated with intangible assets was $4.5 million for the three months ended March 31, 2019, compared to $3.6 million for the three months ended March 31, 2018.

Estimated amortization expense for future years is as follows:

(dollars in thousands)	
2019 remaining	$12,439
2020	14,091
2021	11,336
2022	9,014
2023	7,053
Thereafter	18,611
Total	$72,544

NOTE 12 – LOAN SERVICING RIGHTS

At March 31, 2019, loan servicing rights derived from loans sold with servicing retained totaled $24.3 million, compared to $24.5 million at December 31, 2018. Loans serviced for others are not reported as assets. The principal balance of loans serviced for others was $3.290 billion at March 31, 2019, compared to $3.306 billion at December 31, 2018. Approximately 99.7% of the loans serviced for others at March 31, 2019 were residential mortgage loans. Custodial escrow balances maintained in connection with serviced loans were $25.7 million at March 31, 2019 and $10.7 million at December 31, 2018.

The following table summarizes the carrying values and activity related to loan servicing rights and the related valuation allowance for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,	
(dollars in thousands)	2019	2018
Balance at beginning of period	$24,512	$24,690
Additions	659	770
Amortization	(900)	(1,060)
Balance before valuation allowance at end of period	24,271	24,400
Valuation allowance:		
Balance at beginning of period	(15)	(29)
(Additions)/recoveries	(2)	9
Balance at end of period	(17)	(20)
Loan servicing rights, net	$24,254	$24,380

At March 31, 2019, the fair value of servicing rights was $26.2 million, which was determined using a discount rate of 12% and a weighted average prepayment speed of 137% PSA. At December 31, 2018, the fair value of servicing rights was $27.4 million, which was determined using a discount rate of 12% and a weighted average prepayment speed of 119% PSA.

NOTE 13 – QUALIFIED AFFORDABLE HOUSING PROJECTS AND OTHER TAX CREDIT INVESTMENTS

Old National is a limited partner in several tax-advantaged limited partnerships whose purpose is to invest in approved qualified affordable housing, renewable energy, or other renovation or community revitalization projects. As of March 31, 2019, Old National expects to recover its remaining investments through the use of the tax credits that are generated by the investments.

The following table summarizes Old National's investments in qualified affordable housing projects and other tax credit investments at March 31, 2019 and December 31, 2018:

(dollars in thousands)		March 31, 2019		December 31, 2018	
Investment	Accounting Method	Investment	Unfunded Commitment (1)	Investment	Unfunded Commitment
LIHTC	Proportional amortization	$27,554	$ 1,365	$28,396	$ 2,238
FHTC	Equity	16,815	17,027	16,815	17,945
CReED	Equity	13	—	17	538
Renewable Energy	Equity	8,907	9,536	9,176	17,827
Total		$53,289	$ 27,928	$54,404	$ 38,548

(1) All commitments will be paid by Old National by 2027.

The following table summarizes the amortization expense and tax benefit recognized for Old National's qualified affordable housing projects and other tax credit investments for the three months ended March 31, 2019 and 2018:

(dollars in thousands)	Amortization Expense (1)	Tax Expense (Benefit) Recognized (2)
Three Months Ended March 31, 2019		
LIHTC	$ 792	$ (1,042)
FHTC	—	—
Renewable Energy	260	(244)
Total	$ 1,052	$ (1,286)
Three Months Ended March 31, 2018		
LIHTC	$ 639	$ (831)
FHTC	—	(1,948)
Renewable Energy	716	(3,415)
Total	$ 1,355	$ (6,194)

(1) The amortization expense for the LIHTC investments is included in our income tax expense. The amortization expense for the FHTC and Renewable Energy tax credits is included in noninterest expense.

(2) All of the tax benefits recognized are included in our income tax expense. The tax benefit recognized for the FHTC and Renewable Energy investments primarily reflects the tax credits generated from the investments and excludes the net tax expense (benefit) of the investments' income (loss).

NOTE 14 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase are secured borrowings. Old National pledges investment securities to secure these borrowings. The following table presents securities sold under agreements to repurchase and related weighted-average interest rates at or for the three months ended March 31:

(dollars in thousands)	2019	2018
Outstanding at March 31,	$342,480	$308,189
Average amount outstanding	361,261	342,682
Maximum amount outstanding at any month-end	367,884	336,319
Weighted-average interest rate:		
During the three months ended March 31,	0.74 %	0.42 %
At March 31,	0.79	0.48

The following table presents the contractual maturity of our secured borrowings and class of collateral pledged:

	At March 31, 2019				
	Remaining Contractual Maturity of the Agreements				
(dollars in thousands)	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 days	Total
Repurchase Agreements:					
U.S. Treasury and agency securities	$342,480	$ —	$ —	$ —	$342,480
Total	$342,480	$ —	$ —	$ —	$342,480

The fair value of securities pledged to secure repurchase agreements may decline. Old National has pledged securities valued at 119% of the gross outstanding balance of repurchase agreements at March 31, 2019 to manage this risk.

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NOTE 15 – FEDERAL HOME LOAN BANK ADVANCES

The following table summarizes Old National Bank's FHLB advances at March 31, 2019 and December 31, 2018:

(dollars in thousands)	March 31, 2019	December 31, 2018
FHLB advances (fixed rates 1.50% to 6.08% and variable rates 2.81% to 2.94%) maturing April 2019 to October 2028	$1,703,573	$1,603,643
ASC 815 fair value hedge and other basis adjustments	16,371	9,838
Total other borrowings	$1,719,944	$1,613,481

FHLB advances had weighted-average rates of 2.49% at March 31, 2019 and 2.56% at December 31, 2018. Investment securities and residential real estate loans collateralize these borrowings up to 140% of outstanding debt.

Contractual maturities of FHLB advances at March 31, 2019 were as follows:

(dollars in thousands)	
Due in 2019	$126,408
Due in 2020	100,000
Due in 2021	20,000
Due in 2022	57,000
Due in 2023	164
Thereafter	1,400,001
ASC 815 fair value hedge and other basis adjustments	16,371
Total	$1,719,944

NOTE 16 – OTHER BORROWINGS

The following table summarizes Old National's other borrowings at March 31, 2019 and December 31, 2018:

(dollars in thousands)	March 31, 2019	December 31, 2018
Old National Bancorp:		
Senior unsecured notes (fixed rate 4.125%) maturing August 2024	$175,000	$175,000
Unamortized debt issuance costs related to senior	(831)	(870)

unsecured notes		
Junior subordinated debentures (variable rates of		
3.93% to 6.39%) maturing April 2032		
to June 2037	60,310	60,310
Other basis adjustments	(2,910)	(3,046)
Old National Bank:		
Finance lease liabilities	7,432	5,262
Subordinated debentures (fixed rate 5.75%)	12,000	12,000
Other	583	(773)
Total other borrowings	$251,584	$247,883

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Contractual maturities of other borrowings at March 31, 2019 were as follows:

(dollars in thousands)	
Due in 2019	$338
Due in 2020	471
Due in 2021	494
Due in 2022	521
Due in 2023	557
Thereafter	252,361
Unamortized debt issuance costs and other basis adjustments	(3,158)
Total	$251,584

Senior Notes

In August 2014, Old National issued $175.0 million of senior unsecured notes with a 4.125% interest rate. These notes pay interest on February 15 and August 15. The notes mature on August 15, 2024.

Junior Subordinated Debentures

Junior subordinated debentures related to trust preferred securities are classified in "other borrowings." On November 1, 2017, Old National acquired Anchor (MN) and exceeded $15 billion in assets. As a result, these securities can only be treated as Tier 2 capital for regulatory purposes, subject to certain limitations. Prior to the fourth quarter of 2017, these securities qualified as Tier 1 capital for regulatory purposes.

Through various acquisitions, Old National assumed junior subordinated debenture obligations related to various trusts that issued trust preferred securities. Old National guarantees the payment of distributions on the trust preferred securities issued by the trusts. Proceeds from the issuance of each of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by the trusts.

Old National, at any time, may redeem the junior subordinated debentures at par and, thereby cause a redemption of the trust preferred securities in whole or in part.

The following table summarizes the terms of our outstanding junior subordinated debentures at March 31, 2019:

(dollars in thousands)

Name of Trust	Issuance Date	Issuance Amount	Rate	Rate at March 31, 2019	Maturity Date
VFSC Capital Trust I	April 2002	$3,093	6-month LIBOR plus 3.70%	6.39%	April 22, 2032
VFSC Capital Trust II	October 2002	4,124	3-month LIBOR plus 3.45%	6.14%	November 7, 2032
VFSC Capital Trust III	April 2004	3,093	3-month LIBOR plus 2.80%	5.39%	September 8, 2034
St. Joseph Capital Trust II	March 2005	5,000	3-month LIBOR plus 1.75%	4.36%	March 17, 2035
Anchor Capital Trust III	August 2005	5,000	3-month LIBOR plus 1.55%	4.14%	September 30, 2035

Tower Capital Trust 2	December 2005	8,000	3-month LIBOR plus 1.34%	3.93%	December 30, 2035
Home Federal Statutory Trust I	September 2006	15,000	3-month LIBOR plus 1.65%	4.26%	September 15, 2036
Monroe Bancorp Capital Trust I	July 2006	3,000	3-month LIBOR plus 1.60%	4.39%	October 7, 2036
Tower Capital Trust 3	December 2006	9,000	3-month LIBOR plus 1.69%	4.32%	March 1, 2037
Monroe Bancorp Statutory Trust II	March 2007	5,000	3-month LIBOR plus 1.60%	4.21%	June 15, 2037
Total		$60,310			

Subordinated Debentures

On November 1, 2017, Old National assumed $12.0 million of subordinated fixed-to-floating notes related to the acquisition of Anchor (MN). The subordinated debentures have a 5.75% fixed rate of interest through October 29, 2020. From October 30, 2020 to the October 30, 2025 maturity date, the debentures have a floating rate of interest equal to the three-month LIBOR rate plus 4.356%.

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Finance Lease Liabilities

Old National has long-term finance lease liabilities for certain banking centers totaling $7.4 million. The economic substance of these leases is that Old National is financing the acquisition of the building through the lease and accordingly, the building is recorded as a right-of-use asset in premises and equipment and the lease is recorded as a liability in other borrowings. The right-of-use assets and lease liabilities are initially measured at the present value of the lease payments over the lease term using Old National's incremental borrowing rate based on the information available at the commencement date of the lease. See Note 10 to the consolidated financial statements for a maturity analysis of the Company's finance lease liabilities.

NOTE 17 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes within each classification of AOCI, net of tax, for the three months ended March 31, 2019 and 2018:

(dollars in thousands)	Unrealized Gains and Losses on Available-for-Sale Debt Securities	Unrealized Gains and Losses on Held-to-Maturity Securities	Gains and Losses on Cash Flow Hedges	Defined Benefit Pension Plans	Total
Three Months Ended March 31, 2019					
Balance at beginning of period	$ (37,348)	$ (8,515)	$ 1,099	$ (186)	$ (44,950)
Other comprehensive income (loss) before reclassifications	47,711	—	(296)	—	47,415
Amounts reclassified from AOCI to income (1)	79	351	(290)	15	155
Balance at end of period	$ 10,442	$ (8,164)	$ 513	$ (171)	$ 2,620
Three Months Ended March 31, 2018					
Balance at beginning of period	$ (35,557)	$ (12,107)	$ (2,337)	$ (271)	$ (50,272)
Amount reclassified from AOCI to retained earnings for cumulative effect of change in accounting principle	—	—	(52)	—	(52)
Amounts reclassified from AOCI to retained	(7,583)	(2,600)	(509)	(59)	(10,751)

earnings related to the Tax Cuts and Jobs Act of 2017					
Other comprehensive income (loss) before reclassifications	(8,872)	4,514	3,444	—	(914)
Amounts reclassified from AOCI to income (1)	(593)	456	580	20	463
Balance at end of period	$ (52,605)	$ (9,737)	$ 1,126	$ (310)	$ (61,526)

(1) See table below for details about reclassifications to income.

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The following table summarizes the significant amounts reclassified out of each component of AOCI for the three months ended March 31, 2019 and 2018:

Details about AOCI Components	Amount Reclassified from AOCI Three Months Ended March 31,		Affected Line Item in the Statement of Income
(dollars in thousands)	2019	2018	
Unrealized gains and losses on			
available-for-sale debt securities	$(103)	$788	Net debt securities gains (losses)
	24	(195)	Income tax (expense) benefit
	$(79)	$593	Net income
Unrealized gains and losses on			
held-to-maturity securities	$(457)	$(591)	Interest income (expense)
	106	135	Income tax (expense) benefit
	$(351)	$(456)	Net income
Gains and losses on cash flow hedges			
Interest rate contracts	$385	$(769)	Interest income (expense)
	(95)	189	Income tax (expense) benefit
	$290	$(580)	Net income
Amortization of defined benefit			
pension items			
Actuarial gains (losses)	$(20)	$(51)	Salaries and employee benefits
	5	31	Income tax (expense) benefit
	$(15)	$(20)	Net income
Total reclassifications for the period	$(155)	$(463)	Net income

NOTE 18 – EMPLOYEE BENEFIT PLANS

Employee Stock Ownership Plan

The Employee Stock Ownership and Savings Plan (the “401(k) Plan”) permits employees to participate the first month following one month of service. During the second quarter of 2018, Old National increased its match to 75% of employee compensation deferral contributions of the first 4% of compensation, and 50% of the next 4% of compensation. The change was retroactive for all of 2018. Contribution expense under the 401(k) Plan was $2.8 million in the three months ended March 31, 2019, compared to $1.5 million in the three months ended March 31, 2018.

NOTE 19 – SHARE-BASED COMPENSATION

At March 31, 2019, Old National had 3.9 million shares remaining available for issuance under the Company's Amended and Restated 2008 Incentive Compensation Plan. The granting of awards to key employees is typically in the form of restricted stock awards or units.

Restricted Stock Awards

Old National granted 82 thousand time-based restricted stock awards to certain key officers during the three months ended March 31, 2019, with shares vesting generally over a thirty-six month period. Compensation expense is recognized on a straight-line basis over the vesting period. Shares are subject to certain restrictions and risk of forfeiture by the participants. At March 31, 2019, unrecognized compensation expense was estimated to be $4.9 million for unvested restricted stock awards. The cost is expected to be recognized over a weighted-average period of 2.0 years.

Old National recorded share-based compensation expense related to restricted stock awards of $0.6 million, net of tax, during the three months ended March 31, 2019, compared to $0.5 million, net of tax, during the three months ended March 31, 2018.

Restricted Stock Units

Old National granted 326 thousand shares of performance based restricted stock units to certain key officers during the three months ended March 31, 2019, with shares vesting at the end of a thirty-six month period based on the achievement of certain targets. For certain awards, the level of performance could increase or decrease the percentage of shares earned. Compensation expense is recognized on a straight-line basis over the vesting period. Shares are subject to certain restrictions and risk of forfeiture by the participants. At March 31, 2019, unrecognized compensation expense was estimated to be $7.8 million. The cost is expected to be recognized over a weighted-average period of 2.2 years.

Old National recorded share-based compensation expense related to restricted stock units of $0.8 million, net of tax, during the three months ended March 31, 2019, compared to $0.9 million, net of tax, during the three months ended March 31, 2018.

Stock Options

Old National has not granted stock options since 2009. However, Old National did acquire stock options through prior year acquisitions. Old National did not record any share-based compensation expense related to these stock options during the three months ended March 31, 2019 or 2018.

Stock Appreciation Rights

Old National has never granted stock appreciation rights. However, Old National did acquire stock appreciation rights through a prior year acquisition. Old National did not record any incremental expense associated with the conversion of these stock appreciation rights during the three months ended March 31, 2019 or 2018. At March 31, 2019, 61 thousand stock appreciation rights remained outstanding.

NOTE 20 – INCOME TAXES

Following is a summary of the major items comprising the differences in taxes from continuing operations computed at the federal statutory rate and as recorded in the consolidated statements of income:

	Three Months Ended March 31,	
(dollars in thousands)	2019	2018
Provision at statutory rate of 21%	$14,570	$11,117
Tax-exempt income:		
Tax-exempt interest	(2,531)	(2,191)
Section 291/265 interest disallowance	111	62
Company-owned life insurance income	(669)	(547)
Tax-exempt income	(3,089)	(2,676)
State income taxes	1,999	1,188
Interim period effective rate adjustment	688	92
Tax credit investments - federal	(420)	(5,769)
Other, net	(644)	1,005
Income tax expense	$13,104	$4,957

Effective tax rate	18.9 %	9.4 %

In accordance with ASC 740-270, *Accounting for Interim Reporting*, the provision for income taxes was recorded at March 31, 2019 and 2018 based on the current estimate of the effective annual rate.

The higher effective tax rate during the three months ended March 30, 2019 when compared to the three months ended March 31, 2018 is primarily the result of a decrease in federal tax credits available.

Unrecognized Tax Benefits

Old National has an immaterial amount of unrecognized tax benefits. Old National expects the total amount of unrecognized tax benefits to be reduced to zero in the third quarter of 2019.

Net Deferred Tax Assets

Significant components of net deferred tax assets (liabilities) were as follows at March 31, 2019 and December 31, 2018:

(dollars in thousands)	March 31, 2019	December 31, 2018
Deferred Tax Assets		
Allowance for loan losses, net of recapture	$14,458	$14,514
Benefit plan accruals	14,624	21,754
Alternative minimum tax credit	2,545	2,545
Net operating loss carryforwards	30,168	31,765
Federal tax credits	3,116	1,779
Deferred gain on securities	1,844	1,976
Acquired loans	24,857	26,956
Operating lease liabilities	30,451	—
Lease exit obligation	—	1,025
Unrealized losses on available-for-sale investment securities	—	11,853
Unrealized losses on held-to-maturity investment securities	2,391	2,497
Tax credit investments and other partnerships	3,196	3,004
Other real estate owned	144	144
Other, net	2,691	3,167
Total deferred tax assets	130,485	122,979
Deferred Tax Liabilities		
Accretion on investment securities	(795)	(595)
Purchase accounting	(17,873)	(18,100)
Loan servicing rights	(6,080)	(6,141)
Premises and equipment	(11,019)	(8,507)
Prepaid expenses	(716)	(681)
Operating lease right-of-use assets	(29,393)	—
Unrealized gains on available-for-sale investment securities	(2,725)	—
Unrealized gains on hedges	(167)	(358)
Other, net	(2,287)	(1,549)
Total deferred tax liabilities	(71,055)	(35,931)
Net deferred tax assets	$59,430	$87,048

Through the acquisition of Anchor (WI) in the second quarter of 2016 and Lafayette Savings Bank in the fourth quarter of 2014, both former thrifts, Old National Bank's retained earnings at March 31, 2019 include base-year bad debt reserves, created for tax purposes prior to 1988, totaling $52.8 million. Of this total, $50.9 million was acquired from Anchor (WI), and $1.9 million was acquired from Lafayette Savings Bank. Base-year reserves are subject to recapture in the unlikely event that Old National Bank (1) makes distributions in excess of current and accumulated earnings and profits, as calculated for federal income tax purposes, (2) redeems its stock, or (3) liquidates. Old National Bank has no intention of making such a nondividend distribution. Accordingly, under current accounting principles, a related deferred income tax liability of $13.0 million has not been recognized.

No valuation allowance was recorded at March 31, 2019 or December 31, 2018 because, based on current expectations, Old National believes it will generate sufficient income in future years to realize deferred tax assets. Old

National has federal net operating loss carryforwards totaling $97.1 million at March 31, 2019 and $104.5 million at December 31, 2018. This federal net operating loss was acquired from the acquisition of Anchor (WI) in 2016. If not used, the federal net operating loss carryforwards will expire from 2028 to 2033. Old National has alternative minimum tax ("AMT") credit carryforwards totaling $6.3 million at March 31, 2019 and $10.1 million at December 31, 2018. The enactment of H.R. 1 eliminates the parallel tax system known as the AMT and allows any existing AMT credits to be used to reduce regular tax or be refunded from 2018 to 2021. ASC 740 allows for the reclassification of the AMT credit from a deferred tax asset to a current tax asset, except for the amount limited by section 382. Old National has $2.5 million of AMT credit carryforward subject to section 382 limitations. The $2.5 million is maintained in deferred tax assets and the remaining $3.8 million has been reclassified to a current tax asset. Old National has federal tax credit carryforwards of $3.1 million at March 31, 2019 and $1.8 million at December 31, 2018. The federal tax credits consist mainly of energy efficient home credits, low income housing

credits, and research and development credits that, if not used, will expire from 2025 to 2039. Old National has recorded state net operating loss carryforwards totaling $165.0 million at March 31, 2019 and $165.6 million at December 31, 2018. If not used, the state net operating loss carryforwards will expire from 2024 to 2033.

The federal and recorded state net operating loss carryforwards are subject to an annual limitation under Internal Revenue Code section 382. Old National believes that all of the recorded net operating loss carryforwards will be used prior to expiration.

NOTE 21 – DERIVATIVE FINANCIAL INSTRUMENTS

As part of our overall interest rate risk management, Old National uses derivative instruments, including interest rate swaps, collars, caps, and floors. The notional amount of these derivative instruments was $1.332 billion at March 31, 2019 and $1.482 billion at December 31, 2018. These derivative financial instruments at March 31, 2019 consisted of $857.0 million notional amount of receive-fixed, pay-variable interest rate swaps on certain of its FHLB advances, $175.0 million notional amount of pay-fixed, receive-variable interest rate swaps on certain of its FHLB advances, and $300.0 million notional amount interest rate collars related to a variable-rate commercial loan pool. Derivative financial instruments at December 31, 2018 consisted of $757.0 million notional amount of receive-fixed, pay-variable interest rate swaps on certain of its FHLB advances, $525.0 million notional amount of pay-fixed, receive-variable interest rate swaps on certain of its FHLB advances, and $200.0 million notional amount interest rate collars related to a variable-rate commercial loan pool. These hedges were entered into to manage interest rate risk. Derivative instruments are recognized on the balance sheet at their fair value and are not reported on a net basis.

In accordance with ASC 815-20-35-1, subsequent changes in fair value for a hedging instrument that has been designated and qualifies as part of a hedging relationship should be accounted for in the following manner:

Cash flow hedges: changes in fair value will be recognized as a component in other comprehensive income.

Fair value hedges: changes in fair value will be recognized concurrently in earnings.

Consistent with this guidance, as long as a hedging instrument is designated and the results of the effectiveness testing support that the instrument qualifies for hedge accounting treatment, 100% of the periodic changes in fair value of the hedging instrument will be accounted for as outlined above. This is the case whether or not economic mismatches exist in the hedging relationship. As a result, there will be no periodic measurement or recognition of ineffectiveness. Rather, the full impact of hedge gains and losses will be recognized in the period in which the hedged transactions impact earnings.

While separate measurement and presentation of ineffectiveness is being eliminated, paragraph 815-20-45-1A requires the change in fair value of the hedging instrument that is included in the assessment of hedge effectiveness be presented in the same income statement line item that is used to present the earnings effect of the hedged item.

Commitments to fund certain mortgage loans (interest rate lock commitments) and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. These derivative contracts do not qualify for hedge accounting. At March 31, 2019, the notional amount of the interest rate lock commitments was $68.9 million and forward commitments were $73.5 million. At December 31, 2018, the notional amount of the interest rate lock commitments was $27.6 million and forward commitments were $34.5 million. It is our practice to enter into forward commitments for the future delivery of residential mortgage loans to third party investors when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from our commitment to fund the loans.

Old National also enters into derivative instruments for the benefit of its customers. The notional amounts of these customer derivative instruments and the offsetting counterparty derivative instruments were $877.1 million at March 31, 2019. The notional amounts of these customer derivative instruments and the offsetting counterparty derivative instruments were $793.4 million at December 31, 2018. These derivative contracts do not qualify for hedge accounting. These instruments include interest rate swaps, caps, and collars. Commonly, Old National will economically hedge significant exposures related to these derivative contracts entered into for the benefit of customers by entering into offsetting contracts with approved, reputable, independent counterparties with substantially matching terms.

Old National enters into derivative financial instruments as part of its foreign currency risk management strategies. These derivative instruments consist of foreign currency forward contracts to accommodate the business needs of its customers. Old National does not designate these foreign currency forward contracts for hedge accounting treatment. The notional amounts of these foreign currency forward contracts and the offsetting counterparty derivative instruments were $3.8 million at March 31, 2019 and $3.6 million at December 31, 2018.

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. Old National's exposure is limited to the replacement value of the contracts rather than the notional, principal, or contract amounts. There are provisions in our agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, we minimize credit risk through credit approvals, limits, and monitoring procedures.

Amounts reported in AOCI related to cash flow hedges will be reclassified to interest income or interest expense as interest payments are received or paid on Old National's derivative instruments. During the next 12 months, we estimate that $0.7 million will be reclassified to interest income and $0.6 million will be reclassified to interest expense.

The following table summarizes the fair value of derivative financial instruments utilized by Old National:

(dollars in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
March 31, 2019				
Derivatives designated as hedging instruments				
Interest rate contracts	Other assets	$18,231	Other liabilities	$2,351
Total derivatives designated as hedging instruments		$18,231		$2,351
Derivatives not designated as hedging instruments				
Interest rate contracts	Other assets	$19,749	Other liabilities	$8,849
Mortgage contracts	Other assets	1,872	Other liabilities	292
Foreign currency contracts	Other assets	100	Other liabilities	54
Total derivatives not designated as hedging instruments		$21,721		$9,195
Total		$39,952		$11,546
December 31, 2018				
Derivatives designated as hedging instruments				
Interest rate contracts	Other assets	$12,741	Other liabilities	$1,603
Total derivatives designated as hedging instruments		$12,741		$1,603
Derivatives not designated as hedging instruments				
Interest rate contracts	Other assets	$15,278	Other liabilities	$10,562
Mortgage contracts	Other assets	874	Other liabilities	316
Foreign currency contracts	Other assets	112	Other liabilities	69
Total derivatives not designated as hedging instruments		$16,264		$10,947
Total		$29,005		$12,550

Summary information about the interest rate swaps designated as fair value hedges is as follows:

(dollars in thousands)	March 31, 2019		December 31, 2018	
Notional amounts	$857,000		$757,000	
Weighted average pay rates	2.49	%	2.48	%
Weighted average receive rates	2.65	%	2.70	%
Weighted average maturity	3.6 years		3.9 years	
Fair value of swaps	$16,227		$9,683	

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The effect of derivative instruments in fair value hedging relationships on the consolidated statements of income for the three months ended March 31, 2019 and 2018 were as follows:

(dollars in thousands) Derivatives in Fair Value Hedging Relationships	Location of Gain or (Loss) Recognized in in Income on Derivative	Gain (Loss) Recognized in Income on Derivative	Hedged Items in Fair Value Hedging Relationships	Location of Gain or (Loss) Recognized in in Income on Related Hedged Item	Gain (Loss) Recognized in Income on Related Hedged Items
Three Months Ended March 31, 2019					
Interest rate contracts	Interest income/(expense)	$ 6,552	Fixed-rate debt	Interest income/(expense)	$ (6,548)
Three Months Ended March 31, 2018					
Interest rate contracts	Interest income/(expense)	$ (720)	Fixed-rate debt	Interest income/(expense)	$ 722

Summary information about the interest rate swaps designated as cash flow hedges is as follows:

(dollars in thousands)	March 31, 2019	December 31, 2018
Notional amounts	$175,000	$525,000
Weighted average pay rates	3.01 %	2.21 %
Weighted average receive rates	2.65 %	2.63 %
Weighted average maturity	1.9 years	1.4 years
Unrealized gains (losses)	$(2,351)	$146

Old National has designated its interest rate collars as cash flow hedges. The structure of these instruments is such that Old National pays the counterparty an incremental amount if the collar index exceeds the cap rate. Conversely, Old National receives an incremental amount if it falls below the floor rate. No payments are required if the collar index falls between the cap and floor rates. Summary information about the collars designated as cash flow hedges is as follows:

(dollars in thousands)	March 31, 2019	December 31, 2018
Notional amounts	$300,000	$200,000
Weighted average cap rates	3.21 %	3.44 %
Weighted average floor rates	2.21 %	2.38 %
Weighted average rates	2.49 %	2.35 %

Weighted average maturity	2.6 years	2.8 years
Unrealized gains (losses)	$2,004	$1,309

The effect of derivative instruments in cash flow hedging relationships on the consolidated statements of income for the three months ended March 31, 2019 and 2018 were as follows:

(dollars in thousands)		Three Months Ended March 31,		Three Months Ended March 31,	
		2019	2018	2019	2018
Derivatives in Cash Flow Hedging Relationships	Location of Gain or (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in Other Comprehensive Income on Derivative		Gain (Loss) Reclassified from AOCI into Income	
Interest rate contracts	Interest income/(expense)	$(392)	$4,563	$385	$(769)

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The effect of derivatives not designated as hedging instruments on the consolidated statements of income for the three months ended March 31, 2019 and 2018 were as follows:

		Three Months Ended March 31,	
(dollars in thousands)		2019	2018
Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative	
Interest rate contracts (1)	Other income/(expense)	$(37)	$—
Mortgage contracts	Mortgage banking revenue	1,022	638
Foreign currency contracts	Other income/(expense)	3	17
Total		$988	$655

(1)Includes the valuation differences between the customer and offsetting swaps.

NOTE 22 – COMMITMENTS AND CONTINGENCIES

Litigation

In the normal course of business, Old National Bancorp and its subsidiaries have been named, from time to time, as defendants in various legal actions. Certain of the actual or threatened legal actions may include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages.

Old National contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, Old National cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, or other relief, if any, might be. Subject to the foregoing, Old National believes, based on current knowledge and after consultation with counsel, that the outcome of such pending matters will not have a material adverse effect on the consolidated financial condition of Old National, although the outcome of such matters could be material to Old National's operating results and cash flows for a particular future period, depending on, among other things, the level of Old National's revenues or income for such period. Old National will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated.

Old National is not currently involved in any material litigation.

Credit-Related Financial Instruments

In the normal course of business, Old National's banking affiliates have entered into various agreements to extend credit, including loan commitments of $3.743 billion and standby letters of credit of $100.2 million at March 31, 2019. At March 31, 2019, approximately $3.478 billion of the loan commitments had fixed rates and $265.3 million had floating rates, with the floating interest rates ranging from 1% to 16%. At December 31, 2018, loan commitments totaled $3.566 billion and standby letters of credit totaled $319.0 million. These commitments are not reflected in the

consolidated financial statements. The allowance for unfunded loan commitments totaled $2.2 million at March 31, 2019 and $2.5 million at December 31, 2018.

Old National had credit extensions with various unaffiliated banks related to letter of credit commitments issued on behalf of Old National's clients totaling $2.2 million at March 31, 2019 and $15.5 million at December 31, 2018. Old National provided collateral to the unaffiliated banks to secure credit extensions totaling $7.8 million at March 31, 2019 and December 31, 2018. Old National did not provide collateral for the remaining credit extensions.

Visa Class B Restricted Shares

In 2008, Old National received Visa Class B restricted shares as part of Visa's initial public offering. These shares are transferable only under limited circumstances until they can be converted into the publicly traded Class A common shares. This conversion will not occur until the final settlement of certain litigation for which Visa is

indemnified by the holders of Visa's Class B shares, including Old National. Visa funded an escrow account from its initial public offering to settle these litigation claims. Increases in litigation claims requiring Visa to fund the escrow account due to insufficient funds will result in a reduction of the conversion ratio of each Visa Class B share to unrestricted Class A shares. As of March 31, 2019, the conversion ratio was 1.6298. Based on the existing transfer restriction and the uncertainty of the outcome of the Visa litigation, the 56,210 Class B shares that Old National owns at March 31, 2019 are carried at a zero cost basis and are included in other assets with our equity securities that have no readily determinable fair value.

NOTE 23 – FINANCIAL GUARANTEES

Old National holds instruments, in the normal course of business with clients, that are considered financial guarantees in accordance with FASB ASC 460-10 (FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*), which requires Old National to record the instruments at fair value. Standby letters of credit guarantees are issued in connection with agreements made by clients to counterparties. Standby letters of credit are contingent upon failure of the client to perform the terms of the underlying contract. Credit risk associated with standby letters of credit is essentially the same as that associated with extending loans to clients and is subject to normal credit policies. The term of these standby letters of credit is typically one year or less. At March 31, 2019, the notional amount of standby letters of credit was $100.2 million, which represented the maximum amount of future funding requirements, and the carrying value was $$0.5 million. At December 31, 2018, the notional amount of standby letters of credit was $319.0 million, which represented the maximum amount of future funding requirements, and the carrying value was $0.5 million.

Old National is a party in risk participation transactions of interest rate swaps, which had total notional amount of $38.3 million at March 31, 2019.

NOTE 24 – SEGMENT INFORMATION

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Old National Bank, Old National's bank subsidiary, is the only significant subsidiary upon which management makes decisions regarding how to allocate resources and assess performance. Each of the branches of Old National Bank provide a group of similar community banking services, including such products and services as commercial, real estate and consumer loans, time deposits, checking and savings accounts, cash management, brokerage, trust, and investment advisory services. The individual bank branches located throughout our Midwest footprint have similar operating and economic characteristics. While the chief decision maker monitors the revenue streams of the various products, services, and regional locations, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the community banking services and branch locations are considered by management to be aggregated into one reportable operating segment, community banking.

NOTE 25 – FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

- Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Old National used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using swap and LIBOR curves plus spreads that adjust for loss severities, volatility, credit risk, and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

Residential loans held for sale: The fair value of loans held for sale is determined using quoted prices for a similar asset, adjusted for specific attributes of that loan (Level 2).

Derivative financial instruments: The fair values of derivative financial instruments are based on derivative valuation models using market data inputs as of the valuation date (Level 2).

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which we have elected the fair value option, are summarized below:

		Fair Value Measurements at March 31, 2019 Using		
(dollars in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Equity securities	$6,235	$6,235	$—	$ —
Investment securities available-for-sale:				
U.S. Treasury	9,777	9,777	—	—
U.S. government-sponsored entities and agencies	698,514	—	698,514	—
Mortgage-backed securities - Agency	2,560,703	—	2,560,703	—
States and political subdivisions	965,436	—	965,396	40
Pooled trust preferred securities	8,123	—	—	8,123
Other securities	327,219	30,640	296,579	—
Residential loans held for sale	14,082	—	14,082	—
Derivative assets	39,952	—	39,952	—
Financial Liabilities				
Derivative liabilities	11,546	—	11,546	—

		Fair Value Measurements at December 31, 2018 Using		
(dollars in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Financial Assets				
Equity securities	$5,582	$ 5,582	$ —	$ —
Investment securities available-for-sale:				
U.S. Treasury	5,301	5,301	—	—
U.S. government-sponsored entities and agencies	628,151	—	628,151	—
Mortgage-backed securities - Agency	2,209,295	—	2,209,295	—
States and political subdivisions	940,429	—	936,321	4,108
Pooled trust preferred securities	8,495	—	—	8,495
Other securities	331,745	30,259	301,486	—
Residential loans held for sale	14,911	—	14,911	—
Derivative assets	29,005	—	29,005	—
Financial Liabilities				
Derivative liabilities	12,550	—	12,550	—

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The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

(dollars in thousands)	Pooled Trust Preferred Securities	States and Political Subdivisions
Three Months Ended March 31, 2019		
Balance at beginning of period	$ 8,495	$ 4,108
Accretion (amortization) of discount	4	—
Sales/payments received	(15)	(35)
Increase (decrease) in fair value of securities	(361)	—
Transfers out of Level 3	—	(4,033)
Balance at end of period	$ 8,123	$ 40
Three Months Ended March 31, 2018		
Balance at beginning of period	$ 8,448	$ —
Accretion of discount	5	—
Sales/payments received	(288)	—
Increase (decrease) in fair value of securities	30	—
Transfers into Level 3	—	4,061
Balance at end of period	$ 8,195	$ 4,061

The accretion or amortization of discounts on securities in the table above is included in interest income. An increase in fair value is reflected in the balance sheet as an increase in the fair value of investment securities available-for-sale, an increase in accumulated other comprehensive income, which is included in shareholders' equity, and a decrease in other assets related to the tax impact. A decrease in fair value is reflected in the balance sheet as a decrease in the fair value of investment securities available-for-sale, a decrease in accumulated other comprehensive income, which is included in shareholders' equity, and an increase in other assets related to the tax impact. During the three months ended March 31, 2019, Old National received third party pricing on a $4.0 million state and political subdivisions security and transferred it out of Level 3. Old National transferred a $4.1 million state and political subdivisions security to Level 3 during the three months ended March 31, 2018 because Old National could no longer obtain evidence of observable inputs.

The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy:

(dollars in thousands)	Fair Value	Valuation Techniques	Unobservable Input	Range (Weighted Average)
March 31, 2019				
Pooled trust preferred securities	$8,123	Discounted cash flow	Constant prepayment rate (a)	0.00%
				3.6% - 4.2%
			Additional asset defaults (b)	(4.0%)
			Expected asset recoveries (c)	0.00%

State and political subdivisions	40	Discounted cash flow	No observable inputs Local municipality issuance Old National owns 100% Carried at par	N/A
December 31, 2018				
Pooled trust preferred securities	$8,495	Discounted cash flow	Constant prepayment rate (a)	0.00%
				6.8% - 8.5%
			Additional asset defaults (b)	(7.3%)
			Expected asset recoveries (c)	0.00%
State and political subdivisions	4,108	Discounted cash flow	No observable inputs Local municipality issuance Old National owns 100% Carried at par	N/A

(a) Assuming no prepayments.

(b) Each currently performing pool asset is assigned a default probability based on the banking environment, which is adjusted for specific issuer evaluation, of 0%, 50%, or 100%.

(c) Each currently defaulted pool asset is assigned a recovery probability based on specific issuer evaluation of 0%, 25%, or 100%.

Significant changes in any of the unobservable inputs used in the fair value measurement in isolation would result in a significant change to the fair value measurement. The pooled trust preferred securities Old National owns are subordinate note classes that rely on an ongoing cash flow stream to support their values. The senior note classes receive the benefit of prepayments to the detriment of subordinate note classes since the ongoing interest cash flow stream is reduced by the early redemption. Generally, a change in prepayment rates or additional pool asset defaults has an impact that is directionally opposite from a change in the expected recovery of a defaulted pool asset.

Assets measured at fair value on a non-recurring basis at March 31, 2019 are summarized below:

		Fair Value Measurements at March 31, 2019 Using		
(dollars in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Collateral Dependent Impaired Loans:				
Commercial loans	$4,781	$ —	$ —	$ 4,781
Commercial real estate loans	17,146	—	—	17,146
Foreclosed Assets:				
Commercial	225	—	—	225
Loan servicing rights	93	—	93	—

Impaired commercial and commercial real estate loans that are deemed collateral dependent are valued based on the fair value of the underlying collateral. These estimates are based on the most recently available appraisals with certain adjustments made based on the type of property, age of appraisal, current status of the property, and other related factors to estimate the current value of the collateral. These impaired commercial and commercial real estate loans had a principal amount of $31.4 million, with a valuation allowance of $9.5 million at March 31, 2019. Old National recorded provision expense associated with these loans totaling $1.2 million for the three months ended March 31, 2019. Old National recorded provision recapture associated with impaired commercial and commercial real estate loans that were deemed collateral dependent totaling $1.6 million for the three months ended March 31, 2018.

Other real estate owned and other repossessed property is measured at fair value less costs to sell and had a net carrying amount of $0.2 million at March 31, 2019. The estimates of fair value are based on the most recently available appraisals with certain adjustments made based on the type of property, age of appraisal, current status of the property, and other related factors to estimate the current value of the collateral. There were no write-downs of other real estate owned during the three months ended March 31, 2019 and $0.3 million during the three months ended March 31, 2018.

Loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. If the carrying amount of an individual tranche exceeds fair value, impairment is recorded on that tranche so that the servicing asset is carried at fair value. Fair value is determined at a tranche level, based on market prices for comparable mortgage servicing contracts when available, or alternatively based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model utilizes a discount rate, weighted average prepayment speed, and other economic factors that market participants would use in estimating future net servicing income and that can be validated against available market data (Level 2). The valuation allowance for loan servicing rights with impairments at March 31, 2019 totaled $17 thousand. Old National recorded impairments

associated with these loan servicing rights totaling $2 thousand during the three months ended March 31, 2019 and recoveries of $9 thousand for the three months ended March 31, 2018.

Assets measured at fair value on a non-recurring basis at December 31, 2018 are summarized below:

		Fair Value Measurements at December 31, 2018 Using		
(dollars in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Collateral Dependent Impaired Loans:				
Commercial loans	$ 7,242	$ —	$ —	$ 7,242
Commercial real estate loans	29,125	—	—	29,125
Foreclosed Assets:				
Residential	68	—	—	68
Loan servicing rights	104	—	104	—

At December 31, 2018, impaired commercial and commercial real estate loans had a principal amount of $49.3 million, with a valuation allowance of $12.9 million.

Other real estate owned and other repossessed property had a net carrying amount of $68 thousand at December 31, 2018.

The valuation allowance for loan servicing rights with impairments at December 31, 2018 totaled $15 thousand.

The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy:

(dollars in thousands)	Fair Value	Valuation Techniques	Unobservable Input	Range (Weighted Average)
March 31, 2019				
Collateral Dependent Impaired Loans				
Commercial loans	$ 4,781	Fair value of collateral	Discount for type of property, age of appraisal, and current status	0% - 90% (41%)
Commercial real estate loans	17,146	Fair value of collateral	Discount for type of property, age of appraisal and current status	0% - 50% (35%)
Foreclosed Assets				
Commercial	225	Fair value of collateral	Discount for type of property, age of appraisal, and current status	8%

December 31, 2018				
Collateral Dependent Impaired Loans				
Commercial loans	$7,242	Fair value of collateral	Discount for type of property, age of appraisal, and current status	0% - 90% (35%)
Commercial real estate loans	29,125	Fair value of collateral	Discount for type of property, age of appraisal and current status	0% - 50% (35%)
Foreclosed Assets				
Residential	68	Fair value of collateral	Discount for type of property, age of appraisal, and current status	15% - 16% (15%)

Financial instruments recorded using fair value option

Old National may elect to report most financial instruments and certain other items at fair value on an instrument-by instrument basis with changes in fair value reported in net income. After the initial adoption, the election is made at the acquisition of an eligible financial asset, financial liability or firm commitment or when certain specified reconsideration events occur. The fair value election may not be revoked once an election is made.

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Residential loans held for sale

Old National has elected the fair value option for residential loans held for sale. For these loans, interest income is recorded in the consolidated statements of income based on the contractual amount of interest income earned on the financial assets (except any that are on nonaccrual status). None of these loans are 90 days or more past due, nor are any on nonaccrual status. Included in the income statement is interest income for loans held for sale totaling $188 thousand for the three months ended March 31, 2019 and $22 thousand for the three months ended March 31, 2018.

Old National has elected the fair value option for newly originated conforming fixed-rate and adjustable-rate first mortgage loans held for sale. These loans are intended for sale and are hedged with derivative instruments. Old National has elected the fair value option to mitigate accounting mismatches in cases where hedge accounting is complex and to achieve operational simplification. The fair value option was not elected for loans held for investment.

The difference between the aggregate fair value and the aggregate remaining principal balance for loans for which the fair value option has been elected at March 31, 2019 and December 31, 2018 was as follows:

(dollars in thousands)	Aggregate Fair Value	Difference	Contractual Principal
March 31, 2019			
Residential loans held for sale	$ 14,082	$ 570	$ 13,512
December 31, 2018			
Residential loans held for sale	$ 14,911	$ 475	$ 14,436

Accrued interest at period end is included in the fair value of the instruments.

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets carried at fair value:

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest (Expense)	Total Changes in Fair Values Included in Current Period Earnings
Three Months Ended March 31, 2019				
Residential loans held for sale	$ 90	$ 5	$ —	$ 95
Three Months Ended March 31, 2018				
Residential loans held for sale	$ 35	$ —	$ (4)	$ 31

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The carrying amounts and estimated fair values of financial instruments not carried at fair value at March 31, 2019 and December 31, 2018 were as follows:

		Fair Value Measurements at March 31, 2019 Using		
(dollars in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Cash, due from banks, money market, and other interest-earning investments	$323,116	$323,116	$—	$—
Investment securities held-to-maturity:				
U.S. government-sponsored entities and agencies	74,195	—	74,186	—
Mortgage-backed securities - Agency	123,627	—	123,858	—
State and political subdivisions	287,012	—	295,833	—
Loans, net:				
Commercial	3,022,384	—	—	2,961,284
Commercial real estate	4,998,451	—	—	4,915,521
Residential real estate	2,241,583	—	—	2,205,698
Consumer credit	1,751,000	—	—	1,715,516
Accrued interest receivable	86,279	34	25,225	61,020
Financial Liabilities				
Deposits:				
Noninterest-bearing demand deposits	$3,903,314	$3,903,314	$—	$—
Checking, NOW, savings, and money market interest-bearing deposits	8,464,358	8,464,358	—	—
Time deposits	2,061,598	—	2,046,438	—
Federal funds purchased and interbank borrowings	325,030	325,030	—	—
Securities sold under agreements to repurchase	342,480	342,480	—	—
FHLB advances	1,719,944	—	—	1,731,524
Other borrowings	251,584	—	254,441	—
Accrued interest payable	7,961	—	7,961	—
Standby letters of credit	482	—	—	482
Off-Balance Sheet Financial Instruments				
Commitments to extend credit	$—	$—	$—	$4,105

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(dollars in thousands)	Carrying Value	Fair Value Measurements at December 31, 2018 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Cash, due from banks, money market, and other interest-earning investments	$317,165	$317,165	$—	$—
Investment securities held-to-maturity:				
U.S. government-sponsored entities and agencies	73,986	—	72,359	
Mortgage-backed securities - Agency	127,120	—	124,409	—
State and political subdivisions	305,228	—	309,335	—
Loans, net:				
Commercial	3,211,228	—	—	3,161,132
Commercial real estate	4,935,381	—	—	4,781,294
Residential real estate	2,246,127	—	—	2,225,853
Consumer credit	1,795,695	—	—	1,773,352
Accrued interest receivable	89,464	13	27,580	61,871
Financial Liabilities				
Deposits:				
Noninterest-bearing demand deposits	$3,965,380	$3,965,380	$—	$—
Checking, NOW, savings, and money market interest-bearing deposits	8,360,313	8,360,313	—	—
Time deposits	2,024,256	—	2,002,187	—
Federal funds purchased and interbank borrowings	270,135	270,135	—	—
Securities sold under agreements to repurchase	362,294	362,294	—	—
FHLB advances	1,613,481	—	—	1,611,103
Other borrowings	247,883	—	248,065	—
Accrued interest payable	9,871	—	9,871	—
Standby letters of credit	525	—	—	525
Off-Balance Sheet Financial Instruments				
Commitments to extend credit	$—	$—	$—	$ 3,115

The methods utilized to measure the fair value of financial instruments at March 31, 2019 and December 31, 2018 represent an approximation of exit price, however, an actual exit price may differ.

NOTE 26 – REVENUE FROM CONTRACTS WITH CUSTOMERS

Old National's revenue from contracts with customers in the scope of Topic 606 is recognized within noninterest income. The consolidated statements of income include all categories of noninterest income. The following table reflects only the categories of noninterest income that are within the scope of Topic 606:

	Three Months Ended March 31,	
(dollars in thousands)	2019	2018
Wealth management fees	$8,535	$9,026
Service charges on deposit accounts	10,826	10,759
Debit card and ATM fees	5,503	4,865
Investment product fees	5,271	5,031
Other income:		
Merchant processing fees	707	641
Gain (loss) on other real estate owned	40	135
Safe deposit box fees	411	404
Insurance premiums and commissions	200	104
Total	$31,493	$30,965

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Wealth management fees: Old National earns wealth management fees based upon asset custody and investment management services provided to individual and institutional customers. Most of these customers receive monthly or quarterly billings for services rendered based upon the market value of assets in custody. Fees that are transaction based are recognized at the point in time that the transaction is executed.

Service charges on deposit accounts: Old National earns fees from deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees and overdraft fees are recognized at a point in time, since the customer generally has a right to cancel the depository arrangement at any time. The arrangement is considered a day-to-day contract with ongoing renewals and optional purchases, so the duration of the contract does not extend beyond the services already performed. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which Old National satisfies its performance obligation.

Debit card and ATM fees: Debit card and ATM fees include ATM usage fees and debit card interchange income. As with the transaction-based fees on deposit accounts, the ATM fees are recognized at the point in time that Old National fulfills the customer's request. Old National earns interchange fees from cardholder transactions processed through card association networks. Interchange rates are generally set by the card associations based upon purchase volumes and other factors. Interchange fees represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Investment product fees: Investment product fees are the commissions and fees received from a registered broker/dealer and investment adviser that provide those services to Old National customers. Old National acts as an agent in arranging the relationship between the customer and the third-party service provider. These fees are recognized monthly from the third-party broker based upon services already performed, net of the processing fees charged to Old National by the broker.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is an analysis of our results of operations for the three months ended March 31, 2019 and 2018, and financial condition as of March 31, 2019, compared to March 31, 2018 and December 31, 2018. This discussion and analysis should be read in conjunction with the consolidated financial statements and related notes. This discussion contains forward-looking statements concerning our business that are based on estimates and involves certain risks and uncertainties. Therefore, future results could differ significantly from our current expectations and the related forward-looking statements.

FINANCIAL HIGHLIGHTS

The following table sets forth certain financial highlights of Old National:

	Three Months Ended					
(dollars and shares in thousands, except per share data)	March 31, 2019		December 31, 2018		March 31, 2018	
Income Statement:						
Net interest income	$147,048		$146,225		$128,572	
Taxable equivalent adjustment (1)	3,198		3,049		2,767	
Provision for loan losses	1,043		3,390		380	
Noninterest income	46,416		58,154		41,905	
Noninterest expense	123,041		150,268		117,157	
Net income	56,276		47,498		47,983	
Common Share Data:						
Weighted average diluted shares	175,368		167,992		152,370	
Net income (diluted)	$0.32		$0.28		$0.31	
Cash dividends	0.13		0.13		0.13	
Common dividend payout ratio (2)	41	%	46	%	41	%
Book value	$15.82		$15.36		$14.32	
Stock price	16.40		15.40		16.90	
Tangible common book value (3)	9.44		9.00		8.55	
Performance Ratios:						
Return on average assets	1.14	%	1.01	%	1.10	%
Return on average common equity	8.29		7.59		8.86	
Return on tangible common equity (3)	14.52		12.88		15.62	
Return on average tangible common equity (3)	14.88		13.84		15.80	
Net interest margin (3)	3.51		3.64		3.45	
Efficiency ratio (3)	60.26		70.33		65.84	
Net charge-offs (recoveries) to average loans	0.03		0.02		0.01	

Allowance for loan losses to ending loans	0.46	0.45	0.45
Non-performing loans to ending loans	1.41	1.43	1.28
Balance Sheet:			
Total loans	$12,068,977	$12,243,892	$11,238,682
Total assets	20,084,420	19,728,435	17,496,287
Total deposits	14,429,270	14,349,949	12,788,600
Total borrowed funds	2,639,038	2,493,793	2,371,292
Total shareholders' equity	2,751,872	2,689,570	2,179,118
Nonfinancial Data:			
Full-time equivalent employees	2,908	2,892	2,721
Banking centers	193	191	191

(1) Calculated using the federal statutory tax rate in effect of 21% for all periods.

(2) Cash dividends per share divided by net income per share (basic).

(3) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for reconciliations to GAAP financial measures.

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NON-GAAP FINANCIAL MEASURES

Non-GAAP financial measures exclude certain items that are included in the financial results presented in accordance with GAAP. Management believes these non-GAAP financial measures enhance an investor's understanding of the financial results of Old National by providing a meaningful basis for period-to-period comparisons, assisting in operating results analysis, and predicting future performance.

The following table presents GAAP to non-GAAP reconciliations.

(dollars and shares in thousands, except per share data)	Three Months Ended March 31, 2019	2018
Tangible common book value:		
Shareholders' equity (GAAP)	$2,751,872	$2,179,118
Deduct: Goodwill	1,036,258	828,804
Intangible assets	72,544	48,833
Tangible shareholders' equity (non-GAAP)	$1,643,070	$1,301,481
Period end common shares	173,979	152,172
Tangible common book value	9.44	8.55
Return on tangible common equity:		
Net income (GAAP)	$56,276	$47,983
Add: Intangible amortization (net of tax)	3,373	2,851
Tangible net income (non-GAAP)	$59,649	$50,834
Tangible shareholders' equity (non-GAAP) (see above)	$1,643,070	$1,301,481
Return on tangible common equity	14.52 %	15.62 %
Return on average tangible common equity:		
Tangible net income (non-GAAP) (see above)	$59,649	$50,834
Average shareholders' equity (GAAP)	$2,714,186	$2,166,055
Deduct: Average goodwill	1,036,258	828,141
Average intangible assets	74,849	51,092
Average tangible shareholders' equity (non-GAAP)	$1,603,079	$1,286,822
Return on average tangible common equity	14.88 %	15.80 %

Net interest margin:		
Net interest income (GAAP)	$147,048	$128,572
Taxable equivalent adjustment	3,198	2,767
Net interest income - taxable equivalent basis (non-GAAP)	$150,246	$131,339
Average earning assets	$17,143,574	$15,205,891
Net interest margin	3.51 %	3.45 %
Efficiency ratio:		
Noninterest expense (GAAP)	$123,041	$117,157
Deduct: Intangible amortization expense	4,472	3,609
Adjusted noninterest expense (non-GAAP)	$118,569	$113,548
Net interest income - taxable equivalent basis (non-GAAP) (see above)	$150,246	$131,339
Noninterest income	46,416	41,905
Deduct: Net debt securities gains (losses)	(103)	788
Adjusted total revenue (non-GAAP)	$196,765	$172,456
Efficiency ratio	60.26 %	65.84 %

Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. Although these non-GAAP financial measures are frequently used by investors to evaluate a company, they have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP. These non-GAAP measures are not necessarily comparable to similar measures that may be represented by other companies.

EXECUTIVE SUMMARY

During the first quarter of 2019, net income was $56.3 million, or $0.32 per diluted share. Net income was $48.0 million, or $0.31 per diluted share, for the first quarter of 2018.

We will continue to focus on our core strategic principles of basic banking in 2019, which are loan growth, fee-based income, and expense management. We use our low-cost core deposits to fund our commercial loan growth. That loan growth is filtered through our reliable credit process. We have a disciplined expense culture that permeates into all areas and processes. We are committed to driving and sustaining positive operating leverage.

We have continued to re-mix our earning assets towards more productive commercial and commercial real estate loans and out of indirect and other loans.

Loan Growth: Our loan balances, excluding loans held for sale, declined $174.9 million to $12.069 billion at March 31, 2019 compared to $12.244 billion at December 31, 2018. This was primarily driven by a decline in commercial and industrial outstandings which was influenced by seasonal factors, lower line utilization, and elevated levels of prepayments due to sales of businesses.

Net Interest Income: For the three months ended March 31, 2019 compared to the three months ended March 31, 2018, our net interest income increased primarily due to the acquisition of Klein in November 2018 and increased loan yields. This was partially offset by higher costs of interest-bearing liabilities. Net interest income increased slightly in the first quarter of 2019 compared to the fourth quarter of 2018 with a full quarter of positive impact from our recent Klein partnership, substantially offset by fewer days and a change in in the mix of average interest earning assets and interest-bearing liabilities.

Fee Income: Noninterest income increased to $46.4 million from $41.9 million for the first quarter of 2019 when compared to the first quarter of 2018 substantially due to higher fee income associated with the Klein partnership.

Expenses: Noninterest expenses increased $5.9 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018. The increase was primarily attributable to higher expenses associated with the Klein partnership. The first quarter of 2019 compared to the fourth quarter of 2018 decreased $27.2 million reflecting lower merger and integration charges associated with Klein and continued discipline with respect to expense management.

In regard to future partnerships, we remain an active looker in our target markets and a highly selective, disciplined buyer. We continue to believe in our ability to bring a larger balance sheet with better capital and an enhanced product set to a partner that will allow them to better serve their clients.

RESULTS OF OPERATIONS

The following table sets forth certain income statement information of Old National for the three months ended March 31, 2019 and 2018:

(dollars in thousands)	Three Months Ended March 31, 2019	2018	% Change
Income Statement Summary:			
Net interest income	$147,048	$128,572	14.4 %
Provision for loan losses	1,043	380	174.5
Noninterest income	46,416	41,905	10.8
Noninterest expense	123,041	117,157	5.0
Other Data:			
Return on average common equity	8.29 %	8.86 %	
Return on tangible common equity (1)	14.52	15.62	
Return on average tangible common equity (1)	14.88	15.80	
Efficiency ratio (1)	60.26	65.84	
Tier 1 leverage ratio	8.80	8.11	
Net charge-offs (recoveries) to average loans	0.03	0.01	

(1) Represents a non-GAAP financial measure. Refer to "Non-GAAP Financial Measures" section for reconciliations to GAAP financial measures.

Net Interest Income

Net interest income is the most significant component of our earnings, comprising 76% of revenues for the three months ended March 31, 2019. Net interest income and margin are influenced by many factors, primarily the volume and mix of earning assets, funding sources, and interest rate fluctuations. Other factors include the level of accretion income on purchased loans, prepayment risk on mortgage and investment-related assets, and the composition and maturity of earning assets and interest-bearing liabilities.

The Federal Reserve did not change the discount rate at their March 2019 meeting. The Treasury yield curve flattened as long-term rates declined and short-term interest rates remained flat during the quarter. This could cause our interest rate spread to decline, which may result in a decrease in our net interest income.

Loans typically generate more interest income than investment securities with similar maturities. Funding from client deposits generally costs less than wholesale funding sources. Factors such as general economic activity, Federal Reserve monetary policy, and price volatility of competing alternative investments, can also exert significant influence on our ability to optimize the mix of assets and funding, net interest income, and margin.

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Net interest income is the excess of interest received from earning assets over interest paid on interest-bearing liabilities. For analytical purposes, net interest income is also presented in the table that follows, adjusted to a taxable equivalent basis to reflect what our tax-exempt assets would need to yield in order to achieve the same after-tax yield as a taxable asset. We used the federal statutory tax rate in effect of 21% for all periods. This analysis portrays the income tax benefits related to tax-exempt assets and helps to facilitate a comparison between taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully taxable equivalent basis. Therefore, management believes these measures provide useful information for both management and investors by allowing them to make peer comparisons.

	Three Months Ended March 31,			
(dollars in thousands)	2019		2018	
Net interest income	$147,048		$128,572	
Conversion to fully taxable equivalent	3,198		2,767	
Net interest income - taxable equivalent basis	$150,246		$131,339	
Average earning assets	$17,143,574		$15,205,891	
Net interest margin	3.43	%	3.38	%
Net interest margin - taxable equivalent basis	3.51	%	3.45	%

The increase in net interest income for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 was primarily due to higher average earning assets of $1.938 billion. Partially offsetting the higher average earning assets were higher average interest-bearing liabilities of $1.420 billion in the three months ended March 31, 2019 when compared to the three months ended March 31, 2018. Net interest income for the three months ended March 31, 2019 and 2018 included accretion income (interest income in excess of contractual interest income) associated with acquired loans. Accretion income totaled $8.9 million in the three months ended March 31, 2019, compared to $11.0 million in the three months ended March 31, 2018. We expect accretion income on our PCI loans to decrease over time, but this may be offset by future acquisitions.

The following tables present the average balance sheet for each major asset and liability category, its related interest income and yield, or its expense and rate for the three months ended March 31, 2019 and 2018.

(tax equivalent basis, dollars in thousands)	Three Months Ended March 31, 2019			Three Months Ended March 31, 2018		
Earning Assets	Average Balance	Income (1)/ Expense	Yield/ Rate	Average Balance	Income (1)/ Expense	Yield/ Rate
Money market and other interest-earning investments	$58,701	$278	1.92 %	$66,536	$90	0.55 %
Investment securities:						
Treasury and government sponsored agencies	705,417	3,902	2.21 %	663,096	3,424	2.07 %
Mortgage-backed securities	2,497,368	17,603	2.82 %	1,632,610	9,520	2.33 %
States and political subdivisions	1,232,355	11,453	3.72 %	1,204,855	10,478	3.48 %
Other securities	497,604	4,440	3.57 %	459,458	3,669	3.19 %
Total investment securities	4,932,744	37,398	3.03 %	3,960,019	27,091	2.74 %
Loans: (2)						
Commercial	3,122,402	36,035	4.62 %	2,759,688	28,205	4.09 %
Commercial real estate	4,989,622	65,076	5.22 %	4,394,002	55,787	5.08 %
Residential real estate loans	2,259,243	23,931	4.24 %	2,176,413	21,472	3.95 %
Consumer	1,780,862	19,398	4.42 %	1,849,233	17,828	3.91 %
Total loans	12,152,129	144,440	4.76 %	11,179,336	123,292	4.42 %
Total earning assets	17,143,574	$182,116	4.26 %	15,205,891	$150,473	3.97 %
Less: Allowance for loan losses	(55,789)			(50,953)		
Non-Earning Assets						
Cash and due from banks	229,957			199,132		
Other assets	2,490,524			2,089,790		
Total assets	$19,808,266			$17,443,860		
Interest-Bearing Liabilities						
Checking and NOW accounts	$3,693,886	$3,142	0.34 %	$3,067,437	$819	0.11 %
Savings accounts	2,935,710	2,283	0.32 %	3,052,646	1,343	0.18 %
Money market accounts	1,702,655	2,826	0.67 %	1,159,010	546	0.19 %
Time deposits	2,031,957	8,193	1.64 %	1,736,984	4,547	1.06 %
Total interest-bearing deposits	10,364,208	16,444	0.64 %	9,016,077	7,255	0.33 %
Federal funds purchased and interbank borrowings	316,998	1,918	2.45 %	261,353	1,017	1.58 %
Securities sold under agreements to repurchase	361,261	662	0.74 %	342,682	359	0.42 %
FHLB advances	1,672,376	9,931	2.41 %	1,675,700	7,780	1.88 %
Other borrowings	249,794	2,915	4.67 %	248,828	2,723	4.38 %
Total borrowed funds	2,600,429	15,426	2.41 %	2,528,563	11,879	1.91 %
Total interest-bearing liabilities	$12,964,637	$31,870	1.00 %	$11,544,640	$19,134	0.67 %
Noninterest-Bearing Liabilities and Shareholders' Equity						

Demand deposits	$3,846,828		$3,563,104	
Other liabilities	282,615		170,061	
Shareholders' equity	2,714,186		2,166,055	
Total liabilities and shareholders' equity	$19,808,266		$17,443,860	
Net interest rate spread		3.26 %		3.30 %
Net interest margin (3)		3.51 %		3.45 %
Taxable equivalent adjustment	$3,198		$2,767	

(1) Interest income is reflected on a fully taxable equivalent basis.

(2) Includes loans held for sale.

(3) Net interest margin is defined as net interest income on a tax equivalent basis as a percentage of average earning assets.

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The following table presents the dollar amount of changes in taxable equivalent net interest income attributable to changes in the average balances of assets and liabilities and the yields earned or rates paid for the three months ended March 31, 2019 and 2018.

	From Three Months Ended March 31, 2018 to Three Months Ended March 31, 2019		
	Total	Attributed to	
(dollars in thousands)	Change	Volume	Rate
Interest Income			
Money market and other interest-earning investments	$188	$(26)	$214
Investment securities (1)	10,307	7,015	3,292
Loans (1)	21,148	11,164	9,984
Total interest income	31,643	18,153	13,490
Interest Expense			
Checking and NOW deposits	2,323	339	1,984
Savings deposits	940	(79)	1,019
Money market deposits	2,280	571	1,709
Time deposits	3,646	969	2,677
Federal funds purchased and interbank borrowings	901	274	627
Securities sold under agreements to repurchase	303	25	278
FHLB advances	2,151	(33)	2,184
Other borrowings	192	11	181
Total interest expense	12,736	2,077	10,659
Net interest income	$18,907	$16,076	$2,831

The variance not solely due to rate or volume is allocated equally between the rate and volume variances.

(1) Interest on investment securities and loans includes the effect of taxable equivalent adjustments of $2.0 million and $1.2 million, respectively, during the three months ended March 31, 2019 using the federal statutory rate in effect of 21%.

The increase in the net interest margin on a fully taxable equivalent basis for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 was primarily due to higher yield on interest earning assets, partially offset by higher costs of interest-bearing liabilities and a change in the mix of average interest earning assets and interest-bearing liabilities. Also offsetting the increase in the net interest margin for the three months ended March 31, 2019 were lower yields associated with accretion income on acquired loans. Accretion income represented 21 basis points of the net interest margin for the three months ended March 31, 2019, compared to 28 basis points for the three months ended March 31, 2018. The yield on interest earning assets increased 29 basis points and the cost of interest-bearing liabilities increased 33 basis points in the quarterly year-over-year comparison. The yield on interest earning assets is calculated by dividing annualized taxable equivalent net interest income by average interest earning assets while the cost of interest-bearing liabilities is calculated by dividing annualized interest expense by average interest-bearing liabilities.

Average earning assets were $17.144 billion for the three months ended March 31, 2019, compared to $15.206 billion for the three months ended March 31, 2018, an increase of $1.938 billion, or 13%. The increase in average earning

assets was primarily due to our acquisition of Klein in November 2018. The loan portfolio including loans held for sale, which generally has an average yield higher than the investment portfolio, was approximately 71% of average interest earning assets for the three months ended March 31, 2019, compared to 74% for the three months ended March 31, 2018.

Average loans including loans held for sale increased $972.8 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to loans acquired from Klein in November 2018. Loans including loans held for sale attributable to the Klein acquisition totaled $1.052 billion as of the closing date of the acquisition, which was November 1, 2018.

Average investments increased $972.7 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 reflecting the Klein acquisition.

Average noninterest-bearing deposits increased $283.7 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018. Average interest-bearing deposits increased $1.348 billion for

the three months ended March 31, 2019 when compared to the three months ended March 31, 2018. The increases in average deposits also reflected the Klein acquisition.

Average borrowed funds increased $71.9 million, or 3%, for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018.

Provision for Loan Losses

The provision for loan losses was $1.0 million for the three months ended March 31, 2019, compared to $0.4 million for the three months ended March 31, 2018. Net charge-offs totaled $0.9 million during the three months ended March 31, 2019, compared to net charge-offs of $0.4 million during the three months ended March 31, 2018. The higher provision for loan losses for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 is the result of an increase in net charge-offs and loan growth. Continued loan growth in future periods, a decline in our current level of recoveries, or an increase in charge-offs could result in an increase in provision expense.

Noninterest Income

We generate revenues in the form of noninterest income through client fees, sales commissions, and other gains and losses from our core banking franchise and other related businesses, such as wealth management, investment consulting, and investment products. The following table details the components in noninterest income for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,		%
(dollars in thousands)	2019	2018	Change
Wealth management fees	$8,535	$9,026	(5.4)%
Service charges on deposit accounts	10,826	10,759	0.6
Debit card and ATM fees	5,503	4,865	13.1
Mortgage banking revenue	5,011	4,192	19.5
Investment product fees	5,271	5,031	4.8
Capital markets income	2,517	498	405.4
Company-owned life insurance	3,188	2,605	22.4
Net debt securities gains (losses)	(103)	788	(113.1)
Other income	5,668	4,141	36.9
Total noninterest income	$46,416	$41,905	10.8 %

The increase in noninterest income for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 was primarily due to higher noninterest income attributable to the Klein partnership. Also contributing to the increase in noninterest income was higher capital markets income.

Wealth management fees decreased $0.5 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to lower personal trust fees.

Service charges and overdraft fees increased $0.1 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to service charges and overdraft fees attributable to the Klein partnership.

Debit card and ATM fees increased $0.6 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to higher interchange income attributable to the Klein partnership.

Mortgage banking revenue increased $0.8 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to strong pipeline growth in the three months ended March 31, 2019.

Capital markets income is comprised of customer interest rate swap fees, foreign currency exchange fees, net gains (losses) on foreign currency adjustments, and tax credit fee income. Capital markets income increased $2.0 million

for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to higher customer interest rate swap fees and higher tax credit fee income.

Net debt securities gains (losses) decreased $0.9 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to lower realized gains on sales of available-for-sale securities in 2019, partially offset by lower realized losses on sales of available-for-sale securities in 2019.

Other income increased $1.5 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to higher other income attributable to the Klein acquisition.

Noninterest Expense

The following table details the components in noninterest expense for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,		%
(dollars in thousands)	2019	2018	Change
Salaries and employee benefits	$71,183	$64,179	10.9 %
Occupancy	14,578	13,280	9.8
Equipment	4,474	3,565	25.5
Marketing	3,723	3,697	0.7
Data processing	9,341	8,400	11.2
Communication	3,054	3,064	(0.3)
Professional fees	2,910	2,730	6.6
Loan expenses	1,912	1,744	9.6
Supplies	755	722	4.6
FDIC assessment	2,087	2,645	(21.1)
Other real estate owned expense	36	349	(89.7)
Amortization of intangibles	4,472	3,609	23.9
Amortization of tax credit investments	260	716	(63.7)
Other expense	4,256	8,457	(49.7)
Total noninterest expense	$123,041	$117,157	5.0 %

Noninterest expense increased $5.9 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to higher operating expenses and acquisition and integration costs associated with Klein. This increase was partially offset by impairments of long-lived assets of $2.8 million in the three months ended March 31, 2018 related to branch consolidations.

Salaries and employee benefits increased $7.0 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to higher salaries and employee benefits attributable to the Klein partnership. Also contributing to the increase in salaries and benefits were higher profit sharing expenses and hospitalization expenses.

Occupancy expenses increased $1.3 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to higher occupancy expenses attributable to the Klein partnership and higher lease expense.

Equipment expenses increased $0.9 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to higher equipment expenses attributable to the Klein partnership and an increase in small equipment expenses.

Data processing expenses increased $0.9 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to integration expenses associated with the Klein partnership.

Amortization of intangibles increased $0.9 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to amortization of core deposit intangibles related to the Klein acquisition.

Amortization of tax credit investments was $0.3 million for the three months ended March 31, 2019 and $0.7 million for the three months ended March 31, 2018. The recognition of tax credit amortization expense is contingent upon the successful rehabilitation of a historic building or completion of a solar project within the reporting period. Many factors including weather, labor availability, building regulations, inspections, and other unexpected construction delays related to a rehabilitation project can cause a project to exceed its estimated completion date. Amortization of tax credit investments is expected to be insignificant in 2019. See Note 13 to the consolidated financial statements for additional information on our tax credit investments.

Other expense decreased $4.2 million for the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 primarily due to impairments of long-lived assets of $2.8 million in the three months ended March 31, 2018 related to branch consolidations and integration expenses associated with the Anchor (MN) partnership totaling $1.3 million in the three months ended March 31, 2018.

Provision for Income Taxes

We record a provision for income taxes currently payable and for income taxes payable or benefits to be received in the future, which arise due to timing differences in the recognition of certain items for financial statement and income tax purposes. The major difference between the effective tax rate applied to our financial statement income and the federal statutory tax rate is caused by a tax benefit from our tax credit investments and interest on tax-exempt securities and loans. The provision for income taxes, as a percentage of pre-tax income, was 18.9% for the three months ended March 31, 2019, compared to 9.4% for the three months ended March 31, 2018. In accordance with ASC 740-270, *Accounting for Interim Reporting*, the provision for income taxes was recorded at March 31, 2019 based on the current estimate of the effective annual rate. The higher effective tax rate during the three months ended March 31, 2019 when compared to the three months ended March 31, 2018 was primarily the result of a decrease in federal tax credits available. See Note 20 to the consolidated financial statements for additional information.

FINANCIAL CONDITION

Overview

At March 31, 2019, our assets were $20.084 billion, a $2.588 billion increase compared to assets of $17.496 billion at March 31, 2018, and a $356.0 million increase compared to assets of $19.728 billion at December 31, 2018. The increase from March 31, 2018 to March 31, 2019 was primarily due to the acquisition of Klein in November 2018, which had $2.157 billion in assets as of the closing date of the acquisition, including goodwill of $208.0 million. An increase in investment securities also contributed to the March 31, 2018 to March 31, 2019 increase in assets.

Earning Assets

Our earning assets are comprised of investment securities, portfolio loans, loans held for sale, money market investments, interest earning accounts with the Federal Reserve, and equity securities. Earning assets were $17.413 billion at March 31, 2019, a $2.174 billion increase compared to earning assets of $15.239 billion at March 31, 2018, and a $343.0 million increase compared to earning assets of $17.070 billion at December 31, 2018.

Investment Securities

We classify the majority of our investment securities as available-for-sale to give management the flexibility to sell the securities prior to maturity if needed, based on fluctuating interest rates or changes in our funding requirements. However, we also have $74.2 million of U.S. government-sponsored entities and agencies securities, $123.6 million of fixed-rate mortgage-backed securities, and $287.0 million of state and political subdivision securities in our held-to-maturity investment portfolio at March 31, 2019.

Equity securities are recorded at fair value and totaled $6.2 million at March 31, 2019 compared to $5.6 million at March 31, 2018.

At March 31, 2019, the investment securities portfolio, including equity securities, was $5.218 billion compared to $3.897 billion at March 31, 2018, an increase of $1.321 billion. Investment securities attributable to the Klein

acquisition totaled $700.6 million as of the closing date of the acquisition. Investment securities represented 30% of earning assets at March 31, 2019, compared to 26% at March 31, 2018 and 28% at December 31, 2018. Excess liquidity generated this quarter resulted in a higher percentage of investment securities compared to December 31, 2018. Stronger commercial loan demand in the future and management's decision to deleverage the balance sheet could result in a reduction in the securities portfolio. At March 31, 2019, management does not intend to sell any securities in an unrealized loss position and does not believe we will be required to sell such securities.

The investment securities available-for-sale portfolio had net unrealized gains of $13.2 million at March 31, 2019, compared to net unrealized losses of $69.0 million at March 31, 2018, and net unrealized losses of $49.2 million at December 31, 2018. Net unrealized gains (losses) increased from December 31, 2018 to March 31, 2019 reflecting higher net unrealized gains on mortgage-backed securities and state and political subdivision securities due to a decline in long-term interest rates.

The investment portfolio had an effective duration of 3.65 at March 31, 2019, compared to 4.30 at March 31, 2018, and 4.00 at December 31, 2018. Effective duration measures the percentage change in value of the portfolio in response to a change in interest rates. Generally, there is more uncertainty in interest rates over a longer average maturity, resulting in a higher duration percentage. The annualized average yields on investment securities, on a taxable equivalent basis, were 3.03% for the three months ended March 31, 2019, compared to 2.74% for the three months ended March 31, 2018.

Loans Held for Sale

Mortgage loans held for immediate sale in the secondary market were $14.1 million at March 31, 2019, compared to $14.9 million at December 31, 2018. Certain mortgage loans are committed for sale at or prior to origination at a contracted price to an outside investor. Other mortgage loans held for immediate sale are hedged with TBA forward agreements and committed for sale when they are ready for delivery and remain on the Company's balance sheet for a short period of time (typically 30 to 60 days). These loans are sold without recourse, beyond customary representations and warranties, and Old National has not experienced material losses arising from these sales. Mortgage originations are subject to volatility due to interest rates and home sales, among other factors.

We have elected the fair value option under FASB ASC 825-10 prospectively for residential loans held for sale. The aggregate fair value exceeded the unpaid principal balance by $0.6 million at March 31, 2019, compared to $0.5 million at December 31, 2018.

Commercial and Commercial Real Estate Loans

Commercial and commercial real estate loans are the largest classification within earning assets, representing 46% of earning assets at March 31, 2019, compared to 48% at March 31, 2018 and 48% at December 31, 2018. At March 31, 2019, commercial and commercial real estate loans were $8.066 billion, an increase of $804.8 million, or 11%, compared to March 31, 2018, and a decrease of $125.4 million, or 2%, compared to December 31, 2018. Commercial and commercial real estate loans attributable to the Klein acquisition totaled $836.8 million as of the closing date of the acquisition.

Residential Real Estate Loans

At March 31, 2019, residential real estate loans held in our loan portfolio were $2.244 billion, an increase of $85.4 million compared to March 31, 2018, and a decrease of $4.5 million compared to December 31, 2018. Residential real estate loans attributable to the Klein acquisition totaled $77.7 million as of the closing date of the acquisition. Future increases in interest rates could result in a decline in the level of refinancings and new originations of residential real estate loans.

Consumer Loans

Consumer loans, including automobile loans and personal and home equity loans and lines of credit, decreased $59.9 million at March 31, 2019 compared to March 31, 2018, and decreased $45.0 million from December 31, 2018. Old National assumed student loans in the acquisition of Anchor (WI) in May 2016. Old National sold the remaining student loan portfolio totaling $64.9 million during the second quarter of 2018, resulting in a $2.2 million

gain that is included in other income on the income statement. Consumer loans attributable to the Klein acquisition totaled $134.6 million as of the closing date of the acquisition. We continue to see runoff in our less profitable indirect consumer loan portfolio.

Operating Lease Right-of-Use Assets

Operating lease right-of-use assets totaled $109.9 million at March 31, 2019.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets at March 31, 2019 totaled $1.109 billion, an increase of $231.2 million compared to $877.6 million at March 31, 2018. During 2018, we recorded $247.1 million of goodwill and other intangible assets associated with the acquisition of Klein.

Net Deferred Tax Assets

Net deferred tax assets decreased $29.3 million compared to March 31, 2018 primarily due to decreases in net deferred tax assets related to net unrealized gains or losses on available-for-sale investment securities and federal tax credits. Net deferred tax assets decreased $27.6 million compared to December 31, 2018 primarily due to decreases in net deferred tax assets related to net unrealized gains or losses on available-for-sale investment securities and benefit plan accruals. Future changes in the corporate tax rate could result in a change in value of Old National's deferred tax assets and future income tax expense. See Note 20 to the consolidated financial statements for additional information.

Funding

Total funding, comprised of deposits and wholesale borrowings, was $17.068 billion at March 31, 2019, an increase of $1.908 billion from $15.160 billion at March 31, 2018, and an increase of $224.6 million from $16.844 billion at December 31, 2018. Included in total funding were deposits of $14.429 billion at March 31, 2019, an increase of $1.640 billion from $12.789 billion at March 31, 2018, and an increase of $79.3 million from $14.350 billion at December 31, 2018. Deposits attributable to the Klein acquisition totaled $1.713 billion as of the closing date of the acquisition. Noninterest-bearing deposits increased $247.6 million from March 31, 2018 to March 31,

2019. Interest-bearing checking and NOW deposits increased $606.5 million from March 31, 2018 to March 31, 2019, while savings deposits decreased $149.7 million. Money market deposits increased $650.5 million from March 31, 2018 to March 31, 2019, while time deposits increased $285.9 million.

We use wholesale funding to augment deposit funding and to help maintain our desired interest rate risk position. At March 31, 2019, wholesale borrowings, including federal funds purchased and interbank borrowings, securities sold under agreements to repurchase, FHLB advances, and other borrowings, totaled $2.639 billion, an increase of $267.7 million, or 11%, from March 31, 2018, and an increase of $145.2 million from December 31, 2018. Wholesale funding as a percentage of total funding was 15% at March 31, 2019, 16% at March 31, 2018, and 15% at December 31, 2018. The increase in wholesale funding from March 31, 2018 to March 31, 2019 was due to increases in federal funds purchased and interbank borrowings, securities sold under agreements to repurchase, FHLB advances, and other borrowings.

Operating Lease Liabilities

Operating lease liabilities totaled $114.0 million at March 31, 2019.

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Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities decreased $44.9 million, or 23%, from December 31, 2018 primarily due to incentive payments in the first quarter of 2019 and decreases in unfunded commitments on various tax credit investments.

Capital

Shareholders' equity totaled $2.752 billion at March 31, 2019, compared to $2.179 billion at March 31, 2018 and $2.690 billion at December 31, 2018. Shareholders' equity at March 31, 2019 included $406.5 million from the 22.8 million shares of Common Stock that were issued in conjunction with the acquisition of Klein. Old National

We also paid cash dividends of $0.13 per share in the three months ended March 31, 2019, which reduced equity by $22.8 million. The change in unrealized gains (losses) on available-for-sale investment securities increased equity by $48.1 million during the three months ended March 31, 2019. The Company's Common Stock is traded on the NASDAQ under the symbol "ONB" with 34,729 shareholders of record at March 31, 2019.

Capital Adequacy

Old National and the banking industry are subject to various regulatory capital requirements administered by the federal banking agencies. At March 31, 2019, Old National and its bank subsidiary exceeded the regulatory minimums and Old National Bank met the regulatory definition of well-capitalized based on the most recent regulatory definition.

At March 31, 2019, Old National's consolidated capital position remains strong as evidenced by the following comparisons of key industry ratios.

	Regulatory Guidelines Minimum	March 31, 2019	2018	December 31, 2018
Risk-based capital:				
Tier 1 capital to total average assets (leverage ratio)	4.00 %	8.80 %	8.11 %	9.17 %
Common equity Tier 1 capital to risk-adjusted total assets	7.00	11.77	10.71	11.36

Tier 1 capital to risk-adjusted total assets	8.50	11.77	10.71	11.36
Total capital to risk-adjusted total assets	10.50	12.70	11.72	12.27
Shareholders' equity to assets	N/A	13.70	12.45	13.63

At March 31, 2019, Old National Bank, Old National’s bank subsidiary, maintained a strong capital position as evidenced by the following comparisons of key industry ratios.

	Regulatory Guidelines Minimum		Well Capitalized Guidelines		March 31, 2019		2018		December 31, 2018	
Risk-based capital:										
Tier 1 capital to total average assets (leverage ratio)	4.00	%	5.00	%	9.30	%	8.78	%	9.58	%
Common equity Tier 1 capital to risk-adjusted total assets	7.00		6.50		12.48		11.60		11.98	
Tier 1 capital to risk-adjusted total assets	8.50		8.00		12.48		11.60		11.98	
Total capital to risk-adjusted total assets	10.50		10.00		12.98		12.13		12.47	

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RISK MANAGEMENT

Overview

Old National has adopted a Risk Appetite Statement to enable the Board of Directors, Executive Leadership Group, and Senior Management to better assess, understand, and mitigate the risks of Old National. The Risk Appetite Statement addresses the following major risks: strategic, market, liquidity, credit, operational/technology/cyber, regulatory/compliance/legal, reputational, and human resources. Our Chief Risk Officer is independent of management and reports directly to the Chair of the Board's Enterprise Risk Management Committee. The following discussion addresses these major risks: credit, market, liquidity, operational/technology/cyber, and regulatory/compliance/legal.

Credit Risk

Credit risk represents the risk of loss arising from an obligor's inability or failure to meet contractual payment or performance terms. Our primary credit risks result from our investment and lending activities.

Investment Activities

We carry a higher exposure to loss in our pooled trust preferred securities, which are collateralized debt obligations, due to illiquidity in that market and the performance of the underlying collateral. At March 31, 2019, we had pooled trust preferred securities with a fair value of $8.1 million, or less than 1% of the available-for-sale securities portfolio. These securities remained classified as available-for-sale and at March 31, 2019, the unrealized loss on our pooled trust preferred securities was $5.7 million. The fair value of these securities should improve as we get closer to maturity, but not in all cases. There was no OTTI recorded during the three months ended March 31, 2019 or 2018.

All of our mortgage-backed securities are backed by U.S. government-sponsored or federal agencies. Municipal bonds, corporate bonds, and other debt securities are evaluated by reviewing the credit-worthiness of the issuer and general market conditions. See Note 5 to the consolidated financial statements for additional details about our investment security portfolio.

Counterparty Exposure

Counterparty exposure is the risk that the other party in a financial transaction will not fulfill its obligation. We define counterparty exposure as nonperformance risk in transactions involving federal funds sold and purchased, repurchase agreements, correspondent bank relationships, and derivative contracts with companies in the financial services industry. Old National manages exposure to counterparty risk in connection with its derivatives transactions by generally engaging in transactions with counterparties having ratings of at least A by Standard & Poor's Rating Service or A2 by Moody's Investors Service. Total credit exposure is monitored by counterparty and managed within limits that management believes to be prudent. Old National's net counterparty exposure was an asset of $341.2 million at March 31, 2019.

Lending Activities

Commercial

Commercial and industrial loans are made primarily for the purpose of financing equipment acquisition, expansion, working capital, and other general business purposes. Lease financing consists of direct financing leases and are used by commercial customers to finance capital purchases ranging from computer equipment to transportation equipment. The credit decisions for these transactions are based upon an assessment of the overall financial capacity of the applicant. A determination is made as to the applicant's ability to repay in accordance with the proposed terms as well as an overall assessment of the risks involved. In addition to an evaluation of the applicant's financial condition, a determination is made of the probable adequacy of the primary and secondary sources of repayment, such as additional collateral or personal guarantees, to be relied upon in the transaction. Credit agency reports of the applicant's credit history supplement the analysis of the applicant's creditworthiness.

Commercial mortgages and construction loans are offered to real estate investors, developers, and builders primarily domiciled in the geographic market areas we serve: Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. These loans are secured by first mortgages on real estate at LTV margins deemed appropriate for the property type, quality, location, and sponsorship. Generally, these LTV ratios do not exceed 80%. The commercial properties are predominantly non-residential properties such as retail centers, apartments, industrial properties and, to a lesser extent, more specialized properties. Substantially all of our commercial real estate loans are secured by properties located in our primary market area.

In the underwriting of our commercial real estate loans, we obtain appraisals for the underlying properties. Decisions to lend are based on the economic viability of the property and the creditworthiness of the borrower. In evaluating a proposed commercial real estate loan, we primarily emphasize the ratio of the property's projected net cash flows to the loan's debt service requirement. The debt service coverage ratio normally is not less than 120% and it is computed after deduction for a vacancy factor and property expenses as appropriate. In addition, a personal guarantee of the loan or a portion thereof is often required from the principal(s) of the borrower. In most cases, we require title insurance insuring the priority of our lien, fire, and extended coverage casualty insurance, and flood insurance, if appropriate, in order to protect our security interest in the underlying property. In addition, business interruption insurance or other insurance may be required.

Construction loans are underwritten against projected cash flows derived from rental income, business income from an owner-occupant, or the sale of the property to an end-user. We may mitigate the risks associated with these types of loans by requiring fixed-price construction contracts, performance and payment bonding, controlled disbursements, and pre-sale contracts or pre-lease agreements.

Consumer

We offer a variety of first mortgage and junior lien loans to consumers within our markets, with residential home mortgages comprising our largest consumer loan category. These loans are secured by a primary residence and are underwritten using traditional underwriting systems to assess the credit risks of the consumer. Decisions are primarily based on LTV ratios, DTI ratios, liquidity, and credit scores. A maximum LTV ratio of 80% is generally required, although higher levels are permitted with mortgage insurance or other mitigating factors. We offer fixed rate mortgages and variable rate mortgages with interest rates that are subject to change every year after the first, third, fifth, or seventh year, depending on the product and are based on fully-indexed rates such as LIBOR. We do not offer payment-option facilities, sub-prime loans, or any product with negative amortization.

Home equity loans are secured primarily by second mortgages on residential property of the borrower. The underwriting terms for the home equity product generally permits borrowing availability, in the aggregate, up to 90% of the appraised value of the collateral property at the time of origination. We offer fixed and variable rate home equity loans, with variable rate loans underwritten at fully-indexed rates. Decisions are primarily based on LTV ratios, DTI ratios, and credit scores. We do not offer home equity loan products with reduced documentation.

Automobile loans include loans and leases secured by new or used automobiles. We originate automobile loans and leases primarily on an indirect basis through selected dealerships. We require borrowers to maintain collision insurance on automobiles securing consumer loans, with us listed as loss payee. Our procedures for underwriting automobile loans include an assessment of an applicant's overall financial capacity, including credit history and the ability to meet existing obligations and payments on the proposed loan. Although an applicant's creditworthiness is the primary consideration, the underwriting process also includes a comparison of the value of the collateral security to the proposed loan amount.

Asset Quality

Community-based lending personnel, along with region-based independent underwriting and analytic support staff, extend credit under guidelines established and administered by our Enterprise Risk Committee. This committee, which meets quarterly, is made up of outside directors. The committee monitors credit quality through its review of information such as delinquencies, credit exposures, peer comparisons, problem loans, and charge-offs. In addition, the committee reviews and approves recommended loan policy changes to assure it remains appropriate for the current lending environment.

We lend to commercial and commercial real estate clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling, and retailing. Old National manages concentrations of credit exposure by industry, product, geography, customer relationship, and loan size. At March 31, 2019, our average commercial loan size was under $350,000 and our average commercial real estate loan size was under $650,000. In addition, while loans to lessors of both residential and non-residential real estate exceed 10% of total loans, no individual sub-segment category within those broader categories reaches the 10% threshold. At March 31, 2019, we had minimal exposure to foreign borrowers and no sovereign debt. Our policy is to concentrate our lending activity in the geographic market areas we serve, primarily Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. We are experiencing a slow and gradual improvement in the economy of our principal markets. Management expects that trends in under-performing, criticized, and classified loans will be influenced by the degree to which the economy strengthens or weakens.

On November 1, 2018, Old National closed on its acquisition of Klein. As of the closing date of the acquisition, loans totaled $1.049 billion and other real estate owned totaled $1.0 million. In accordance with accounting for business combinations, there was no allowance brought forward on any of the acquired loans, as the credit losses evident in the loans were included in the determination of the fair value of the loans at the acquisition date. Old National reviewed the acquired loans and determined that as of March 31, 2019, $47.8 million met the definition of criticized and $59.8 million were considered classified (of which $16.3 million are reported with nonaccrual loans). Our current preference would be to work these loans and avoid foreclosure actions unless additional credit deterioration becomes apparent. These acquired impaired loans are included in our summary of under-performing, criticized, and classified assets found below.

Summary of under-performing, criticized, and classified assets:

(dollars in thousands)	March 31, 2019	2018	December 31, 2018
Nonaccrual loans:			
Commercial	$34,046	$33,175	$ 38,648
Commercial real estate	83,958	60,403	86,601
Residential real estate	25,791	21,137	24,954
Consumer	9,086	12,581	7,281
Total nonaccrual loans (1)	152,881	127,296	157,484
Renegotiated loans not on nonaccrual	17,123	16,802	17,356
Past due loans (90 days or more and still accruing):			
Commercial	98	10	52
Commercial real estate	140	—	40
Residential real estate	49	16	258
Consumer	273	301	1,003
Total past due loans	560	327	1,353
Other real estate owned	3,279	6,735	3,232
Total under-performing assets	$173,843	$151,160	$ 179,425
Classified loans (includes nonaccrual, renegotiated, past due 90 days, and other problem loans)	$364,121	$245,746	$ 334,785
Other classified assets (2)	2,715	2,987	2,820
Criticized loans	268,836	174,873	238,752
Total criticized and classified assets	$635,672	$423,606	$ 576,357
Asset Quality Ratios:			
Non-performing loans/total loans (3) (4)	1.41 %	1.28 %	1.43 %
Under-performing assets/total loans and other real estate owned (3)	1.44	1.34	1.47
Under-performing assets/total assets	0.87	0.86	0.91
Allowance for loan losses/under-performing assets (5)	31.96	33.33	30.91
Allowance for loan losses/nonaccrual loans (1)	36.34	39.58	35.22

(1) Includes purchased credit impaired loans of $19.6 million at March 31, 2019, $11.5 million at March 31, 2018, and $20.5 million at December 31, 2018 that are categorized as nonaccrual for credit analysis purposes because the collection of principal or interest is doubtful. However, these loans are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.

(2) Includes one pooled trust preferred security and one insurance policy at March 31, 2019.

(3) Loans exclude loans held for sale.

(4) Non-performing loans include nonaccrual and renegotiated loans.

(5) Because the acquired loans were recorded at fair value in accordance with ASC 805 at the date of acquisition, the credit risk is incorporated in the fair value recorded. No allowance for loan losses is recorded on the acquisition date.

Under-performing assets totaled $173.8 million at March 31, 2019, compared to $151.2 million at March 31, 2018 and $179.4 million at December 31, 2018. Under-performing assets as a percentage of total loans and other real estate owned at March 31, 2019 were 1.44%, an increase of 10 basis points from 1.34% at March 31, 2018 and a decrease of 3 basis points from 1.47% at December 31, 2018.

Nonaccrual loans increased from March 31, 2018 primarily due to an increase in nonaccrual commercial real estate loans. Nonaccrual loans at March 31, 2019 include $16.3 million of loans related to the Klein acquisition. As a percentage of nonaccrual loans, the allowance for loan losses was 36.34% at March 31, 2019, compared to 39.58% at March 31, 2018 and 35.22% at December 31, 2018. PCI loans that were included in the nonaccrual category for credit analysis purposes because the collection of principal or interest is doubtful totaled $19.6 million at March 31, 2019, compared to $11.5 million at March 31, 2018 and $20.5 million at December 31, 2018. However, they are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.

Total criticized and classified assets were $635.7 million at March 31, 2019, an increase of $212.1 million from March 31, 2018, and an increase of $59.3 million from December 31, 2018. Other classified assets include investment securities that fell below investment grade rating totaling $2.7 million at March 31, 2019, compared to $3.0 million at March 31, 2018 and $2.8 million at December 31, 2018.

Old National may choose to restructure the contractual terms of certain loans. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit Old National by increasing the ultimate probability of collection.

Any loans that are modified are reviewed by Old National to identify if a TDR has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, Old National Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status. The modification of the terms of such loans include one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate of new debt with similar risk, or a permanent reduction of the recorded investment of the loan.

Loans modified in a TDR are typically placed on nonaccrual status until we determine the future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate a period of performance according to the restructured terms for six months.

If we are unable to resolve a nonperforming loan issue, the credit will be charged off when it is apparent there will be a loss. For large commercial type loans, each relationship is individually analyzed for evidence of apparent loss based on quantitative benchmarks or subjectively based upon certain events or particular circumstances. Generally, Old National charges off small commercial loans scored through our small business credit center with contractual balances under $250,000 that are 90 days or more delinquent and do not have adequate collateral support. For residential and consumer loans, a charge off is recorded at the time foreclosure is initiated or when the loan becomes 120 to 180 days past due, whichever is earlier.

For commercial TDRs, an allocated reserve is established within the allowance for loan losses for the difference between the carrying value of the loan and its computed value. To determine the value of the loan, one of the following methods is selected: (1) the present value of expected cash flows discounted at the loan's original effective interest rate, (2) the loan's observable market price, or (3) the fair value of the collateral value, if the loan is collateral dependent. The allocated reserve is established as the difference between the carrying value of the loan and the collectable value. If there are significant changes in the amount or timing of the loan's expected future cash flows, impairment is recalculated and the valuation allowance is adjusted accordingly.

When a residential or consumer loan is identified as a TDR, the loan is typically written down to its collateral value less selling costs.

At March 31, 2019, our TDRs consisted of $11.6 million of commercial loans, $29.1 million of commercial real estate loans, $3.3 million of residential loans, and $2.3 million of consumer loans totaling $46.3 million. Approximately $27.0 million of the TDRs at March 31, 2019 were included with nonaccrual loans. At December 31, 2018, our TDRs consisted of $10.3 million of commercial loans, $27.6 million of commercial real estate loans, $3.4 million of

residential loans, and $2.4 million of consumer loans totaling $43.7 million. Approximately $26.3 million of the TDRs at December 31, 2018 were included with nonaccrual loans.

Old National has allocated specific reserves to customers whose loan terms have been modified in TDRs totaling $3.8 million at March 31, 2019 and $3.0 million of December 31, 2018. At March 31, 2019, Old National had committed to lend an additional $5.0 million to customers with outstanding loans that are classified as TDRs.

The terms of certain other loans were modified during 2019 and 2018 that did not meet the definition of a TDR. It is our process to review all classified and criticized loans that, during the period, have been renewed, have entered into a forbearance agreement, have gone from principal and interest to interest only, or have extended the maturity date. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on its debt in the foreseeable future without the modification. The evaluation is performed under our internal underwriting policy. We also evaluate whether a concession has been granted or if we were adequately compensated through a market interest rate, additional collateral, or a bona fide guarantee. We also consider whether the modification was insignificant relative to the other terms of the agreement or the delay in a payment.

PCI loans are not considered impaired until after the point at which there has been a degradation of cash flows below our expected cash flows at acquisition. If a PCI loan is subsequently modified, and meets the definition of a TDR, it will be removed from PCI accounting and accounted for as a TDR only if the PCI loan was being accounted for individually. If the PCI loan is being accounted for as part of a pool, it will not be removed from the pool. At March 31, 2019, it has not been necessary to remove any loans from PCI accounting.

In general, once a modified loan is considered a TDR, the loan will always be considered a TDR, and therefore impaired, until it is paid in full, otherwise settled, sold, or charged off. However, guidance also permits for loans to be removed from TDR status when subsequently restructured under these circumstances: (1) at the time of the subsequent restructuring, the borrower is not experiencing financial difficulties, and this is documented by a current credit evaluation at the time of the restructuring, (2) under the terms of the subsequent restructuring agreement, the institution has granted no concession to the borrower; and (3) the subsequent restructuring agreement includes market terms that are no less favorable than those that would be offered for a comparable new loan. For loans subsequently restructured that have cumulative principal forgiveness, the loan should continue to be measured in accordance with ASC 310-10, *Receivables – Overall*. However, consistent with ASC 310-40-50-2, *Troubled Debt Restructurings by Creditors, Creditor Disclosure of Troubled Debt Restructurings*, the loan would not be required to be reported in the years following the restructuring if the subsequent restructuring meets both of these criteria: (1) has an interest rate at the time of the subsequent restructuring that is not less than a market interest rate; and (2) is performing in compliance with its modified terms after the subsequent restructuring.

Allowance for Loan Losses and Reserve for Unfunded Commitments

Loan charge-offs, net of recoveries, totaled $0.9 million for the three months ended March 31, 2019, compared to $0.4 million for the three months ended March 31, 2018. Annualized, net charge-offs (recoveries) to average loans were 0.03% for the three months ended March 31, 2019 compared to 0.01% for the three months ended March 31, 2018. Management will continue its efforts to reduce the level of non-performing loans and may consider the possibility of sales of troubled and non-performing loans, which could result in additional charge-offs to the allowance for loan losses.

To provide for the risk of loss inherent in extending credit, we maintain an allowance for loan losses. The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses incurred in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience.

At March 31, 2019, the allowance for loan losses was $55.6 million, an increase of $5.2 million compared to $50.4 million at March 31, 2018, and an increase of $0.1 million compared to $55.5 million at December 31, 2018. Continued loan growth in future periods, a decline in our current level of recoveries, or an increase in charge-offs could result in an increase in provision expense.

As a percentage of total loans excluding loans held for sale, the allowance was 0.46% at March 31, 2019, compared to 0.45% at March 31, 2018 and 0.45% at December 31, 2018.

The following table provides additional details of the components of the allowance for loan losses, including ASC 450, *Contingencies*, for loans collectively evaluated for impairment, ASC 310-10, *Receivables*, for loans individually evaluated for impairment, and ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, for loans acquired with deteriorated credit quality:

(dollars in thousands)	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Acquired with Deteriorated Credit Quality	Total
Originated loans	$ 8,786,867	$ 83,971	$ —	$ 8,870,838
Acquired loans	3,213,192	32,068	65,387	3,310,647
Total loans	$ 12,000,059	$ 116,039	$ 65,387	$ 12,181,485
Remaining purchase discount	(86,092)	(3,324)	(23,092)	(112,508)
Loans, net of discount	$ 11,913,967	$ 112,715	$ 42,295	$ 12,068,977
Allowance, January 1, 2019	$ 40,642	$ 14,341	$ 478	$ 55,461
Charge-offs	(2,507)	(364)	(21)	(2,892)
Recoveries	992	908	47	1,947
Provision expense	5,249	(4,015)	(191)	1,043
Allowance, March 31, 2019	$ 44,376	$ 10,870	$ 313	$ 55,559

We maintain an allowance for losses on unfunded commercial lending commitments and letters of credit to provide for the risk of loss inherent in these arrangements. The allowance is computed using a methodology similar to that used to determine the allowance for loan losses, modified to take into account the probability of a drawdown on the commitment. The reserve for unfunded loan commitments is classified as a liability account on the balance sheet and totaled $2.2 million at March 31, 2019, compared to $2.5 million at December 31, 2018.

Market Risk

Market risk is the risk that the estimated fair value of our assets, liabilities, and derivative financial instruments will decline as a result of changes in interest rates or financial market volatility, or that our net income will be significantly reduced by interest rate changes.

The objective of our interest rate management process is to maximize net interest income while operating within acceptable limits established for interest rate risk and maintaining adequate levels of funding and liquidity.

Potential cash flows, sales, or replacement value of many of our assets and liabilities, especially those that earn or pay interest, are sensitive to changes in the general level of interest rates. This interest rate risk arises primarily from our normal business activities of gathering deposits and extending loans. Many factors affect our exposure to changes in

interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships, and re-pricing characteristics of financial instruments. Our earnings can also be affected by the monetary and fiscal policies of the U.S. Government and its agencies, particularly the Federal Reserve.

In managing interest rate risk, we, through the Funds Management Committee, a committee of the Board of Directors, establish guidelines, for asset and liability management, including measurement of short and long-term sensitivities to changes in interest rates. Based on the results of our analysis, we may use different techniques to manage changing trends in interest rates including:

- adjusting balance sheet mix or altering interest rate characteristics of assets and liabilities;
- changing product pricing strategies;
- modifying characteristics of the investment securities portfolio; or
- using derivative financial instruments, to a limited degree.

A key element in our ongoing process is to measure and monitor interest rate risk using a model to quantify the impact of changing interest rates on Old National. The model quantifies the effects of various possible interest rate scenarios on projected net interest income. The model measures the impact on net interest income relative to a base case scenario. The base case scenario assumes that the balance sheet and interest rates are held at current levels.

The model shows our projected net interest income sensitivity based on interest rate changes only and does not consider other forecast assumptions.

The following table illustrates our projected net interest income sensitivity over a two year cumulative horizon based on the asset/liability model at March 31, 2019 and 2018:

(dollars in thousands)	Immediate Rate Decrease -50 Basis Points	Base	Immediate Rate Increase +100 Basis Points	+200 Basis Points	+300 Basis Points
March 31, 2019					
Projected interest income:					
Money market, other interest earning investments, and investment securities	$ 323,632	$ 335,556	$ 352,559	$ 368,113	$ 382,116
Loans	1,067,651	1,125,848	1,242,294	1,354,498	1,466,586
Total interest income	1,391,283	1,461,404	1,594,853	1,722,611	1,848,702
Projected interest expense:					
Deposits	97,668	139,307	229,789	320,256	410,715
Borrowings	119,915	140,240	180,901	221,569	262,270
Total interest expense	217,583	279,547	410,690	541,825	672,985
Net interest income	$ 1,173,700	$ 1,181,857	$ 1,184,163	$ 1,180,786	$ 1,175,717
Change from base	$ (8,157)		$ 2,306	$ (1,071)	$ (6,140)
% change from base	-0.69 %		0.20 %	-0.09 %	-0.52 %
March 31, 2018					
Projected interest income:					
Money market, other interest earning investments, and investment securities	$ 228,367	$ 234,331	$ 247,550	$ 260,121	$ 272,410
Loans	901,486	958,043	1,069,783	1,180,736	1,291,192
Total interest income	1,129,853	1,192,374	1,317,333	1,440,857	1,563,602
Projected interest expense:					
Deposits	45,434	73,864	150,906	227,942	304,974
Borrowings	94,407	109,648	140,103	170,531	200,953
Total interest expense	139,841	183,512	291,009	398,473	505,927
Net interest income	$ 990,012	$ 1,008,862	$ 1,026,324	$ 1,042,384	$ 1,057,675
Change from base	$ (18,850)		$ 17,462	$ 33,522	$ 48,813
% change from base	-1.87 %		1.73 %	3.32 %	4.84 %

Our asset sensitivity decreased year over year primarily due to changes in our hedging strategies, balance sheet mix, investment duration, and prepayment speed behavior.

A key element in the measurement and modeling of interest rate risk is the re-pricing assumptions of our transaction deposit accounts, which have no contractual maturity dates. We assume this deposit base is comprised of both core and more volatile balances and consists of both noninterest-bearing and interest-bearing accounts. Core deposit balances are assumed to be less interest rate sensitive and provide longer term funding. Volatile balances are assumed to be more interest rate sensitive and shorter in term. As part of our semi-static balance sheet modeling, we assume interest rates paid on the volatile deposits move in conjunction with changes in interest rates, in order to retain these deposits. This may include current noninterest-bearing accounts.

Because the models are driven by expected behavior in various interest rate scenarios and many factors besides market interest rates affect our net interest income, we recognize that model outputs are not guarantees of actual results. For this reason, we model many different combinations of interest rates and balance sheet assumptions to understand our overall sensitivity to market interest rate changes, including shocks, yield curve flattening, yield curve steepening, as well as forecasts of likely interest rate scenarios. At March 31, 2019, our projected net interest income sensitivity based on the asset/liability models we utilize was within the limits of our interest rate risk policy for the scenarios tested.

We use derivative instruments, primarily interest rate swaps, to mitigate interest rate risk, including certain cash flow hedges on variable-rate debt with a notional amount of $475 million at March 31, 2019. Our derivatives had an estimated fair value gain of $28.4 million at March 31, 2019, compared to an estimated fair value gain of $16.5 million at December 31, 2018. See Note 21 to the consolidated financial statements for further discussion of derivative financial instruments.

Liquidity Risk

Liquidity risk arises from the possibility that we may not be able to satisfy current or future financial commitments, or may become unduly reliant on alternative funding sources. The Funds Management Committee of the Board of Directors establishes liquidity risk guidelines and, along with the Balance Sheet Management Committee, monitors liquidity risk. The objective of liquidity management is to ensure we have the ability to fund balance sheet growth and meet deposit and debt obligations in a timely and cost-effective manner. Management monitors liquidity through a regular review of asset and liability maturities, funding sources, and loan and deposit forecasts. We maintain strategic and contingency liquidity plans to ensure sufficient available funding to satisfy requirements for balance sheet growth, properly manage capital markets' funding sources and to address unexpected liquidity requirements.

Loan repayments and maturing investment securities are a relatively predictable source of funds. However, deposit flows, calls of investment securities and prepayments of loans and mortgage-related securities are strongly influenced by interest rates, the housing market, general and local economic conditions, and competition in the marketplace. We continually monitor marketplace trends to identify patterns that might improve the predictability of the timing of deposit flows or asset prepayments.

A time deposit maturity schedule for Old National Bank is shown in the following table at March 31, 2019.

(dollars in thousands)		
Maturity Bucket	Amount	Rate
2019	$1,315,351	1.78 %
2020	469,375	1.67
2021	123,320	1.40
2022	58,648	1.46
2023	55,408	1.73
2024 and beyond	39,496	1.59
Total	$2,061,598	1.72 %

Our ability to acquire funding at competitive prices is influenced by rating agencies' views of our credit quality, liquidity, capital, and earnings. Moody's Investor Service places us in an investment grade that indicates a low risk of default. For both Old National and Old National Bank:

- Moody’s Investor Service affirmed the Long-Term Rating of A3 of Old National’s senior unsecured/issuer rating on February 2, 2018.
- Moody’s Investor Service affirmed Old National Bank’s long-term deposit rating of Aa3 on February 2, 2018. The bank’s short-term deposit rating was affirmed at P-1 and the bank’s issuer rating was affirmed at A3.

The rating outlook from Moody’s Investor Service is negative. Moody’s Investor Service concluded a rating review of Old National Bank on February 2, 2018.

The credit ratings of Old National and Old National Bank at March 31, 2019 are shown in the following table.

	Moody's Investor Service	
	Long-term	Short-term
Old National	A3	N/A
Old National Bank	Aa3	P-1

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Old National Bank maintains relationships in capital markets with brokers and dealers to issue certificates of deposit and short-term and medium-term bank notes as well. At March 31, 2019, Old National and its subsidiaries had the following availability of liquid funds and borrowings:

(dollars in thousands)	Parent Company	Subsidiaries
Available liquid funds:		
Cash and due from banks	$ 61,046	$ 262,070
Unencumbered government-issued debt securities	—	1,954,533
Unencumbered investment grade municipal securities	—	556,700
Unencumbered corporate securities	—	142,946
Availability of borrowings:		
Amount available from Federal Reserve discount window*	—	474,222
Amount available from Federal Home Loan Bank Indianapolis*	—	671,468
Total available funds	$ 61,046	$ 4,061,939

*Based on collateral pledged

Old National Bancorp has routine funding requirements consisting primarily of operating expenses, dividends to shareholders, debt service, net derivative cash flows, and funds used for acquisitions. Old National Bancorp can obtain funding to meet its obligations from dividends and management fees collected from its subsidiaries, operating line of credit, and through the issuance of debt securities. Additionally, Old National Bancorp has a shelf registration in place with the SEC permitting ready access to the public debt and equity markets. At March 31, 2019, Old National Bancorp's other borrowings outstanding were $231.6 million.

Federal banking laws regulate the amount of dividends that may be paid by banking subsidiaries without prior approval. Prior regulatory approval is required if dividends to be declared in any year would exceed net earnings of the current year plus retained net profits for the preceding two years. Prior regulatory approval to pay dividends was not required in 2018 and is not currently required.

Operational/Technology/Cyber Risk

Operational/technology/cyber risk is the potential that inadequate information systems, operational problems, breaches in internal controls, information security breaches, fraud, or unforeseen catastrophes will result in unexpected losses. We maintain frameworks, programs, and internal controls to prevent or minimize financial loss from failure of systems, people, or processes. This includes specific programs and frameworks intended to prevent or limit the effects of cyber risks including cyber-attacks or other information security breaches that might allow unauthorized transactions or unauthorized access to customer, associate, or company sensitive information. Metrics and measurements are used by Executive Leaders in the management of day-to-day operations to ensure effective customer service, minimization of service disruptions, and oversight of operational and cyber risk. We continually monitor and report on operational, technology, and cyber risks related to clients, products, and business practices; external and internal fraud; business disruptions and systems failures; cyber-attacks, information security or data breaches; damage to physical assets; and execution, delivery, and process management.

The Enterprise Risk Management Committee of the Board of Directors is responsible for the oversight, guidance, and monitoring of risks, including operational/technology/cyber risks, being taken by the Company. The monitoring is accomplished through on-going review of management reports, data on risks, policy limits and discussion on enterprise risk management strategies, policies, and risk assessments.

Regulatory/Compliance/Legal Risk

Regulatory/compliance/legal risk is the risk that the Company violated or was not in compliance with applicable laws, regulations or practices, industry standards, or ethical standards. The legal portion assesses the risk that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively impact the Company. The Board of Directors expects we will perform business in a manner compliant with applicable laws and/or regulations and expects issues to be identified, analyzed, and remediated in a timely and complete manner.

OFF-BALANCE SHEET ARRANGEMENTS

Off-balance sheet arrangements include commitments to extend credit and financial guarantees. Commitments to extend credit and financial guarantees are used to meet the financial needs of our customers. Our banking affiliates have entered into various agreements to extend credit, including loan commitments of $3.743 billion and standby letters of credit of $100.2 million at March 31, 2019. At March 31, 2019, approximately $3.478 billion of the loan commitments had fixed rates and $265.3 million had floating rates, with the floating rates ranging from 1% to 16%. At December 31, 2018, loan commitments were $3.566 billion and standby letters of credit were $319.0 million. The term of these off-balance sheet arrangements is typically one year or less.

Old National is a party in risk participation transactions of interest rate swaps, which had total notional amount of $38.3 million at March 31, 2019.

CONTRACTUAL OBLIGATIONS

The following table presents our significant fixed and determinable contractual obligations at March 31, 2019:

	Payments Due In				
(dollars in thousands)	One Year or Less (1)	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without stated maturity	$12,367,672	$ —	$—	$—	$12,367,672
IRAs, consumer, and brokered certificates of deposit	1,315,351	592,695	114,056	39,496	2,061,598
Federal funds purchased and interbank borrowings	325,030	—	—	—	325,030
Securities sold under agreements to repurchase	342,480	—	—	—	342,480
FHLB advances	126,408	120,000	57,164	1,416,372	1,719,944
Other borrowings	338	965	1,078	249,203	251,584
Fixed interest payments (2)	37,992	94,852	90,242	124,099	347,185
Operating leases	13,094	32,454	23,805	44,687	114,040
Other long-term liabilities (3)	16,399	11,312	169	48	27,928

(1) For the remaining nine months of fiscal 2019.

(2) Our senior notes, subordinated notes, certain trust preferred securities, and certain FHLB advances have fixed rates ranging from 1.50% to 6.08%. All of our other long-term debt is at LIBOR based variable rates at March 31, 2019. The projected variable interest assumes no increase in LIBOR rates from March 31, 2019.

(3) Includes unfunded commitments on qualified affordable housing projects and other tax credit investments.

We rent certain premises and equipment under operating leases. See Note 10 to the consolidated financial statements for additional information on long-term lease arrangements.

We are party to various derivative contracts as a means to manage the balance sheet and our related exposure to changes in interest rates, to manage our residential real estate loan origination and sale activity, and to provide derivative contracts to our clients. Since the derivative liabilities recorded on the balance sheet change frequently and do not represent the amounts that may ultimately be paid under these contracts, these liabilities are not included in the table of contractual obligations presented above. Further discussion of derivative instruments is included in Note 21 to the consolidated financial statements.

In the normal course of business, various legal actions and proceedings are pending against us and our affiliates which are incidental to the business in which they are engaged. Further discussion of contingent liabilities is included in Note 22 to the consolidated financial statements.

In addition, liabilities recorded under FASB ASC 740-10 (FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*) are not included in the table because the amount and timing of any cash payments cannot be reasonably estimated. Further discussion of income taxes and liabilities recorded under FASB ASC 740-10 is included in Note 20 to the consolidated financial statements.

CRITICAL ACCOUNTING POLICIES AND **ESTIMATES**

Our accounting policies are described in Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018. Certain accounting policies require management to use significant judgment and estimates, which can have a material impact on the carrying value of certain assets and liabilities. We consider these policies to be critical accounting policies. The judgment and assumptions made are based upon historical experience or other factors that management believes to be reasonable under the circumstances. Because of the nature of the judgment and assumptions, actual results could differ from estimates, which could have a material effect on our financial condition and results of operations.

The following accounting policies materially affect our reported earnings and financial condition and require significant judgments and estimates. Management has reviewed these critical accounting estimates and related disclosures with our Audit Committee.

Goodwill

- **Description.** For acquisitions, we are required to record the assets acquired, including identified intangible assets, and the liabilities assumed at their fair value. These often involve estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques that may include estimates of attrition, inflation, asset growth rates, or other relevant factors. Under FASB ASC 350, *Intangibles – Goodwill and Other*, goodwill recorded must be reviewed for impairment on an annual basis, as well as on an interim basis if events or changes indicate that the asset might be impaired. An impairment loss must be recognized for any excess of carrying value over fair value of the goodwill.
- **Judgments and Uncertainties.** The determination of fair values is based on valuations using management's assumptions of future growth rates, future attrition, discount rates, multiples of earnings or other relevant factors.
- **Effect if Actual Results Differ From Assumptions.** Changes in these factors, as well as downturns in economic or business conditions, could have a significant adverse impact on the carrying value of goodwill and could result in impairment losses affecting our financials as a whole and our banking subsidiary in which the goodwill resides.

Allowance for Loan Losses

- **Description.** The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience. The allowance represents management's best estimate, but significant downturns in circumstances relating to loan quality and economic conditions could result in a requirement for additional allowance. Likewise, an upturn in loan quality and improved economic conditions may allow a reduction in the required allowance. In either instance, unanticipated changes could have a significant impact on results of operations.

The allowance is increased through a provision charged to operating expense. Uncollectible loans are charged-off through the allowance. Recoveries of loans previously charged-off are added to the allowance. A loan is considered impaired when it is probable that contractual interest and principal payments will not be collected either for the amounts or by the dates as scheduled in the loan agreement. Our policy for recognizing income on impaired loans is to accrue interest unless a loan is placed on nonaccrual status. A loan is generally placed on nonaccrual status when principal or interest becomes 90 days past due unless it is well secured and in the process of collection, or earlier when concern exists as to the ultimate collectibility of principal or interest. We monitor the quality of our loan portfolio on an on-going basis and use a combination of detailed credit assessments by relationship managers and credit officers, historic loss trends, and economic and business environment factors in determining the allowance for loan losses. We record provisions for loan losses based on current loans outstanding, grade changes, mix of loans, and expected losses. A detailed loan loss evaluation on an individual loan basis for our highest risk loans is performed

quarterly. Management follows the progress of the economy and how it might affect our borrowers in both the near and the intermediate term. We have a formalized and disciplined independent

loan review program to evaluate loan administration, credit quality, and compliance with corporate loan standards. This program includes periodic, regular reviews of problem loan reports, delinquencies and charge-offs.

- **Judgments and Uncertainties.** We utilize a PD/LGD model as a tool to determine the adequacy of the allowance for loan losses for performing commercial and commercial real estate loans. The PD is forecast using a transition matrix to determine the likelihood of a customer's AQR migrating from its current AQR to any other status within the time horizon. Transition rates are measured using Old National's own historical experience. The model assumes that recent historical transition rates will continue into the future. The LGD is defined as credit loss incurred when an obligor of the bank defaults. The sum of all net charge-offs for a particular portfolio segment are divided by all loans that have defaulted over a given period of time. The expected loss derived from the model considers the PD, LGD, and exposure at default. Additionally, qualitative factors, such as changes in lending policies or procedures, and economic business conditions are also considered.

We use historic loss ratios adjusted for economic conditions to determine the appropriate level of allowance for residential real estate and consumer loans.

- **Effect if Actual Results Differ From Assumptions.** The allowance represents management's best estimate, but significant downturns in circumstances relating to loan quality and economic conditions could result in a requirement for additional allowance. Likewise, an upturn in loan quality and improved economic conditions may allow a reduction in the required allowance. In either instance, unanticipated changes could have a significant impact on results of operations.

Management's analysis of probable losses in the portfolio at March 31, 2019 resulted in a range for allowance for loan losses of $16.9 million. The range pertains to general (FASB ASC 450, *Contingencies*) reserves for both retail and performing commercial loans. Specific (FASB ASC 310, *Receivables*) reserves do not have a range of probable loss. Due to the risks and uncertainty associated with the economy and our projection of loss rates inherent in the portfolio, we establish a range of probable outcomes (a high-end estimate and a low-end estimate) and evaluate our position within this range. The potential effect to net income based on our position in the range relative to the high and low endpoints is a decrease of $1.8 million and an increase of $10.9 million, respectively, after taking into account the tax effects. These sensitivities are hypothetical and may not represent actual results.

Derivative Financial Instruments

- **Description.** As part of our overall interest rate risk management, we use derivative instruments to reduce exposure to changes in interest rates and market prices for financial instruments. The application of the hedge accounting policy requires judgment in the assessment of hedge effectiveness, identification of similar hedged item groupings and measurement of changes in the fair value of derivative financial instruments and hedged items. To the extent hedging relationships are found to be effective, as determined by FASB ASC 815, *Derivatives and Hedging* ("ASC Topic 815"), changes in fair value of the derivatives are offset by changes in the fair value of the related hedged item or recorded to other comprehensive income. Management believes hedge effectiveness is evaluated properly in preparation of the financial statements. All of the derivative financial instruments we use have an active market and indications of fair value can be readily obtained. We are not using the "short-cut" method of accounting for any fair value derivatives.
- **Judgments and Uncertainties.** The application of the hedge accounting policy requires judgment in the assessment of hedge effectiveness, identification of similar hedged item groupings and measurement of changes in the fair value of derivative financial instruments and hedged items.
- **Effect if Actual Results Differ From Assumptions.** To the extent hedging relationships are found to be effective, as determined by ASC Topic 815, changes in fair value of the derivatives are offset by changes in the fair value of the related hedged item or recorded to other comprehensive income. However, if in the future the derivative financial instruments used by us no longer qualify for hedge accounting treatment, all changes in fair value of the derivative would flow through the consolidated statements of income in other noninterest income, resulting in greater volatility in our earnings.

Income Taxes

- **Description.** We are subject to the income tax laws of the U.S., its states, and the municipalities in which we operate. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant government taxing authorities. We review income tax expense and the carrying value of deferred tax assets quarterly; and as new information becomes available, the balances are adjusted as appropriate. FASB ASC 740-10 (FIN 48) prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. See Note 20 to the consolidated financial statements for a further description of our provision and related income tax assets and liabilities.
- **Judgments and Uncertainties.** In establishing a provision for income tax expense, we must make judgments and interpretations about the application of these inherently complex tax laws. We must also make estimates about when in the future certain items will affect taxable income in the various tax jurisdictions. Disputes over interpretations of the tax laws may be subject to review/adjudication by the court systems of the various tax jurisdictions or may be settled with the taxing authority upon examination or audit.
- **Effect if Actual Results Differ From Assumptions.** Although management believes that the judgments and estimates used are reasonable, actual results could differ and we may be exposed to losses or gains that could be material. To the extent we prevail in matters for which reserves have been established, or are required to pay amounts in excess of our reserves, our effective income tax rate in a given financial statement period could be materially affected. An unfavorable tax settlement would result in an increase in our effective income tax rate in the period of resolution. A favorable tax settlement would result in a reduction in our effective income tax rate in the period of resolution.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee and the Audit Committee has reviewed our disclosure relating to it in this “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

FORWARD-LOOKING STATEMENTS

In this report, we have made various statements regarding current expectations or forecasts of future events, which speak only as of the date the statements are made. These statements are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are also made from time-to-time in press releases and in oral statements made by the officers of Old National Bancorp (“Old National” or the “Company”). Forward-looking statements can be identified by the use of the words “expect,” “may,” “could,” “intend,” “project,” “estimate,” “believe,” “anticipate,” and other words of similar meaning. Forward-looking statements also include, but are not limited to, statements regarding estimated cost savings, plans and objectives for future operations, the Company’s business and growth strategies, including future acquisitions of banks, regulatory developments, and expectations about performance as well as economic and market conditions and trends.

Such forward-looking statements are based on assumptions and estimates, which although believed to be reasonable, may turn out to be incorrect. Therefore, undue reliance should not be placed upon these estimates and statements. We cannot assure that any of these statements, estimates, or beliefs will be realized and actual results may differ from those contemplated in these "forward-looking statements." We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or otherwise. You are advised to consult further disclosures we may make on related subjects in our filings with the SEC. In addition to other factors discussed in this report, some of the important factors that could cause actual results to differ materially from those discussed in the forward-looking statements include the following:

- economic, market, operational, liquidity, credit, and interest rate risks associated with our business;
- economic conditions generally and in the financial services industry;
- expected cost savings in connection with the consolidation of recent acquisitions may not be fully realized or realized within the expected time frames, and deposit attrition, customer loss, and revenue loss following completed acquisitions may be greater than expected;
- failure to properly understand risk characteristics of newly entered markets;
- increased competition in the financial services industry either nationally or regionally, resulting in, among other things, credit quality deterioration;
- our ability to achieve loan and deposit growth;
- volatility and direction of market interest rates;
- governmental legislation and regulation, including changes in accounting regulation or standards;
- our ability to execute our business plan;
- a weakening of the economy which could materially impact credit quality trends and the ability to generate loans;
- changes in the securities markets; and
- changes in fiscal, monetary, and tax policies.

Investors should consider these risks, uncertainties, and other factors in addition to risk factors included in this filing and our other filings with the SEC.

ITEM 3. QUANTITIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Management's Discussion and Analysis of Financial Condition and Results of Operations – Market Risk and Liquidity Risk.

ITEM 4. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Evaluation of disclosure controls and procedures. Old National's principal executive officer and principal financial officer have concluded that Old National's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended), based on their evaluation of these controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q, are effective at the reasonable assurance level as discussed below to ensure that information required to be disclosed by Old National in the reports it files under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to Old National's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Limitations on the Effectiveness of Controls. Management, including the principal executive officer and principal financial officer, does not expect that Old National's disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be only reasonable assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, control may become inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in Internal Control over Financial Reporting. There were no changes in Old National's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are

reasonably likely to materially affect, Old National’s internal control over financial reporting.

PART II

OTHER INFORMATION

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed in the “Risk Factors” section of the Company’s Annual Report on Form 10-K for the year ended December 31, 2018.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND **USE OF PROCEEDS**

(c) **ISSUER PURCHASES OF EQUITY SECURITIES**

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
01/01/19 - 01/31/19	—	$ —	—	7,000,000
02/01/19 - 02/28/19	145,617	16.92	—	7,000,000
03/01/19 - 03/31/19	1,504,823	16.47	1,500,000	5,500,000
Quarter-to-date 03/31/19	1,650,440	$ 16.51	1,500,000	5,500,000

In the first quarter of 2019, the Board of Directors approved the repurchase of up to 7.0 million shares of the Company's stock to be repurchased, as conditions warrant, through January 31, 2020. During the three months ended March 31, 2019, Old National also repurchased a limited number of shares associated with employee share-based incentive programs.

ITEM 5. OTHER INFORMATION

(a) None

(b) There have been no material changes in the procedure by which security holders recommend nominees to the Company's board of directors.

ITEM 6. EXHIBITS

Exhibit No.	Description
2.1	Agreement and Plan of Merger dated as of June 20, 2018 by and between Old National Bancorp and Klein Financial, Inc. (the schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K) (incorporated by reference to Exhibit 2.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2018).
3.1	Fourth Amended and Restated Articles of Incorporation of Old National, amended May 13, 2016 (incorporated by reference to Exhibit 3.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 16, 2016).
3.2	Amended and Restated By-Laws of Old National, amended July 28, 2016 (incorporated by reference to Exhibit 3.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2016).
4.1	Senior Indenture between Old National and The Bank of New York Trust Company (as successor to J.P. Morgan Trust Company, National Association (as successor to Bank One, N.A.)), as trustee, dated as of July 23, 1997 (incorporated by reference to Exhibit 4.3 to Old National's Registration Statement on Form S-3, Registration No. 333-118374, filed with the Securities and Exchange Commission on December 2, 2004).
4.2	Second Indenture Supplement, dated as of August 15, 2014, between Old National and The Bank of New York Mellon Trust Company, N.A., as trustee, providing for the issuance of its 4.125% Senior Notes due 2024 (incorporated by reference to Exhibit 4.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 15, 2014).
10.1	Form of Employment Agreement for Robert G. Jones (incorporated by reference to Exhibit 10.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 27, 2011).*
10.2	Amended Employment Agreement for Robert G. Jones (incorporated by reference to Exhibit 10.2 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 25, 2019).*
10.3	Employment Agreement dated as of May 2, 2019 between Old National Bancorp and James C. Ryan, III is filed herewith.*
10.4	Employment Agreement dated as of May 2, 2019 between Old National Bancorp and Brendon B. Falconer is filed herewith.*
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101	The following materials from Old National's Form 10-Q Report for the quarterly period ended March 31, 2019, formatted in iXBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements.

* Management contract or compensatory plan or arrangement

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SIGNATURE

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.

OLD NATIONAL BANCORP
(Registrant)

By: /s/ Brendon B. Falconer
Brendon B. Falconer
Senior Executive Vice President and Chief Financial Officer
Duly Authorized Officer and Principal Financial Officer

Date: May 2, 2019

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