OLD NATIONAL BANCORP /IN/
Form 10-Q
October 31, 2008

Table of Contents

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

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________
Commission File Number 1-15817

OLD NATIONAL BANCORP
(Exact name of Registrant as specified in its charter)

INDIANA	**35-1539838**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1 Main Street Evansville, Indiana	**47708**
(Address of principal executive offices)	(Zip Code)

(812) 464-1294
(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to the filing requirements for at least the past 90 days. Yes þ No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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

Indicate the number of shares outstanding of each of the issuer s classes of common stock. The Registrant has one class of common stock (no par value) with 66,285,000 shares outstanding at September 30, 2008.

OLD NATIONAL BANCORP
FORM 10-Q
INDEX

	Page No.
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Consolidated Balance Sheet September 30, 2008 (unaudited), December 31, 2007 and September 30, 2007 (unaudited)	3
Consolidated Statement of Income Three and nine months ended September 30, 2008 and 2007 (unaudited)	4
Consolidated Statement of Changes in Shareholders Equity Nine months ended September 30, 2008 and 2007 (unaudited)	5
Consolidated Statement of Cash Flows Nine months ended September 30, 2008 and 2007 (unaudited)	6
Notes to Consolidated Financial Statements (unaudited)	7
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 3. Quantitative and Qualitative Disclosures About Market Risk	47
Item 4. Controls and Procedures	47
PART II OTHER INFORMATION	48
SIGNATURES	53

Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
Exhibit 32.2

Table of Contents

OLD NATIONAL BANCORP
CONSOLIDATED BALANCE SHEET

(dollars and shares in thousands, except per share data)	September 30, 2008 (unaudited)	December 31, 2007	September 30, 2007 (unaudited)
Assets			
Cash and due from banks	**$ 166,078**	$ 255,192	$ 192,921
Federal funds sold and resell agreements	**9,292**		179
Money market investments	**18,591**	8,480	4,074
Total cash and cash equivalents	**193,961**	263,672	197,174
Investment securities available-for-sale, at fair value			
U.S. Government-sponsored entities and agencies	**319,793**	688,947	661,221
Mortgage-backed securities	**1,108,944**	940,967	960,462
States and political subdivisions	**327,370**	294,884	259,581
Other securities	**167,645**	215,843	205,096
Investment securities available-for-sale	**1,923,752**	2,140,641	2,086,360
Investment securities held-to-maturity, at amortized cost (fair value $104,641, $124,504 and $130,053 respectively)	**105,316**	126,769	134,444
Federal Home Loan Bank stock, at cost	**41,090**	41,090	41,170
Residential loans held for sale, at fair value	**11,118**	13,000	13,313
Loans:			
Commercial	**1,799,764**	1,694,736	1,692,521
Commercial real estate	**1,170,775**	1,270,408	1,308,287
Residential real estate	**508,112**	533,448	539,297
Consumer credit, net of unearned income	**1,203,265**	1,187,764	1,210,260
Total loans	**4,681,916**	4,686,356	4,750,365
Allowance for loan losses	**(63,466)**	(56,463)	(64,138)
Net loans	**4,618,450**	4,629,893	4,686,227
Premises and equipment, net	**46,658**	48,652	47,277
Accrued interest receivable	**43,714**	50,277	50,427
Goodwill	**159,198**	159,198	159,198
Other intangible assets	**28,567**	31,778	32,679
Company-owned life insurance	**222,380**	214,486	211,853
Assets held for sale	**2,996**	3,969	31,065
Other assets	**171,088**	122,701	141,298
Total assets	**$ 7,568,288**	$ 7,846,126	$ 7,832,485
Liabilities			
Deposits:			
Noninterest-bearing demand	**$ 845,705**	$ 855,449	$ 840,501
Interest-bearing:			

NOW	**1,222,967**	1,410,667	1,427,485
Savings	**923,202**	774,054	653,448
Money market	**448,667**	562,127	690,391
Time (including $48,875, $0 and $0, respectively, at fair value)	**1,905,680**	2,061,086	2,262,717
Total deposits	**5,346,221**	5,663,383	5,874,542
Short-term borrowings	**541,648**	638,247	527,033
Other borrowings	**837,315**	656,722	612,129
Accrued expenses and other liabilities	**207,751**	234,893	171,362
Total liabilities	**6,932,935**	7,193,245	7,185,066
Shareholders Equity			
Preferred stock, 2,000 shares authorized, no shares issued or outstanding			
Common stock, $1 stated value, 150,000 shares authorized, 66,285, 66,205 and 66,200 shares issued and outstanding, respectively	**66,285**	66,205	66,200
Capital surplus	**566,067**	563,675	562,959
Retained earnings	**59,684**	34,346	41,885
Accumulated other comprehensive loss, net of tax	**(56,683)**	(11,345)	(23,625)
Total shareholders equity	**635,353**	652,881	647,419
Total liabilities and shareholders equity	**$ 7,568,288**	$ 7,846,126	$ 7,832,485

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

Table of Contents

OLD NATIONAL BANCORP
CONSOLIDATED STATEMENT OF INCOME (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands, except per share data)	**2008**	**2007**	**2008**	**2007**
Interest Income				
Loans including fees:				
Taxable	**$ 63,455**	$ 82,561	**$ 199,862**	$ 245,055
Nontaxable	**5,930**	5,502	**17,029**	16,118
Investment securities, available-for-sale:				
Taxable	**21,252**	23,054	**65,312**	68,591
Nontaxable	**3,642**	3,005	**10,298**	9,141
Investment securities, held-to-maturity, taxable	**1,252**	1,611	**4,005**	5, 140
Money market investments	**148**	215	**672**	6,133
Total interest income	**95,679**	115,948	**297,178**	350,178
Interest Expense				
Deposits	**22,979**	45,064	**74,812**	145,188
Short-term borrowings	**2,552**	5,447	**9,532**	13,011
Other borrowings	**10,552**	10,219	**32,104**	30,618
Total interest expense	**36,083**	60,730	**116,448**	188,817
Net interest income	**59,596**	55,218	**180,730**	161,361
Provision for loan losses	**6,842**		**34,447**	2,445
Net interest income after provision for loan losses	**52,754**	55,218	**146,283**	158,916
Noninterest Income				
Wealth management fees	**4,163**	4,554	**13,644**	14,267
Service charges on deposit accounts	**11,835**	11,496	**33,355**	32,965
ATM fees	**4,508**	3,771	**13,013**	10,487
Mortgage banking revenue	**1,380**	1,208	**3,984**	3,298
Insurance premiums and commissions	**8,782**	8,889	**30,155**	29,682
Investment product fees	**2,335**	2,675	**7,461**	8,285
Company-owned life insurance	**2,924**	2,419	**8,435**	7, 184
Net securities gains (losses)	**45**	(472)	**6,625**	(3,163)
Gain (loss) on derivatives	**(186)**	170	**(1,159)**	(22)
Gain on sale leaseback transactions	**1,601**	774	**4,765**	947
Other income	**1,608**	2,087	**9,106**	7, 137
Total noninterest income	**38,995**	37,571	**129,384**	111,067
Noninterest Expense				
Salaries and employee benefits	**40,466**	39,638	**125,972**	122,534
Occupancy	**9,834**	5, 898	**29,029**	17,787
Equipment	**2,354**	2,683	**7,421**	8,580

Marketing	**3,094**	1,738	**7,789**	6,291
Data processing	**4,768**	4,656	**14,320**	14,537
Communication	**2,303**	2,337	**6,825**	7, 069
Professional fees	**1,729**	1,740	**5,278**	5,548
Loan expense	**1,888**	1,541	**4,882**	4,585
Supplies	**782**	795	**2,416**	2,584
Loss (gain) on extinguishment of debt	**(148)**	66	**(148)**	1,300
Impairment of long-lived assets			**585**	1,163
Other expense	**5, 393**	4,403	**13,864**	14,984
Total noninterest expense	**72,463**	65,495	**218,233**	206,962
Income before income taxes	**19,286**	27,294	**57,434**	63,021
Income tax expense	**2,271**	4,730	**1,604**	10,116
Net income	**$ 17,015**	$ 22,564	**$ 55,830**	$ 52,905
Net income per common share				
Basic net income per share	**$ 0.26**	$ 0.35	**$ 0.85**	$ 0.81
Diluted net income per share	**0.26**	0.34	**0.85**	0.80
Weighted average number of common shares outstanding				
Basic	**65,645**	65,601	**65,636**	65,709
Diluted	**65,790**	65,658	**65,738**	65,766
Dividends per common share (1)	**$ 0.23**	$ 0.22	**$ 0.46**	$ 0.66

(1) A $0.23 cash dividend was paid in the first quarter of 2008. However, the first quarter dividend was declared in December 2007 and is included in fourth quarter 2007 results.

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

Table of Contents

OLD NATIONAL BANCORP
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (unaudited)

(dollars and shares in thousands)	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity	Comprehensive Income
Balance, December 31, 2006	66,503	$ 66,503	$ 565,106	$ 35,873	$ (25,113)	$ 642,369	
Comprehensive income							
Net income				52,905		52,905	$ 52,905
Other comprehensive income (1)							
Change in unrealized gain (loss) on securities available for sale, net of reclassification and tax					(65)	(65)	(65)
Reclassification adjustment on cash flows hedges, net of tax					299	299	299
Reclassification adjustment on defined benefit pension plans, net of tax					1,254	1,254	1,254
Total comprehensive income							$ 54,393
Adjustment to apply FIN No. 48				(3,368)		(3,368)	
Adjustment to apply EITF No. 06-5				(118)		(118)	
Cash dividends				(43,407)		(43,407)	
Stock repurchased	(228)	(228)	(3,850)			(4,078)	
Stock based compensation expense			949			949	
Stock activity under incentive comp plans	(75)	(75)	202			127	
Stock options issued in acquisition			552			552	
Balance, September 30, 2007	66,200	$ 66,200	$ 562,959	$ 41,885	$ (23,625)	$ 647,419	
Balance, December 31, 2007	**66,205**	**$ 66,205**	**$ 563,675**	**$ 34,346**	**$ (11,345)**	**$ 652,881**	

Comprehensive income							
Net income				**55,830**		**55,830**	**$ 55,830**
Other comprehensive income (1)							
Change in unrealized gain (loss) on securities available for sale, net of reclassification and tax					**(40,579)**	**(40,579)**	**(40,579)**
Reclassification adjustment on cash flows hedges, net of tax					**131**	**131**	**131**
Reclassification adjustment on defined benefit pension plans, net of tax					**(4,890)**	**(4,890)**	**(4,890)**
Total comprehensive income							**$ 10,492**
Cash dividends				**(30,492)**		**(30,492)**	
Stock repurchased	**(26)**	**(26)**	**(413)**			**(439)**	
Stock based compensation expense			**1,469**			**1,469**	
Stock activity under incentive comp plans	**106**	**106**	**1,336**			**1,442**	
Balance, September 30, 2008	**66,285**	**$ 66,285**	**$ 566,067**	**$ 59,684**	**$ (56,683)**	**$ 635,353**	

(1) See Note 5 to the consolidated financial statements.

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

5

Table of Contents

OLD NATIONAL BANCORP
CONSOLIDATED STATEMENT OF CASH FLOWS (unaudited)

(dollars in thousands)	Nine Months Ended September 30, 2008	2007
Cash Flows From Operating Activities		
Net income	**$ 55,830**	$ 52,905
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	**4,454**	6,276
Amortization and impairment of other intangible assets	**3,411**	2,596
Net discount accretion on investment securities	**(1,181)**	(1,881)
Restricted stock expense	**1,162**	728
Stock option expense	**308**	221
Provision for loan losses	**34,447**	2,445
Net securities (gains) losses	**(6,625)**	3,163
Gain on sale leasebacks	**(4,765)**	(947)
Loss on derivatives	**1,159**	22
Net gains on sales and write-downs of loans and other assets	**(2,172)**	(1,021)
(Gain) loss on extinguishment of debt	**(148)**	1,300
Increase in cash surrender value of company owned life insurance	**(7,894)**	(5,123)
Residential real estate loans originated for sale	**(132,942)**	(195,879)
Proceeds from sale of residential real estate loans	**137,094**	202,000
Decrease in interest receivable	**6,563**	5,140
Increase in other assets	**(27,161)**	(9,058)
Decrease in accrued expenses and other liabilities	**(11,358)**	(19,491)
Total adjustments	**(5,648)**	(9,509)
Net cash flows provided by operating activities	**50,182**	43,396
Cash Flows From Investing Activities		
Cash and cash equivalents of subsidiaries acquired, net		17,429
Purchase of subsidiaries		(78,109)
Purchases of investment securities available-for-sale	**(786,880)**	(644,936)
Proceeds from maturities, prepayments and calls of investment securities available-for-sale	**682,189**	630,865
Proceeds from sales of investment securities available-for-sale	**262,058**	180,257
Proceeds from maturities, prepayments and calls of investment securities held-to-maturity	**20,958**	27,018
Proceeds from redemption of FHLB stock		758
Proceeds from sale of loans	**2,251**	11,712
Net principal collected from (loans made to) customers	**(25,200)**	256,056
Proceeds from sale of premises and equipment and other assets	**7,574**	4,286
Proceeds from sale leaseback of real estate	**4,542**	98,649
Purchase of premises and equipment	**(9,349)**	(5,826)
Net cash flows provided by investing activities	**158,143**	498,159

Cash Flows From Financing Activities		
Net increase (decrease) in deposits and short-term borrowings:		
Noninterest-bearing demand deposits	**(9,744)**	(76,669)
Savings, NOW and money market deposits	**(152,012)**	(301,237)
Time deposits	**(153,519)**	(431,733)
Short-term borrowings	**(96,599)**	185,803
Payments for maturities on other borrowings	**(151,581)**	(6,541)
Proceeds from issuance of other borrowings	**330,000**	25,000
Payments related to retirement of debt		(189,551)
Cash dividends paid	**(45,407)**	(43,407)
Common stock repurchased	**(439)**	(4,078)
Proceeds from exercise of stock options, including tax benefit	**1,265**	75
Common stock issued under restricted stock and stock compensation plans		52
Net cash flows used in financing activities	**(278,036)**	(842,286)
Net decrease in cash and cash equivalents	**(69,711)**	(300,731)
Cash and cash equivalents at beginning of period	**263,672**	497,905
Cash and cash equivalents at end of period	**$ 193,961**	$ 197,174
Supplemental cash flow information:		
Total interest paid	**$ 119,825**	$ 189,803
Total taxes paid (net of refunds)	**$ 16,202**	$ 9,787

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 (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. The allowance for loan losses, goodwill and intangibles, derivative financial instruments, income taxes and valuation of securities are particularly subject to change. 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 September 30, 2008 and 2007, and December 31, 2007, and the results of its operations for the three and nine months ended September 30, 2008 and 2007. 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, 2007.

All significant intercompany transactions and balances have been eliminated. Certain prior year amounts have been reclassified to conform with the 2008 presentation. Such reclassifications had no effect on net income.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 157 In September 2006, the FASB issued Statement No. 157 *Fair Value Measurements*. The standard defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The standard establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. SFAS No. 157 became effective for the Company on January 1, 2008. See note 19 to the consolidated financial statements for additional information.

FSP SFAS No. 157-2 In February 2008, the FASB issued FASB Staff Position No. 157-2. The staff position delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The delay is intended to allow additional time to consider the effect of various implementation issues with regard to the application of SFAS No. 157. The new staff position defers the effective date of SFAS No. 157 to January 1, 2009, for items within the scope of the staff position.

SFAS No. 159 In February 2007, the FASB issued Statement No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities.* The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. On January 1, 2008, the date this pronouncement became effective for the Company, Old National elected the fair value option on newly originated residential mortgage loans held for sale and certain retail certificates of deposit on a prospective basis. See note 19 to the consolidated financial statements for additional information.

SFAS No. 141(R) In December 2007, the FASB issued Statement No. 141(R) *Business Combinations*. This statement replaces FASB Statement No. 141 *Business Combinations*. SFAS No. 141(R) establishes principles and requirements for how an acquiring company (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree, (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The new standard is effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 141(R) on the consolidated financial statements.

SFAS No. 160 In December 2007, the FASB issued Statement No. 160 *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. SFAS No. 160 requires the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled and presented in the consolidated balance sheet within equity, but separate from the parent s equity. It also requires the amount of consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income. The new standard is effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 160 on the consolidated financial statements.

SFAS No. 161 In March 2008, the FASB issued Statement No. 161 *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*. SFAS No. 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related items are accounted for under Statement 133 and how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. The new standard is effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 161 on the consolidated financial statements.

SFAS No. 162 In May 2008, the FASB issued Statement No. 162 *The Hierarchy of Generally Accepted Accounting Principles*. The standard identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The new standard becomes effective 60 days following the Security and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411. SFAS No. 162 is not expected to have a material impact on Old National s consolidated financial position or results of operations.

FSP FAS 133-1 and FIN 45-4 In September 2008, the FASB issued FASB Staff Position No. FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. This staff position amends FASB Statement 133 to require sellers of credit derivatives to disclose information about their credit derivatives and hybrid instruments that have embedded credit derivatives. This staff position also amends FASB Interpretation No. 45 to require additional disclosure about the current status of the payment/performance risk of the guarantee. It also clarifies the intent of FASB about the effective date of SFAS No. 161. These provisions of this FASB staff position are effective for the Company for reporting periods ending after November 15, 2008. FSP FAS 133-1 and FIN 45-4 are not expected to have a material impact on Old National s consolidated financial position or results of operations.

FSP FAS 157-3 In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. This FASB staff position clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FASB staff position became effective for the Company on October 10, 2008 and did not have a material impact on Old National s consolidated financial position or results of operations.

SAB 109 In November 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 109 (SAB 109). SAB 109 modifies how to apply generally accepted accounting principles to loan commitments that are accounted for at fair value through earnings. Prior to SAB 109, when companies measured the fair value of a derivative loan commitment, the expected net future cash flows related to the associated servicing of the loan was excluded. Under SAB 109, the expected net future cash flows related to the associated servicing of the loans sold will

be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SAB 109 was effective for the Company on January 1, 2008. There was no material impact to Old National s consolidated financial position or results of operations upon adoption.

Table of Contents

EITF 06-4 In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements.* This EITF Issue addresses accounting for separate agreements which split life insurance policy benefits between an employer and employee. The Issue requires the employer to recognize a liability for future benefits payable to the employee under these agreements. The effects of applying this issue must be recognized through either a change in accounting principle through an adjustment to equity or through the retrospective application to all prior periods. EITF 06-4 became effective for the Company on January 1, 2008, and did not have a material impact on the Company s consolidated financial position or results of operations.

EITF 06-10 In March 2007, the FASB Emerging Issues Task Force reached a consensus on Issue No. 06-10, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements.* This Issue provides guidance to help companies determine whether a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement should be recorded in accordance with either SFAS No. 106 - *Employers Accounting for Postretirement Benefits Other Than Pensions* (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract). EITF 06-10 also provides guidance on how a company should recognize and measure the asset in a collateral assignment split-dollar life insurance contract. EITF 06-10 became effective for the Company on January 1, 2008, and did not have a material impact on the Company s consolidated financial position or results of operations.

EITF 06-11 In June 2007, the FASB Emerging Issues Task Force reached a consensus on Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (EITF 06-11). EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for non-vested equity-classified employee share-based payment awards as an increase to additional paid-in capital. The amount recognized in additional paid-in capital for the realized income tax benefit from dividends on those awards should be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards. EITF 06-11 became effective for the Company on January 1, 2008, and did not have a material impact on the Company s consolidated financial position or results of operations.

NOTE 3 ACQUISITION

On February 1, 2007, Old National acquired St. Joseph Capital Corporation ("St. Joseph), a banking franchise headquartered in Mishawaka, Indiana, for $78.1 million, including acquisition costs. Pursuant to the merger agreement, the shareholders of St. Joseph received $40.00 in cash for each share of St. Joseph stock in an all-cash transaction. Goodwill of $45.8 million was recorded, of which none is deductible for tax purposes. In addition, intangible assets totaling $14.5 million related to core deposits and customer relationships were recorded and are being amortized over 10 to 11 years. See Note 9 to the consolidated financial statements for additional information. On the date of acquisition, unaudited financial statements of St. Joseph showed assets of $452.9 million, which included $336.6 million of loans and $78.6 million of securities, $357.3 million of deposits and year-to-date net interest income and other income of $0.8 million and net loss of $3.3 million.

NOTE 4 NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during each period. Diluted net income per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. At September 30, 2008 and 2007, stock options to purchase approximately 5.7 million and 5.8 million shares, respectively, and restricted stock of 0.2 and 0.4 million shares, respectively, were excluded from the computation of diluted net income per share because their inclusion would have been anti-dilutive.

Table of Contents

The following table reconciles basic and diluted net income per share for the three and nine months ended September 30:

(dollars and shares in thousands, except per share data)	**Three Months Ended September 30, 2008**			**Three Months Ended September 30, 2007**		
	Income	**Shares**	**Amount**	**Income**	**Shares**	**Amount**
Basic Net Income Per Share						
Income from operations	**$ 17,015**	**65,645**	**$ 0.26**	$ 22,564	65,601	$ 0.35
Effect of dilutive securities:						
Restricted stock		**111**			34	
Stock options		**34**			23	
Diluted Net Income Per Share						
Income from operations and assumed conversions	**$ 17,015**	**65,790**	**$ 0.26**	$ 22,564	65,658	$ 0.34

(dollars and shares in thousands, except per share data)	**Nine Months Ended September 30, 2008**			**Nine Months Ended September 30, 2007**		
	Income	**Shares**	**Amount**	**Income**	**Shares**	**Amount**
Basic Net Income Per Share						
Income from continuing operations	**$ 55,830**	**65,636**	**$ 0.85**	$ 52,905	65,709	$ 0.81
Effect of dilutive securities:						
Restricted stock		**69**			30	
Stock options		**33**			27	
Diluted Net Income Per Share						
Income from operations and assumed conversions	**$ 55,830**	**65,738**	**$ 0.85**	$ 52,905	65,766	$ 0.80

NOTE 5 COMPREHENSIVE INCOME

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available-for-sale and unrealized gains and losses on cash flow hedges and changes in funded status of pension plans which are also recognized as separate components of equity. Following is a summary of other comprehensive income (loss) for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	**2008**	**2007**	**2008**	**2007**
Net income	**$ 17,015**	$ 22,564	**$ 55,830**	$ 52,905
Other comprehensive income (loss)				
Change in securities available for sale:				
Unrealized holding gains (losses) arising during the period	**(23,060)**	22,079	**(60,802)**	(3,072)
Reclassification adjustment for securities (gains) losses realized in income	**(45)**	472	**(6,625)**	3,163
Income tax effect	**9,218**	(8,898)	**26,848**	(156)
Cash flow hedges:				
Net unrealized derivative gains (losses) on cash flow hedges				
Reclassification adjustment on cash flow hedges	**73**	141	**216**	492
Income tax effect	**(29)**	(55)	**(85)**	(193)
Defined benefit pension plans:				
Amortization of net (gain) loss recognized in income	**(4,076)**		**(8,151)**	2,091
Income tax effect	**1,630**		**3,261**	(837)
Total other comprehensive income (loss)	**(16,289)**	13,739	**(45,338)**	1,488
Comprehensive income (loss)	**$ 726**	$ 36,303	**$ 10,492**	$ 54,393

The following table summarizes the changes within each classification of accumulated other comprehensive income for the nine months ended September 30, 2008 and 2007:

(dollars in thousands)	Unrealized gains (losses) on securities	Unrecognized gain (loss) on cash flow hedges	Defined benefit pension plans	Accumulated other comprehensive income (loss)
Balance at December 31, 2007	**$ (3,704)**	**$ (655)**	**$ (6,986)**	**$ (11,345)**
Other comprehensive income (loss)	**(40,579)**	**131**	**(4,890)**	**(45,338)**
Balance at September 30, 2008	**$ (44,283)**	**$ (524)**	**$ (11,876)**	**$ (56,683)**
Balance at December 31, 2006	$ (16,286)	$ (998)	$ (7,829)	$ (25,113)
Other comprehensive income (loss)	(65)	299	1,254	1,488

Balance at September 30, 2007	$	(16,351)	$	(699)	$	(6,575)	$	(23,625)

Table of Contents

NOTE 6 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 September 30, 2008 and December 31, 2007 and the corresponding amounts of unrealized gains and losses therein:

(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2008				
Available-for-sale				
U.S. Government-sponsored entities and agencies	**$ 320,414**	**$ 1,587**	**$ (2,208)**	**$ 319,793**
Mortgage-backed securities	**1,147,056**	**4,808**	**(42,920)**	**1,108,944**
States and political subdivisions	**326,110**	**6,608**	**(5,348)**	**327,370**
Other securities	**204,327**	**102**	**(36,784)**	**167,645**
Total available-for-sale securities	**$ 1,997,907**	**$ 13,105**	**$ (87,260)**	**$ 1,923,752**
Held-to-maturity				
Mortgage-backed securities	**$ 94,647**	**$ 44**	**$ (503)**	**$ 94,188**
Other securities	**10,669**		**(216)**	**10,453**
Total held-to-maturity securities	**$ 105,316**	**$ 44**	**$ (719)**	**$ 104,641**
December 31, 2007				
Available-for-sale				
U.S. Government-sponsored entities and agencies	$ 678,545	$ 10,757	$ (355)	$ 688,947
Mortgage-backed securities	963,039	1,838	(23,910)	940,967
States and political subdivisions	286,898	8,404	(418)	294,884
Other securities	218,888	1,007	(4,052)	215,843
Total available-for-sale securities	$ 2,147,370	$ 22,006	$ (28,735)	$ 2,140,641
Held-to-maturity				
Mortgage-backed securities	$ 107,830	$	$ (2,237)	$ 105,593
Other securities	18,939		(28)	18,911
Total held-to-maturity securities	$ 126,769	$	$ (2,265)	$ 124,504

Proceeds from the sales and calls of investment securities available-for-sale during the first nine months of 2008 were $262.1 million and $384.7 million, respectively. For the nine months ended September 30, 2008, realized gains were $8.6 million and losses were $2.0 million. Included in the realized net gains were $4.5 million of gains related to securities that were called by the issuers. For the nine months ended September 30, 2007, proceeds from the sales of investment securities available-for-sale were $180.3 million and realized gains were $0.9 million and losses were $4.1 million.

As of September 30, 2008, Old National s security portfolio consisted of 1,047 securities, 363 of which were in an unrealized loss position. Old National does not believe any individual unrealized loss represents other-than-temporary impairment. The unrealized losses are primarily attributable to changes in interest rates and continued financial market stress. Factors considered in evaluating the securities included whether the securities were backed by U.S. Government-sponsored entities and agencies and credit quality concerns surrounding the recovery of the full principal balance.

At September 30, 2008, approximately 79% of the mortgage-backed securities held by Old National were issued by U.S. government-sponsored entities and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in market value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company has the intent and ability to hold these mortgage-backed securities until a recovery of fair value, which may be maturity, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2008.

The Company s unrealized losses on other securities relate primarily to its investment in pooled trust preferred securities. The decline in value is attributable to temporary illiquidity and the financial crisis affecting these markets and not the expected cash flows of the individual securities. Due to the illiquidity in the market, it is unlikely that the Company would be able to recover its investment in these securities if the Company sold the securities at this time. Because the Company has analyzed the cash flow characteristics of the securities and has the intent and ability to hold these securities until a recovery of fair value, which may be at maturity; and, for investments within the scope of EITF 99-20, determined that there was no adverse change in the cash flow as viewed by a market participant, it does not consider the investment in these securitized assets to be other-than-temporarily impaired at September 30, 2008.

The investments within the scope EITF 99-20 include $12.3 million of pooled trust preferred securities made up of seven different issues. These securities were rated A2 and A3 at inception, but during the quarter two were downgraded to Ba1 and one was downgraded to Baa2. The issuers in these securities are primarily banks, but some of the pools do include a limited number of insurance companies. The Company uses an OTTI evaluation model to compare the present value of current cash flows to the previous estimate to ensure there are no adverse changes in cash flows during the quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of cash flows is based on the most recent trustee reports and any other relevant market information including announcements of deferrals or defaults of trust preferred securities. Assumptions used in the model include expected future default rates and prepayments. We assume no recoveries on defaults and treat all deferrals as defaults. In addition we use the model to stress each CDO, or make assumptions more severe than expected activity, to determine the degree to which assumptions could deteriorate before the CDO could no longer fully support repayment of Old National s note class. At September 30, 2008, our model indicated no adverse change in cash flows despite the fact that the fair values of these securities declined substantially from June 30, 2008 resulting in an unrealized loss of $22.5 million at the end of the quarter.

At September 30, 2008, Old National did not have any securities in its portfolio issued by Lehman Brothers or any preferred or common equity securities issued by Fannie Mae or Freddie Mac.

NOTE 7 LOANS HELD FOR SALE

Effective January 1, 2008, residential loans that Old National has committed to sell are recorded at fair value in accordance with SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*. Prior to this, these residential loans had been recorded at the lower of cost or market value. At September 30, 2008 and December 31, 2007, Old National had residential loans held for sale of $11.1 million and $13.0 million, respectively. During the first nine months of 2008, $2.2 million of commercial loans held for investment were reclassified to loans held for sale at the lower of cost or market and sold, with no write-down on the loans transferred. During the first nine months of 2007, commercial real estate loans held for investment of $10.2 million and commercial loans of $4.0 million were transferred to loans held for sale and sold, resulting in a $2.5 million reduction to the allowance for loan losses.

NOTE 8 ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses was as follows:

	Nine Months Ended September 30,	
(dollars in thousands)	**2008**	**2007**
Balance, January 1	**$ 56,463**	$ 67,790
Additions:		
Provision charged to expense	**34,447**	2,445
Allowance of acquired bank		5,699
Deductions:		
Write-downs from loans transferred to held for sale		2,527
Loans charged-off	**35,345**	17,963
Recoveries	**(7,901)**	(8,694)
Net charge-offs	**27,444**	11,796
Balance, September 30	**$ 63,466**	$ 64,138

Individually impaired loans were as follows:

(dollars in thousands)	**September 30, 2008**	**December 31, 2007**
Impaired loans without an allowance for loan losses allocation	**$ 12,941**	$ 11,278
Impaired loans with an allowance for loan losses allocation	**43,326**	19,027
Total impaired loans	**$ 56,267**	$ 30,305
Allowance for loan losses allocated to impaired loans	**$ 15,349**	$ 5,904

For the nine months ended September 30, 2008 and 2007, the average balance of impaired loans was $50.9 million and $43.3 million, respectively, for which no interest income was recorded. No additional funds are committed to be advanced in connection with impaired loans. Loans deemed impaired are evaluated using the fair value of the underlying collateral.

Nonperforming loans were as follows:

(dollars in thousands)	**September 30, 2008**	**December 31, 2007**
Nonaccrual loans	**$ 68,446**	$ 40,816
Renegotiated loans		
Total nonperforming loans	**$ 68,446**	$ 40,816
Past due loans (90 days or more and still accruing)	**$ 1,927**	$ 1,511

Nonperforming loans includes both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. As discussed in the Credit Risk section of Management s Discussion and Analysis of Financial Condition and Results of Operations, nonaccrual loans at September 30, 2008, included $12.3 million related to the misconduct of a former loan officer.

Table of Contents

NOTE 9 GOODWILL AND OTHER INTANGIBLE ASSETS

The following table shows the changes in the carrying amount of goodwill by segment for the nine months ended September 30, 2008 and 2007:

(dollars in thousands)	Community Banking	Other	Total
Balance, January 1, 2008	**$ 119,325**	**$ 39,873**	**$ 159,198**
Adjustments to goodwill			
Balance, September 30, 2008	**$ 119,325**	**$ 39,873**	**$ 159,198**
Balance, January 1, 2007	$ 73,477	$ 39,873	$ 113,350
Goodwill acquired during the period	45,848		45,848
Balance, September 30, 2007	$ 119,325	$ 39,873	$ 159,198

Goodwill is reviewed annually for impairment. Old National completed its most recent annual goodwill impairment test as of August 31, 2008 and determined that no impairment existed as of this date. Old National recorded $45.8 million of goodwill in 2007 associated with the acquisition of St. Joseph Capital Corporation.

The gross carrying amount and accumulated amortization of other intangible assets at September 30, 2008 and December 31, 2007 was as follows:

(dollars in thousands)	Gross Carrying Amount	Accumulated Amortization and Impairment	Net Carrying Amount
September 30, 2008			
Amortized intangible assets:			
Core deposit	**$ 15,623**	**$ (6,884)**	**$ 8,739**
Customer business relationships	**25,753**	**(9,669)**	**16,084**
Customer loan relationships	**4,413**	**(669)**	**3,744**
Total intangible assets	**$ 45,789**	**$ (17,222)**	**$ 28,567**
December 31, 2007			
Amortized intangible assets:			
Core deposit	$ 15,623	$ (5,897)	$ 9,726
Customer business relationships	25,553	(7,546)	18,007
Customer loan relationships	4,413	(368)	4,045
Total intangible assets	$ 45,589	$ (13,811)	$ 31,778

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 10 to 25 years. Old National reviews intangible assets for possible impairment whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. During the second quarter of 2008, Old National recorded $0.7 million for impairment of intangibles due to the loss of a significant insurance client at one of its insurance subsidiaries. The

insurance subsidiary is included in the Other column for segment reporting. Old National recorded $14.5 million of other intangibles associated with the acquisition of St. Joseph Capital Corporation in 2007. Total amortization expense associated with other intangible assets for the nine months ended September 30 was $3.4 million in 2008 and $2.6 million in 2007.

Table of Contents

Estimated amortization expense for the future years is as follows:

(dollars in thousands)		
2008 remaining	$	939
2009		3,633
2010		3,458
2011		3,321
2012		3,151
Thereafter		14,065
Total	$	28,567

NOTE 10 ASSETS HELD FOR SALE

Assets held for sale are summarized as follows:

(dollars in thousands)		**September 30, 2008**		**December 31, 2007**
Assets held for sale:				
Land	**$**	**895**	$	1,210
Building and improvements		**5,862**		7,521
Total		**6,757**		8,731
Accumulated depreciation		**(3,761)**		(4,762)
Assets held for sale net	**$**	**2,996**	$	3,969

Included in assets held for sale at September 30, 2008 are five financial centers which are pending sale. Old National plans to continue occupying these properties under long-term lease arrangements. See note 16 to the consolidated financial statements for additional information on Old National s long-term lease arrangements.

Table of Contents

NOTE 11 FINANCING ACTIVITIES

The following table summarizes Old National s and its subsidiaries other borrowings at September 30, 2008, and December 31, 2007:

(dollars in thousands)	September 30, 2008	December 31, 2007
Old National Bancorp:		
Medium-term notes, Series 1997 (fixed rate 3.50%) matured June 2008	**$**	$ 100,000
Senior unsecured note (fixed rate 5.00%) maturing May 2010	**50,000**	50,000
Junior subordinated debenture (fixed rates 6.27% to 8.00% and variable rate 6.81%) maturing April 2032 to March 2035	**108,000**	108,000
SFAS 133 fair value hedge and other basis adjustments	**(782)**	(1,872)
Old National Bank:		
Securities sold under agreements to repurchase (fixed rates 2.45% to 4.06%) maturing December 2010 to October 2012	**99,000**	74,000
Federal Home Loan Bank advances (fixed rates 2.11% to 8.34%) maturing September 2009 to January 2023	**427,815**	124,369
Senior unsecured bank notes (fixed rate 3.95%) maturing February 2008		50,000
Subordinated bank notes (fixed rate 6.75%) maturing October 2011	**150,000**	150,000
Capital lease obligation	**4,400**	4,427
SFAS 133 fair value hedge and other basis adjustments	**(1,118)**	(2,202)
Total other borrowings	**$ 837,315**	$ 656,722

Contractual maturities of other borrowings at September 30, 2008, were as follows:

(dollars in thousands)	
Due in 2008	$ 10
Due in 2009	2,040
Due in 2010	124,043
Due in 2011	275,046
Due in 2012	150,688
Thereafter	287,388
SFAS 133 fair value hedge and other basis adjustments	(1,900)
Total	$ 837,315

FEDERAL HOME LOAN BANK

Federal Home Loan Bank advances had weighted-average rates of 3.61% and 5.19% at September 30, 2008, and December 31, 2007, respectively. These borrowings are collateralized by investment securities and residential real estate loans up to 155% of outstanding debt.

SUBORDINATED BANK NOTES

Subordinated bank notes qualify as Tier 2 Capital for regulatory purposes, subject to certain limitations, and are in accordance with the senior and subordinated global bank note program in which Old National Bank may issue and sell up to a maximum of $1 billion. Notes issued by Old National Bank under the global note program are not obligations of, or guaranteed by, Old National Bancorp.

JUNIOR SUBORDINATED DEBENTURES

Junior subordinated debentures related to trust preferred securities are classified in other borrowings . These securities qualify as Tier 1 capital for regulatory purposes, subject to certain limitations.

Old National guarantees the payment of distributions on the trust preferred securities issued by ONB Capital Trust II. ONB Capital Trust II issued $100 million in preferred securities in April 2002. The preferred securities have a liquidation amount of $25 per share with a cumulative annual distribution rate of 8.0% or $2.00 per share payable quarterly and maturing on April 15, 2032. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by ONB Capital Trust II. Old National may redeem the junior subordinated debentures and thereby cause a redemption of the trust preferred securities in whole (or in part from time to time) on or after April 12, 2007. Costs associated with the issuance of these trust preferred securities totaling $3.3 million in 2002 were capitalized and are being amortized through the maturity dates of the securities. The unamortized balance is included in other assets in the consolidated balance sheet.

During February 2007, Old National acquired St. Joseph Capital Trust I and St. Joseph Capital Trust II in conjunction with its acquisition of St. Joseph Capital Corporation. Old National guarantees the payment of distributions on the trust preferred securities issued by St. Joseph Capital Trust I and St. Joseph Capital Trust II. St. Joseph Capital Trust I issued $3.0 million in preferred securities in July 2003. The preferred securities carry a variable rate of interest priced at the three-month LIBOR plus 305 basis points, payable quarterly and maturing on July 11, 2033. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by St. Joseph Capital Trust I. St. Joseph Capital Trust II issued $5.0 million in preferred securities in March 2005. The preferred securities have a cumulative annual distribution rate of 6.27% until March 2010 when it will carry a variable rate of interest priced at the three-month LIBOR plus 175 basis points, payable quarterly and maturing on March 17, 2035. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by St. Joseph Capital Trust II. Old National may redeem the junior subordinated debentures and thereby cause a redemption of the trust preferred securities in whole (or in part from time to time) on or after September 30, 2008 (for debentures owned by St. Joseph Capital Trust I) and on or after March 31, 2010 (for debentures owned by St. Joseph Capital Trust II), and in whole (but not in part) following the occurrence and continuance of certain adverse federal income tax or capital treatment events.

CAPITAL LEASE OBLIGATION

On January 1, 2004, Old National entered into a long-term capital lease obligation for a financial center in Owensboro, Kentucky, which extends for 25 years with one renewal option for 10 years. The economic substance of this lease is that Old National is financing the acquisition of the building through the lease and accordingly, the building is recorded as an asset and the lease is recorded as a liability. The fair value of the capital lease obligation was estimated using a discounted cash flow analysis based on Old National s current incremental borrowing rate for similar types of borrowing arrangements.

At September 30, 2008, the future minimum lease payments under the capital lease were as follows:

(dollars in thousands)		
2008 remaining	$	93
2009		390
2010		390
2011		390
2012		390
Thereafter		11,704
Total minimum lease payments		13,357
Less amounts representing interest		8,957
Present value of net minimum lease payments	$	4,400

18

LINE OF CREDIT

During the first quarter of 2008, Old National entered into a $100 million revolving credit facility at the parent company level. Three unrelated financial institutions serve as lenders for the facility. At September 30, 2008, Old National had drawn $55 million on the revolving credit facility which is included in short-term borrowings. The facility has an interest rate of LIBOR plus 1.00% and a maturity of 364 days. The revolving line of credit was amended on September 5, 2008 to adjust debt covenant requirements, resulting in a waiver fee of $55 thousand. Old National was in compliance with its debt covenant requirements at September 30, 2008.

NOTE 12 EMPLOYEE BENEFIT PLANS

RETIREMENT PLAN

Old National maintains a funded noncontributory defined benefit plan (the Retirement Plan) that was frozen as of December 31, 2005. Retirement benefits are based on years of service and compensation during the highest paid five years of employment. The freezing of the plan provides that future salary increases will not be considered. Old National s policy is to contribute at least the minimum funding requirement determined by the plan s actuary.

Old National also maintains an unfunded pension restoration plan (the Restoration Plan) which provides benefits for eligible employees that are in excess of the limits under Section 415 of the Internal Revenue Code of 1986, as amended, that apply to the Retirement Plan. The Restoration Plan is designed to comply with the requirements of ERISA. The entire cost of the plan, which was also frozen as of December 31, 2005, is supported by contributions from the Company.

Old National contributed $0.7 million to cover benefit payments from the Restoration Plan during the first nine months of 2008. Old National expects to contribute an additional $0.1 million to cover benefit payments from the Restoration Plan during the remainder of 2008.

The net periodic benefit cost and its components were as follows for the three and nine months ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	**2008**	**2007**	**2008**	**2007**
Interest cost	**$ 536**	$ 586	**$ 1,607**	$ 1,757
Expected return on plan assets	**(792)**	(833)	**(2,376)**	(2,498)
Recognized actuarial loss	**158**	193	**474**	579
Settlement	**375**	451	**809**	1,050
Net periodic benefit cost	**$ 277**	$ 397	**$ 514**	$ 888

NOTE 13 STOCK-BASED COMPENSATION

During May 2008, shareholders approved the Company s 2008 Incentive Compensation Plan which authorizes up to a maximum of 1.0 million shares plus certain shares covered under the 1999 Equity Incentive Plan. At September 30, 2008, 1.5 million shares remained available for issuance. The granting of awards to key employees is typically in the form of options to purchase capital stock or restricted stock.

Stock Options

The Company granted 278 thousand stock options during the first nine months of 2008. Using the Black-Scholes option pricing model, the Company estimated the fair value of these stock options to be $0.3 million. The Company will expense this amount ratably over the three-year vesting period. The assumptions used in the option pricing model and the determination of stock option expense were an expected volatility of 15.8%; a risk free interest rate of 3.03%; an expected option term of six years; a 5.33% dividend yield; and a forfeiture rate of 7%. These options expire in ten years.

Old National recorded $0.2 million of stock based compensation expense, net of tax, during the first nine months of 2008 as compared to $0.1 million for the first nine months of 2007.

19

Table of Contents

Restricted Stock

The Company granted 136 thousand shares of performance based restricted stock awards to certain key officers during 2008, with shares vesting at the end of a thirty-six month period based on the achievement of certain targets. In addition, the Company granted 46 thousand time-based restricted stock awards to certain key officers during 2008, with shares vesting at the end of 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. As of September 30, 2008, unrecognized compensation expense was estimated to be $4.7 million for unvested restricted share awards.

Old National recorded expense of $0.8 million, net of tax benefit, during the first nine months of 2008, compared to expense of $0.5 million during the first nine months of 2007 related to the vesting of restricted share awards. Included in the first nine months of 2008 and 2007 is the reversal of $1.2 million and $1.4 million of expense, respectively, associated with certain performance-based restricted stock grants.

NOTE 14 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 statement of income for the three and nine months ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	**2008**	**2007**	**2008**	**2007**
Provision at statutory rate of 35%	**$ 6,750**	$ 9,553	**$ 20,102**	$ 22,057
Tax-exempt income	**(4,156)**	(3,564)	**(11,850)**	(10,604)
Reversal of portion of unrecognized tax benefits		(1,847)	**(6,611)**	(1,847)
State income taxes	**(353)**		**5**	
Other, net	**30**	588	**(42)**	510
Income tax expense (benefit)	**$ 2,271**	$ 4,730	**$ 1,604**	$ 10,116
Effective tax rate	**11.8%**	17.3%	**2.8%**	16.1%

For the three and nine months ended September 30, 2008, the effective tax rate was lower than the three and nine months ended September 30, 2007. The lower effective tax rate for the three months ended September 30, 2008, resulted from a higher percentage of tax-exempt income to income before income taxes compared to the three months ended September 30, 2007. The lower effective tax rate for the nine months ended September 30, 2008, was primarily a result of a decrease in the unrecognized tax benefit liability, as discussed below.

Unrecognized Tax Benefits

The Company and its subsidiaries file a consolidated U.S. federal income tax return, as well as filing various state returns. In the first quarter of 2008, the Company reversed $6.6 million related to uncertain tax positions accounted for under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.* The positive $6.6 million income tax reversal primarily relates to a U.S. Tax Court decision confirming that a subsidiary of a bank can deduct the interest expense of tax exempt obligations it has purchased. The time for the Internal Revenue Service to appeal the court ruling expired in the first quarter. The Company also has been informed by the Internal Revenue Service that they will not audit tax year 2005 as they previously indicated. As a result of these items, the Company reversed a total of $6.6 million from its unrecognized tax benefit liability which includes $0.5 million of interest.

During the three months ended September 30, 2007, the Company reversed $1.8 million related to uncertain tax positions due to the conclusion of a tax audit effectively settling the year 2002 as well as several items from 2003 and 2004.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

(dollars in thousands)		2008
Balance at January 1	$	11,554
Additions based on tax positions related to the current year		115
Reductions of tax positions of prior years		(4,735)
Settlements		(1,360)
Balance at September 30	$	5,574

Approximately $1.8 million of unrecognized tax benefits, if recognized, would favorably affect the effective income tax rate in future periods.

NOTE 15 DERIVATIVE FINANCIAL INSTRUMENTS

As part of the Company s overall interest rate risk management, Old National uses derivative instruments, including interest rate swaps, caps and floors. The notional amount of these derivative instruments was $55.1 million and $216.7 million at September 30, 2008 and December 31, 2007, respectively. In addition, 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. At September 30, 2008, the notional amount of the interest rate lock commitments and forward commitments were $12.7 million and $23.2 million, respectively. At December 31, 2007, the notional amount of the interest rate lock commitments and forward commitments were $6.9 million and $19.6 million, respectively. It is the Company s 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 its commitment to fund the loans. All derivative instruments are recognized on the balance sheet at their fair value in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. Any ineffectiveness associated with these instruments is immaterial and reported in other income in the Consolidated Statement of Income.

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 $451.3 million and $451.3 million, respectively, at September 30, 2008. At December 31, 2007, the notional amounts of the customer derivative instruments and the offsetting counterparty derivative instruments were $373.2 million and $373.2 million, respectively. These derivative contracts are not designated against specific assets or liabilities on the Consolidated Balance Sheet and, therefore, do not qualify for hedge accounting. These instruments include interest rate swaps, caps, foreign exchange forward contracts and commodity swaps and options. Old National may 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.

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, the Company minimizes credit risk through credit approvals, limits, and monitoring procedures.

Table of Contents

The following tables summarize the fair value of derivative financial instruments utilized by Old National:

	Asset Derivatives					
	September 30, 2008			December 31, 2007		
(dollars in thousands)	Balance Sheet Location		Fair Value	Balance Sheet Location		Fair Value
Derivatives designated as hedging instruments under Statement 133						
Interest rate contracts	Other assets	**$**		Other assets	$	716
Total derivatives designated as hedging instruments under Statement 133		**$**			$	716
Derivatives not designated as hedging instruments under Statement 133						
Interest rate contracts	Other assets	**$**	**15,545**	Other assets	$	14,100
Commodity contracts	Other assets		**662**	Other assets		2,011
Foreign exchange contracts	Other assets		**62**	Other assets		
Mortgage contracts	Other assets		**189**	Other assets		70
Total derivatives not designated as hedging instruments under Statement 133		**$**	**16,458**		$	16,181
Total derivatives		**$**	**16,458**		$	16,897

	Liability Derivatives					
	September 30, 2008			December 31, 2007		
(dollars in thousands)	Balance Sheet Location		Fair Value	Balance Sheet Location		Fair Value
Derivatives designated as hedging instruments under Statement 133						
Interest rate contracts	Other liabilities	**$**	**67**	Other liabilities	$	649
Mortgage contracts	Other liabilities			Other liabilities		62
Total derivatives designated as hedging instruments under Statement 133		**$**	**67**		$	711
Derivatives not designated as hedging instruments under Statement 133						
Interest rate contracts	Other liabilities	**$**	**16,200**	Other liabilities	$	14,100
Commodity contracts	Other liabilities		**662**	Other liabilities		2,011
Foreign exchange contracts			**62**			

Mortgage contracts	Other liabilities Other liabilities		Other liabilities Other liabilities		55
Total derivatives not designated as hedging instruments under Statement 133		**$ 16,924**		$	16,166
Total derivatives		**$ 16,991**		$	16,877

Table of Contents

The effect of derivative instruments on the Consolidated Statement of Income for the three and nine months ended September 30, 2008, are as follows:

(dollars in thousands)		Three months ended September 30, 2008	Nine months ended September 30, 2008
Derivatives in Statement 133 Fair Value Hedging Relationships	**Location of Gain or (Loss) Recognized in Income on Derivative**	**Amount of Gain or (Loss) Recognized in Income on Derivative**	
Interest rate contracts (1)	Interest income / (expense)	$ 34	$ 710
Interest rate contracts (2)	Other income / (expense)	128	199
Total		$ 162	$ 909
Derivatives Not Designated as Hedging Instruments under Statement 133	**Location of Gain or (Loss) Recognized in Income on Derivative**	**Amount of Gain or (Loss) Recognized in Income on Derivative**	
Interest rate contracts (1)	Interest income / (expense)	$ 95	$ 218
Interest rate contracts (3)	Other income / (expense)	(314)	(1,358)
Mortgage contracts	Mortgage banking revenue	287	172
Total		$ 68	$ (968)

(1) Amounts represent the net interest payments as stated in the contractual agreements.

(2) Amounts represent ineffectiveness on derivatives designated as fair value hedges under SFAS 133.

(3) Includes both the valuation differences between the customer and offsetting

counterparty swaps as well as the change in the value of the derivative instruments entered into to offset the change in fair value of certain retail certificates of deposit which the company elected to record at fair value under SFAS 159.

See Note 19 to the consolidated financial statements.

NOTE 16 COMMITMENTS AND CONTINGENCIES

LITIGATION

In the normal course of business, various legal actions and proceedings, which are being vigorously defended, are pending against Old National and its affiliates. Management does not believe any of these claims will have a material impact on Old National s results of operations.

LEASES

Old National rents certain premises and equipment under operating leases, which expire at various dates. Many of these leases require the payment of property taxes, insurance premiums, maintenance and other costs. In some cases, rentals are subject to increase in relation to a cost-of-living index.

In December 2006, Old National entered into a sale leaseback agreement with an unrelated third party for its three main buildings in downtown Evansville, Indiana. Old National sold assets with a carrying value of $69.9 million, received approximately $79.0 million in cash and incurred $0.4 million of selling costs. The $8.7 million deferred gain will be amortized over the term of the lease. The agreement requires rent payments of approximately $6.6 million per year over the next 23 years.

During 2007, seventy-three financial centers were sold in a series of sale leaseback transactions to an unrelated party. Old National received cash proceeds of $176.3 million, net of selling costs. The properties sold had a carrying value of $65.3 million, resulting in a gain of $111.1 million. In 2007, $4.7 million of this gain was recognized, the remainder has been deferred and is being amortized over the term of the leases. The leases have terms of ten to twenty-four years, and Old National has the right, at its option, to extend the term of the leases for four additional successive terms of five years each, upon specified terms and conditions. Under the agreements signed in 2007, Old National is obligated to pay base rents for the properties in an aggregate annual amount of $14.0 million in the first year.

In addition, Old National sold an office building located in Evansville, Indiana to an unrelated party in a separate transaction during 2007. This transaction resulted in cash proceeds of $3.4 million, net of selling costs. The property had a carrying value of $3.7 million, resulting in a loss of $0.3 million. Old National agreed to lease back the building for a term of five years. Under the lease agreement, Old National is obligated to pay a base rent of $0.4 million per year.

Table of Contents

During the first nine months of 2008, Old National sold six financial centers in a series of sale leaseback transactions to unrelated parties. Old National received cash proceeds of $9.7 million, net of selling costs. The properties sold had a carrying value of $7.2 million. The $2.5 million deferred gain will be amortized over the term of the leases. The leases have terms of fifteen to twenty years. Under the lease agreements, Old National is obligated to pay a base rent of $0.9 million per year.

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 $1.118 billion and standby letters of credit of $111.0 million at September 30, 2008. At September 30, 2008, approximately $1.056 billion of the loan commitments had fixed rates and $62 million had floating rates, with the fixed interest rates ranging from 1% to 21%. At December 31, 2007, loan commitments were $1.195 billion and standby letters of credit were $114.1 million. These commitments are not reflected in the consolidated financial statements. At both September 30, 2008 and December 31, 2007, the balance of the allowance for unfunded loan commitments was $3.7 million, respectively.

At September 30, 2008 and December 31, 2007, Old National had credit extensions of $30.9 million and $55.6 million, respectively, with various unaffiliated banks related to letter of credit commitments issued on behalf of Old National s clients. At September 30, 2008 and December 31, 2007, Old National provided collateral to the unaffiliated banks to secure credit extensions totaling $26.8 million and $41.8 million, respectively. Old National did not provide collateral for the remaining credit extensions.

NOTE 17 FINANCIAL GUARANTEES

Old National holds instruments, in the normal course of business with clients, that are considered financial guarantees in accordance with FIN 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* which requires the Company 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 September 30, 2008, the notional amount of standby letters of credit was $111.0 million, which represents the maximum amount of future funding requirements, and the carrying value was $0.4 million.

During the second quarter of 2007, Old National entered into a risk participation in an interest rate swap. The interest rate swap has a notional amount of $9.6 million.

NOTE 18 SEGMENT INFORMATION

Old National operates in two operating segments: community banking and treasury. The community banking segment serves customers in both urban and rural markets providing a wide range of financial services including commercial, real estate and consumer loans; lease financing; checking, savings, time deposits and other depository accounts; cash management services; and debit cards and other electronically accessed banking services and Internet banking. Treasury manages investments, wholesale funding, interest rate risk, liquidity and leverage for Old National. Additionally, treasury provides other miscellaneous capital markets products for its corporate banking clients. Other is comprised of the parent company and several smaller business units including insurance, wealth management and brokerage. It includes unallocated corporate overhead and intersegment revenue and expense eliminations.

In order to measure performance for each segment, Old National allocates capital and corporate overhead to each segment. Capital and corporate overhead are allocated to each segment using various methodologies, which are subject to periodic changes by management. Intersegment sales and transfers are not significant.

Old National uses a funds transfer pricing (FTP) system to eliminate the effect of interest rate risk from net interest income in the community banking segment and from companies included in the other column. The FTP system is used to credit or charge each segment for the funds the segments create or use. The net FTP credit or charge is reflected in segment net interest income.

The financial information for each operating segment is reported on the basis used internally by Old National s management to evaluate performance and is not necessarily comparable with similar information for any other financial institution.

Summarized financial information concerning segments is shown in the following table for the three and nine months ended September 30:

(dollars in thousands)	Community Banking	Treasury	Other	Total
Three months ended September 30, 2008				
Net interest income	**$ 63,799**	**$ (3,537)**	**$ (666)**	**$ 59,596**
Provision for loan losses	**6,508**	**334**		**6,842**
Noninterest income	**21,228**	**2,319**	**15,448**	**38,995**
Noninterest expense	**55,856**	**742**	**15,865**	**72,463**
Income (loss) before income taxes	**22,663**	**(2,294)**	**(1,083)**	**19,286**
Total assets	**4,892,941**	**2,569,476**	**105,871**	**7,568,288**
Three months ended September 30, 2007				
Net interest income	$ 59,296	$ (3,366)	$ (712)	$ 55,218
Provision for loan losses	(106)	106		
Noninterest income	19,418	1,906	16,247	37,571
Noninterest expense	49,191	954	15,350	65,495
Income (loss) before income taxes	29,629	(2,520)	185	27,294
Total assets	4,992,685	2,716,897	122,903	7,832,485
Nine months ended September 30, 2008				
Net interest income	**$ 191,852**	**$ (9,218)**	**$ (1,904)**	**$ 180,730**
Provision for loan losses	**33,887**	**560**		**34,447**
Noninterest income	**61,711**	**14,198**	**53,475**	**129,384**
Noninterest expense	**163,964**	**3,225**	**51,044**	**218,233**
Income before income taxes	**55,712**	**1,195**	**527**	**57,434**
Total assets	**4,892,941**	**2,569,476**	**105,871**	**7,568,288**
Nine months ended September 30, 2007				
Net interest income	$ 172,994	$ (9,512)	$ (2,121)	$ 161,361
Provision for loan losses	2,066	379		2,445
Noninterest income	55,634	3,035	52,398	111,067
Noninterest expense	153,536	3,392	50,034	206,962
Income (loss) before income taxes	73,026	(10,248)	243	63,021
Total assets	4,992,685	2,716,897	122,903	7,832,485

Table of Contents

NOTE 19 FAIR VALUE

Effective January 1, 2008, the Company adopted SFAS No. 157 and SFAS No. 159. Both standards address aspects of the expanding application of fair value accounting.

SFAS No. 157 defines fair value as 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. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes 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 spread to swap and libor curves that are updated to incorporate loss severities, volatility, credit spread 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).

Deposits: The fair value of retail certificates of deposit is estimated by discounting future cash flows using rates currently offered for deposits with similar remaining maturities (Level 2).

Assets and liabilities measured at fair value under SFAS No. 157 on a recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

		Fair Value Measurements at September 30, 2008 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				
Investment securities available-for-sale	**$ 1,923,752**		**$ 1,904,232**	**$ 19,520**
Residential loans held for sale	**11,118**		**11,118**	

Derivative assets	**16,458**	**16,458**
Financial Liabilities		
Certain retail certificates of deposit	**48,875**	**48,875**
Derivative liabilities	**16,991**	**16,991**

Table of Contents

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarter ended September 30, 2008:

(dollars in thousands)		Fair Value Measurements using Significant Unobservable Inputs (Level 3) Pooled Trust Preferred Securities Available-for-Sale
Beginning balance, June 30, 2008	$	28,735
Accretion/amortization of discount or premium		1
Payments received		
Decease in market value of securities		(12,767)
Transfers in and/or out of Level 3		3,551
Ending balance, September 30, 2008	$	19,520

Included in the income statement is $1 thousand in interest income from the amortization of discounts on securities. The decrease in market value is reflected in the balance sheet as a reduction 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. The transfers into Level 3 were due to changes in the observability of significant inputs.

Assets measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurements at September 30, 2008 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				
Impaired loans	$ 27,977			$ 27,977

Impaired loans, which are measured for impairment using the fair value of the collateral, had a principal amount of $43.3 million, with a valuation allowance of $15.3 million at September 30, 2008.

Financial instruments recorded using SFAS No. 159

Under SFAS No. 159, the Company 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. Additionally, the transaction provisions of SFAS No. 159 permit a one-time election for existing positions at the adoption date with a cumulative-effect adjustment included in beginning retained earnings and future changes in fair

value reported in net income. The Company did not elect the fair value option for any existing position at January 1, 2008.

The Company did elect the fair value option under SFAS No. 159 prospectively for the following items:

- Residential mortgage loans held for sale
- Certain retail certificates of deposit

For items for which the fair value option has been elected, interest income is recorded in the consolidated statements of income based on the contractual amount of interest income earned on financial assets (except any that are on nonaccrual status). Included in the income statement are $122 thousand and $342 thousand of interest income for residential loans held for sale for the three and nine months ended September 30, 2008, respectively. Interest expense is recorded based on the contractual amount of interest expense incurred. The income statement includes $437 thousand and $1.0 million of interest expense for the three and nine months ended September 30, 2008, respectively, for certain retail certificates of deposit under SFAS No. 159.

Residential mortgage loans held for sale

Old National has elected the fair value option under SFAS No. 159 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. None of these loans are 90 days or more past due, nor are any on nonaccrual status. 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. This election was effective for applicable loans originated since January 1, 2008.

Certain retail certificates of deposit

Old National has elected the fair value option under SFAS No. 159 for certain retail certificates of deposit; specifically, pools of retail certificates of deposit that have been matched 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. This election was adopted prospectively for certain retail certificates of deposit originated since January 1, 2008.

As of September 30, 2008, the difference between the aggregate fair value and the aggregate remaining principal balance for loans and certificates of deposit for which the fair value option has been elected was as follows. Accrued interest at period end is included in the fair value of the instruments.

(dollars in thousands)	Aggregate Fair Value	Difference	Contractual Principal
Residential loans held for sale	$ 11,118	$ 241	$ 10,877
Certain retail certificates of deposit	48,875	(290)	49,165

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets and liabilities carried at fair value for the three months ended September 30, 2008:

Changes in Fair Value for the Three Months ended September 30, 2008, for Items Measured at Fair Value Pursuant to Election of the Fair Value Option

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest Expense	Total Changes in Fair Values Included in Current Period Earnings
Residential loans held for sale	$ (48)	$	$	$ (48)
Certain retail certificates of deposit	40		367	327

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets and liabilities carried at fair value for the nine months ended September 30, 2008:

Changes in Fair Value for the Nine Months ended September 30, 2008, for Items Measured at Fair Value Pursuant to Election of the Fair Value Option

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest Expense	Total Changes in Fair Values Included in Current Period Earnings
Residential loans held for sale	$ 238	$ 3	$	$ 241
Certain retail certificates of deposit	498		208	290

Table of Contents

NOTE 20 SUBSEQUENT EVENT

In response to the financial crisis affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Pursuant to the EESA, the U.S. Treasury will have the authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, Secretary Paulson, after consulting with the Federal Reserve and the FDIC, announced that the Department of the Treasury will purchase equity stakes in a wide variety of banks and thrifts. Under this program, known as the Troubled Asset Relief Program Capital Purchase Program (the TARP Capital Purchase Program), from the $700 billion authorized by the EESA, the Treasury will make $250 billion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions will be required to adopt the Treasury s standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program. On October 27, 2008, Old National was notified that they had been preliminarily approved to participate in the TARP Capital Purchase Program and is eligible for $150 million of capital. The Company has thirty days to determine if it will commit to participate in the program.

Also on October 14, 2008, after receiving a recommendation from the boards of the FDIC and the Federal Reserve, and consulting with the President, Secretary Paulson signed the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing transaction deposit accounts under a Temporary Liquidity Guarantee Program. Coverage under the Temporary Liquidity Guarantee Program is available for 30 days without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for non-interest bearing transaction deposits. The Corporation is assessing its participation in the Temporary Liquidity Guarantee Program but has not yet made a definitive decision as to whether it will participate.

PART I. FINANCIAL INFORMATION

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 and nine months ended September 30, 2008 and 2007, and financial condition as of September 30, 2008, compared to September 30, 2007, and December 31, 2007. 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.

EXECUTIVE SUMMARY

Net income for the third quarter of 2008 is $17.0 million, compared to $19.5 million and $22.6 million for the quarters ended June 30, 2008 and September 30, 2007, respectively. Third quarter earnings decreased $2.5 million from the prior quarter primarily as a result of lower net interest income and higher provision expense. Securities gains in the third quarter were $45 thousand compared to $2.1 million during the second quarter, however, the third quarter benefited from the reversal of approximately $2.1 million of performance-based compensation expense. The third quarter of 2007 benefited from no provision expense, a $1.6 million recovery of interest on a commercial real estate loan, and a $1.8 million release of a portion of the unrecognized tax benefit liability.

Net interest margin in the third quarter of 2008 was 3.79% compared to 3.85% during the second quarter of 2008, and 3.37% year-over-year. The margin remained strong in the third quarter of 2008 despite a slight decline in average earning assets and our shift to a more neutral balance sheet, or a balance sheet which is less sensitive to falling interest rates.

29

Although we believe our conservative stance toward underwriting policies and real estate lending has positioned us well, the credit markets continue to be a challenge in 2008. We recorded provision expense of $6.8 million during the third quarter and are seeing core credit quality starting to soften. Non-accrual loans remained relatively flat compared to the prior quarter, however, criticized and classified loans increased 16.5%. We remain cautious on consumer, construction and commercial real estate credit quality. As a percent of total loans, the allowance was 1.36% at September 30, 2008, compared to 1.31% and 1.35% at June 30, 2008 and September 30, 2007, respectively. Net charge- offs were 0.46% of average loans in the third quarter of 2008 compared to 1.35% in the second quarter of 2008, and 0.28% year-over-year. Nonperforming loans totaled 1.46% of total loans at September 30, 2008, compared to 1.43% at June 30, 2008 and 1.04% a year ago.

In addition to the provision, management has been monitoring our investment portfolio very closely. As of September 30, 2008, we had no other than temporary impairment. We had no Lehman Brothers exposure in the available-for-sale investment portfolio at September 30 and only 2.7% of the securities are associated with companies in the financial services industry. In addition, only 1% of the investment portfolio s market value, or approximately $19.5 million, is invested in pooled trust preferred securities.

During the remainder of 2008, we will continue to focus on maintaining our well-capitalized position, improving our risk profile, and managing through this unprecedented credit cycle.

RESULTS OF OPERATIONS

The following table sets forth certain income statement information of Old National for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,		**%**	**Nine Months Ended September 30,**		**%**
(dollars in thousands)	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Income Statement Summary:						
Net interest income	**$ 59,596**	$ 55,218	7.9%	**$ 180,730**	$ 161,361	12.0%
Provision for loan losses	**6,842**		NM	**34,447**	2,445	NM
Noninterest income	**38,995**	37,571	3.8	**129,384**	111,067	16.5
Noninterest expense	**72,463**	65,495	10.6	**218,233**	206,962	5.4
Other Data:						
Return on average equity	**10.50**%	14.22%		**11.20**%	11.08%	
Efficiency ratio	**70.03**	67.46		**67.36**	72.56	
Tier 1 leverage ratio	**8.29**	7.66		**8.29**	7.66	
Net charge-offs to average loans	**0.46**	0.28		**0.78**	0.32	

NM = Not meaningful

Net Interest Income

Net interest income is our most significant component of earnings, comprising over 58% of revenues at September 30, 2008. 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 prepayment risk on mortgage and investment-related assets and the composition and maturity of earning assets and interest-bearing liabilities. Loans typically generate more interest income than investment securities with similar maturities. Funding from client deposits generally cost less than wholesale funding sources. Factors such as general economic activity, Federal Reserve Board monetary policy and price volatility of competing alternative investments, can also exert significant influence on our ability to optimize our mix of assets and funding and our net interest income and margin.

Net interest income and net interest margin in the following discussion are presented on a fully taxable equivalent basis, which adjusts tax-exempt or nontaxable interest income to an amount that would be comparable to interest subject to income taxes using the federal statutory tax rate of 35% in effect for all periods. Net income is unaffected

by these taxable equivalent adjustments as the offsetting increase of the same amount is made to income tax expense. Net interest income includes taxable equivalent adjustments of $4.9 million and $4.3 million for the three months ended September 30, 2008 and 2007, respectively. Taxable equivalent adjustments for the nine months ended September 30, 2008 and 2007 were $13.9 million and $12.8 million, respectively.

Taxable equivalent net interest income was $64.5 million and $194.6 million for the three and nine months ended September 30, 2008, up from the $59.5 million and $174.1 million reported for the three and nine months ended September 30, 2007. The net interest margin was 3.79% and 3.77% for the three and nine months ended September 30, 2008, compared to 3.37% and 3.19% for the three and nine months ended September 30, 2007. The increase in both net interest income and net interest margin is primarily due to the decrease in the cost of funding being greater than the decrease in the earning asset yields, combined with a change in the mix of interest earning assets and interest-bearing liabilities. The yield on average earning assets decreased 88 basis points from 6.77% to 5.89% while the cost of interest-bearing liabilities decreased 139 basis points from 3.84% to 2.45% in the quarterly year-over-year comparison. In the year-to-date comparison, the yield on average earning assets decreased 61 basis points from 6.65% to 6.04% while the cost of interest-bearing liabilities decreased 126 basis points from 3.89% to 2.63%.

Average earning assets were $6.804 billion for the three months ended September 30, 2008, compared to $7.067 billion for the three months ended September 30, 2007, a decrease of 3.7%, or $263.0 million. Average earning assets were $6.878 billion for the nine months ended September 30, 2008, compared to $7.288 billion for the nine months ended September 30, 2007, a decrease of 5.6%, or $410.0 million. Significantly affecting average earning assets at September 30, 2008 compared to September 30, 2007, was the reduction in the size of the investment portfolio combined with the reduction of the size of the loan portfolio. During the nine months ended September 30, 2008, $259.8 million of investment securities were sold and $384.7 million were called by the issuers. In addition, commercial and commercial real estate loans have been affected by continued weak loan demand in our markets, more stringent loan underwriting standards and our desire to lower future potential credit risk by being cautious towards the real estate market. During the fourth quarter of 2007, we sold $6.7 million of nonaccrual and substandard commercial and commercial real estate loans. During the first quarter of 2008, we sold $2.2 million of commercial loans. Year over year, commercial and consumer loans, which have an average yield higher than the investment portfolio, have increased as a percent of interest earning assets.

Also affecting margin was a decrease in time deposits. During the fourth quarter of 2007, we called $43.1 million of high cost brokered certificates of deposit and $25.5 million of retail certificates of deposit. During the first nine months of 2008, $118.2 million of high cost brokered certificates of deposit were called or matured and $100.5 million of retail certificates of deposit were called. In addition, a $50 million bank note matured in the first quarter of 2008, $100 million of medium-term notes matured in the second quarter of 2008 and $26 million of FHLB advances matured in the third quarter of 2008. Year over year, brokered certificates of deposit, which have an average interest rate higher than other types of deposits, have decreased as a percent of interest-bearing liabilities. Borrowed funds have increased as a percent of interest-bearing liabilities, due to our ability to purchase low-cost FHLB advances during 2008.

Provision for Loan Losses

The provision for loan losses was $6.8 million for the three months ended September 30, 2008, with a $34.4 million provision for loan losses year-to-date. The 2008 provision compares to no provision during the third quarter of 2007 and $2.4 million provision for the nine months ended September 30, 2007. The higher provision in 2008 is primarily attributable to the increase in nonaccrual loans in the first quarter of 2008 associated with the misconduct of a former loan officer in the Indianapolis market and subsequent deterioration of these credits.

Noninterest Income

We generate revenues in the form of noninterest income through client fees and sales commissions from our core banking franchise and other related businesses, such as wealth management, investment consulting, investment products and insurance. Noninterest income for the three months ended September 30, 2008, was $39.0 million, an increase of $1.4 million, or 3.7%, from the $37.6 million reported for the three months ended September 30, 2007. For the nine months ended September 30, 2008, noninterest income was $129.4 million, an increase of $18.3 million, or 16.5%, from the $111.1 million reported for the nine months ended September 30, 2007.

Net securities gains were $45 thousand and $6.6 million for the three and nine months ended September 30, 2008, compared to net securities losses of $0.5 million and $3.2 million for the three and nine months ended September 30, 2007. The 2008 net securities gains were primarily the result of securities which were called by the issuers. Partially

offsetting these gains during the third quarter is a $1.0 million loss related to the sale of $2.0 million of Lehman Brothers securities. At September 30, 2008, we had no Lehman Brothers securities remaining in the investment portfolio. The 2007 net securities losses resulted from the balance sheet restructuring.

ATM fees increased by $0.7 million and $2.5 million for the three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007. The increase is primarily attributable to a higher volume of debit card usage.

Revenue from company-owned life insurance increased $0.5 million and $1.3 million for the three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007. During the third quarter of 2008, the crediting rate formula for the 1997 company-owned life insurance policy was amended to adopt a more conservative position and improve the overall market to book value ratio. This change will result in lower revenues from company-owned life insurance in future periods.

Amortization of deferred gains associated with the sale leaseback transactions were $1.6 million and $4.8 million for the three and nine months ended September 30, 2008, compared to $0.8 million and $0.9 million for the three and nine months ended September 30, 2007. As discussed in Note 16 to the consolidated financial statements, we entered into a series of sale and leaseback transactions beginning in December of 2006. The majority of the gains associated with these transactions were deferred and are being amortized over the term of the leases.

Other income decreased $0.5 million for the three months ended September 30, 2008 as compared to the three months ended September 30, 2007, and increased $2.0 million for the nine months ended September 30, 2008 as compared to the nine months ended September 30, 2007. The decrease in the quarterly comparison was primarily as a result of an increase in losses on sales of other real estate owned. The increase in the nine month comparison is primarily as a result of a $1.5 million gain associated with the redemption of class B VISA shares recorded during the first quarter of 2008 combined with an increase in customer derivative fee revenue.

Noninterest Expense

Noninterest expense for the three months ended September 30, 2008, totaled $72.5 million, an increase of $7.0 million, or 10.6%, from the $65.5 million recorded for the three months ended September 30, 2007. For the nine months ended September 30, 2008, noninterest expense was $218.2 million, an increase of $11.2 million, or 5.4%, from the $207.0 million recorded for the nine months ended September 30, 2007.

Salaries and benefits is the largest component of noninterest expense. For the three months ended September 30, 2008, salaries and benefits were $40.5 million compared to $39.6 million for the three months ended September 30, 2007. Included in the third quarter of 2008 is a reversal of approximately $2.1 million of restricted stock and other performance-based compensation expense compared to a $0.7 million adjustment during the third quarter of 2007. For the nine months ended September 30, 2008, salaries and benefits were $126.0 million compared to $122.5 million for the nine months ended September 30, 2007. The nine months of 2008 includes higher performance-based compensation, medical insurance expenses and an additional $1.1 million of personnel expense associated with the acquisition of St. Joseph Capital Corporation on February 1, 2007.

Occupancy expense increased to $9.8 million and $29.0 million for the three and nine months ended September 30, 2008, compared to $5.9 million and $17.8 million for the three and nine months ended September 30, 2007, primarily as a result of an increase in rent expense. The increase in rent expense is related to the sale leaseback transactions discussed in Note 16 to the consolidated financial statements. Partially offsetting the increase in rent expense was a decrease in depreciation expense, also related to the sale leaseback transactions.

Marketing expense increased by $1.4 million and $1.5 million for the three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007. Increases in newspaper, radio and direct mail advertising were the primary reason for the increases.

During the first quarter of 2007, we recorded a $1.2 million loss on the extinguishment of debt related to the early retirement of Federal Home Loan Bank advances and repurchase agreements.
During the second quarter of 2008, we recorded $0.7 million for impairment of intangibles due to the loss of a significant insurance client at one of our insurance subsidiaries. The insurance subsidiary is included in the Other column for segment reporting. The first quarter of 2007 included $1.2 million of impairment associated with eight financial centers that we consolidated into other higher performing financial centers during the first quarter of 2007.
Other expense for the three months ended September 30, 2008, totaled $5.4 million, an increase of $1.0 million compared to the three months ended September 30, 2007. Other expense for the nine months ended September 30, 2008, totaled $13.9 million, a decrease of $1.1 million compared to the nine months ended September 30, 2007. Increases in loan collection expenses and the provision for unfunded commitments were the primary reason for the increase in the quarterly comparison. Included in the first quarter of 2007 is a $1.2 million charge to terminate leases on certain financial centers that were consolidated into more profitable centers. Also included in other expense is the Federal Deposit Insurance Corporation (FDIC) assessment expense. On October 7, 2008, the FDIC voted to adopt a restoration plan accompanied by a notice of proposed rulemaking that would increase the rates banks pay for deposit insurance. We anticipate a significant increase in our assessment beginning in 2009 as a result of both the increase in the assessment and the expiration of our one-time assessment credit.

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 interest on tax-exempt securities and loans. The provision for income taxes, as a percentage of pre-tax income, was 11.8% for the three months ended September 30, 2008, compared to 17.3% for the three months ended September 30, 2007. The provision for income taxes, as a percentage of pre-tax income, was 2.8% for the nine months ended September 30, 2008, compared to 16.1% for the nine months ended September 30, 2007. The lower effective tax rate for the three months ended September 30, 2008, resulted from a higher percentage of tax-exempt income to income before income taxes compared to the three months ended September 30, 2007. The lower effective tax rate for the nine months ended September 30, 2008, was primarily a result of a decrease in the unrecognized tax benefit liability. See note 14 to the consolidated financial statements for additional information.

FINANCIAL CONDITION

Overview

At September 30, 2008, our assets were $7.568 billion, a 3.4% decrease compared to September 30, 2007 assets of $7.832 billion, and an annualized decrease of 4.7% compared to December 31, 2007 assets of $7.846 billion. The reduction of $238.3 million of investment securities in the first nine months of 2008 combined with a decrease in commercial real estate loan balances and the various sale-leaseback transactions have lowered our total assets, reducing our reliance on high-cost deposits and brokered certificates of deposit. Year over year, brokered certificates of deposit, which have an average interest rate higher than other types of deposits, have decreased as a percent of interest-bearing liabilities. Borrowed funds have increased as a percent of interest-bearing liabilities due to our ability to obtain low-cost FHLB advances during 2008.

Earning Assets

Our earning assets are comprised of investment securities, loans and loans held for sale, and money market investments. Earning assets were $6.791 billion at September 30, 2008, a decrease of 3.4% from September 30, 2007, and an annualized decrease of 4.3% since December 31, 2007.

Investment Securities

We classify investment securities primarily 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 some 15- and 20-year fixed-rate mortgage pass-through securities in our held-to-maturity investment portfolio. At September 30, 2008, we do not believe any individual unrealized loss on available-for-sale securities represents other-than-temporary impairment. The unrealized losses are primarily attributable to changes in interest rates and continued financial market stress. As of September 30, 2008, we had both the intent and ability to

hold the securities for a time necessary to recover the amortized cost.

At September 30, 2008, the investment securities portfolio was $2.070 billion compared to $2.262 billion at September 30, 2007, a decrease of $191.8 million or 8.5%. Investment securities decreased $238.3 million compared to December 31, 2007, an annualized decrease of 13.8%. Investment securities represented 30.5% of earning assets at September 30, 2008, compared to 32.2% at September 30, 2007, and 32.9% at December 31, 2007. Approximately $384.7 million of investment securities were called by their issuers and $259.8 million of investment securities were sold during the first nine months of 2008. The cash proceeds from these sales were used to purchase similarly yielding securities and to reduce brokered certificates of deposit. Stronger commercial loan demand in the future could result in increased investments in loans and a continued reduction in the investment securities portfolio.

The investment securities available-for-sale portfolio had net unrealized losses of $74.2 million at September 30, 2008, an increase of $46.6 million compared to net unrealized losses of $27.6 million at September 30, 2007, and an increase of $67.4 million compared to net unrealized losses of $6.7 million at December 31, 2007. The increase over the past twelve months was primarily attributable to changes in interest rates and the financial crisis affecting the banking system and financial markets.

The investment portfolio had an average duration of 4.76 years at September 30, 2008, compared to 3.30 years at September 30, 2007, and 2.96 years at December 31, 2007. The annualized average yields on investment securities, on a taxable equivalent basis, were 5.38% for the three months ended September 30, 2008, compared to 5.18% for the three months ended September 30, 2007, and 5.21% for the three months ended December 31, 2007. Average yields on investment securities, on a taxable equivalent basis, were 5.25%, 5.11% and 5.13% for the nine months ended September 30, 2008 and 2007, and for the year ended December 31, 2007, respectively.

Residential Loans Held for Sale

Residential loans held for sale were $11.1 million at September 30, 2008, compared to $13.3 million at September 30, 2007, and $13.0 million at December 31, 2007. Residential loans held for sale are loans that are closed, but not yet purchased by investors. The amount of residential loans held for sale on the balance sheet varies depending on the amount of originations and timing of loan sales to the secondary market. The decrease in residential loans held for sale from September 30, 2007, is primarily attributable to increased efficiencies in processing loan sales and the timing of loan sales to the secondary market.

We elected the fair value option under SFAS No. 159 prospectively for residential loans held for sale. The election was effective for loans originated since January 1, 2008. The aggregate fair value exceeded the unpaid principal balances by $0.2 million as of September 30, 2008.

Commercial and Commercial Real Estate Loans

Commercial and commercial real estate loans are the largest classification within earning assets, representing 43.7% of earning assets at September 30, 2008, an increase from 42.7% at September 30, 2007, and an increase from 42.3% at December 31, 2007. At September 30, 2008, commercial and commercial real estate loans were $2.971 billion, a decrease of $30.3 million since September 30, 2007, and an increase of $5.4 million since December 31, 2007. Commercial loans have increased $107.2 million since September 30, 2007 while commercial real estate loans have decreased $137.5 million since September 30, 2007. During the last quarter of 2007, we sold $4.3 million of commercial and $2.4 million of commercial real estate loans. During the first quarter of 2008, we sold $2.2 million of commercial loans. Weak loan demand in our markets continues to affect loan growth. Our conservative underwriting standards have also contributed to slower loan growth. We continue to be cautious towards the real estate market in an effort to lower credit risk.

Consumer Loans

At September 30, 2008, consumer loans, including automobile loans, personal and home equity loans and lines of credit, and student loans, decreased $7.0 million or 0.6% compared to September 30, 2007, and increased $15.5 million or, annualized, 1.7% since December 31, 2007.

Table of Contents

Residential Real Estate Loans

Residential real estate loans, primarily 1-4 family properties, have decreased in significance to the loan portfolio over the past five years due to higher levels of loan sales into the secondary market, primarily to private investors. We sell the majority of residential real estate loans originated as a strategy to better manage interest rate risk and liquidity. We sell almost all residential real estate loans servicing released without recourse.

At September 30, 2008, residential real estate loans were $508.1 million, a decrease of $31.2 million, or 5.8%, from September 30, 2007.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets at September 30, 2008, totaled $187.8 million, a decrease of $4.1 million compared to $191.9 million at September 30, 2007, and a decrease of $3.2 million compared to $191.0 million at December 31, 2007. During the second quarter of 2008, we recorded $0.7 million for impairment of intangibles due to the loss of a significant insurance client at one of our insurance subsidiaries. The insurance subsidiary is included in the Other column for segment reporting. The remaining decreases were the result of standard amortization expense related to the other intangible assets.

Assets Held for Sale

Assets held for sale were $3.0 million at September 30, 2008, a decrease of $28.1 million compared to $31.1 million at September 30, 2007. The sale leaseback transactions during 2007 and the first nine months of 2008 were the reason for the decline. Included in assets held for sale at September 30, 2008 are five financial centers that are pending sale. We plan to continue occupying these properties under long-term lease agreements.

Other assets have increased $48.4 million, or 39.4%, since December 31, 2007 primarily as a result of an increase in deferred tax assets.

Funding

Total funding, comprised of deposits and wholesale borrowings, was $6.725 billion at September 30, 2008, a decrease of 4.1% from $7.014 billion at September 30, 2007, and an annualized decrease of 4.5% from $6.958 billion at December 31, 2007. Included in total funding were deposits of $5.346 billion at September 30, 2008, a decrease of $528.3 million, or 9.0%, compared to September 30, 2007, and a decrease of $317.2 million compared to December 31, 2007. In the last quarter of 2007, we called $43.1 million of high cost brokered certificates of deposit and $25.5 million of retail certificates of deposit. In the first nine months of 2008, we called $100.5 million of retail certificates of deposit; and $118.2 million of high cost brokered certificates of deposit were called or matured. Savings deposits increased 41.3% or $269.8 million compared to September 30, 2007. Money market deposits decreased 35.0% or $241.7 million and time deposits decreased 15.8% or $357.0 million compared to September 30, 2007. Year over year, we have experienced a shift into lower cost deposit types.

Effective January 1, 2008, we elected the fair value option under SFAS No. 159 prospectively for certain retail certificates of deposit. The balance of these retail certificates of deposit was $49.2 million as of September 30, 2008. The aggregate fair value was lower than the carrying value by $0.3 million as of September 30, 2008.

We use wholesale funding to augment deposit funding and to help maintain our desired interest rate risk position. At September 30, 2008, wholesale borrowings, including short-term borrowings and other borrowings, increased $239.8 million, or 21.1%, from September 30, 2007 and increased $84.0 million, or 8.6%, annualized, from December 31, 2007, respectively. Wholesale funding as a percentage of total funding was 20.5% at September 30, 2008, compared to 16.2% at September 30, 2007, and 18.6% at December 31, 2007. Short-term borrowings have increased $14.6 million since September 30, 2007 while long-term borrowings have increased $225.2 million since September 30, 2007. We purchased $355.0 million low-cost FHLB advances during the first nine months of 2008. In addition, a $50 million bank note matured in the first quarter of 2008, $100 million of medium-term notes matured in the second quarter of 2008 and $26 million of FHLB advances matured in the third quarter of 2008. At September 30, 2008, we had drawn $55 million on our revolving credit facility which is included in short-term borrowings. The proceeds were used to help retire the medium term notes.

Other liabilities have increased $36.4 million, or 21.2%, since September 30, 2007 primarily as a result of the deferred gains arising from the sale leaseback transactions that we entered into during 2007 and 2008.

Table of Contents

Capital

Shareholders equity totaled $635.4 million at September 30, 2008, compared to $647.4 million at September 30, 2007, and $652.9 million at December 31, 2007.

During the fourth quarter of 2007, we declared a cash dividend of $0.23 per share to be paid in the first quarter of 2008, which was included in the fourth quarter 2007 financial results. We declared cash dividends of $0.23 and $0.46 per share for the three and nine months ended September 30, 2008, which reduced equity by $30.5 million. We paid cash dividends of $0.22 and $0.66 per share for the three and nine months ended September 30, 2007, which decreased equity by $43.4 million. We purchased shares of our stock, reducing shareholders equity by $0.4 million during the nine months ended September 30, 2008, and $4.1 million during the nine months ended September 30, 2007. The change in unrealized losses on investment securities decreased equity by $40.6 million and $0.1 million during the nine months ended September 30, 2008, and 2007, respectively. Shares issued for stock options, restricted stock and stock compensation plans increased shareholders equity by $2.9 million during the nine months ended September 30, 2008, compared to $1.1 million during the nine months ended September 30, 2007. In addition, $0.5 million of restricted stock and options were issued in connection with the acquisition of St. Joseph in 2007. The adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*, resulted in a $3.4 million reduction in equity during the first quarter of 2007. The adoption of EITF 06-5, *Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4 (Accounting for Purchases of Life Insurance)*, also affected equity in the first quarter of 2007, resulting in a $0.1 million reduction.

Capital Adequacy

Old National and the banking industry are subject to various regulatory capital requirements administered by the federal banking agencies. At September 30, 2008, 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. To be categorized as well-capitalized, the bank subsidiary must maintain at least a total risk-based capital ratio of 10.0%, a Tier 1 risk-based capital ratio of 6.0% and a Tier 1 leverage ratio of 5.0%. As of September 30, 2008, Old National s consolidated capital position remains strong as evidenced by the following comparisons of key industry ratios.

	Regulatory Guidelines Minimum	**September 30, 2008**	**September 30, 2007**	**December 31, 2007**
Risk-based capital:				
Tier 1 capital to total avg assets (leverage ratio)	4.00%	**8.29%**	7.66%	7.72%
Tier 1 capital to risk-adjusted total assets	4.00	**11.36**	10.52	10.60
Total capital to risk-adjusted total assets	8.00	**14.28**	13.91	13.34
Shareholders equity to assets	N/A	**8.39**	8.27	8.32

RISK MANAGEMENT

Overview

Management, with the oversight of the Board of Directors, has in place company-wide structures, processes, and controls for managing and mitigating risk. The following discussion addresses the three major risks that we face: credit, market, and liquidity.

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

Within our securities portfolio, the non-agency collateralized mortgage obligations represent the greatest exposure to the current instability in the residential real estate and credit markets. At September 30, 2008, we had non-agency collateralized mortgage obligations of $230.6 million or approximately 12% of the available-for-sale securities

portfolio.

We expect conditions in the overall residential real estate and credit markets to remain uncertain for the foreseeable future. Deterioration in the performance of the underlying loan collateral could result in deterioration in the performance of our asset-backed securities.

At September 30, 2008, we do not believe that any individual unrealized loss represents an other-than-temporary impairment. The majority of the unrealized losses on mortgage-backed securities are attributable to both changes in interest rates and financial market stress.

We also carry a higher exposure to loss in our pooled trust preferred securities, which are collateralized debt obligations, due to illiquidity in that market and performance of underlying collateral. At September 30, 2008, we had pooled trust preferred securities of approximately $19.5 million, or 1% of the available-for-sale securities portfolio.

The majority of the remaining 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. We have the intent and ability to hold all securities in an unrealized loss position at September 30, 2008 until the market value recovers or the securities mature.

Counterparty Exposure

Counterparty exposure is the risk that the other party in a financial transaction will not fulfill its obligation in a financial transaction. 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 s net counterparty exposure was a liability of $121.6 million at September 30, 2008.

Lending Activities

Community-based lending personnel, along with region-based independent underwriting and analytic support staff, extend credit under guidelines established and administered by our Risk and Credit Policy 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 primarily to small- and medium-sized commercial and commercial real estate clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling and retailing. At September 30, 2008, we had no concentration of loans in any single industry exceeding 10% of its portfolio and had no exposure to foreign borrowers or lesser-developed countries. Our policy is to concentrate our lending activity in the geographic market areas we serve, primarily Indiana, Illinois and Kentucky. We continue to be affected by weakness 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.

Table of Contents

Summary of under-performing, criticized and classified loans:

(dollars in thousands)	September 30, 2008	September 30, 2007	December 31, 2007
Nonaccrual loans			
Commercial and commercial real estate	**$ 56,266**	$ 39,403	$ 30,303
Residential real estate	**6,207**	5,621	5,996
Consumer	**5,973**	4,288	4,517
Total nonaccrual loans	**68,446**	49,312	40,816
Renegotiated loans			
Past due loans (90 days or more and still accruing)			
Commercial and commercial real estate	**1,074**	1,384	738
Residential real estate			
Consumer	**853**	789	773
Total past due loans	**1,927**	2,173	1,511
Foreclosed properties	**3,178**	7,931	2,876
Total under-performing assets	**$ 73,551**	$ 59,416	$ 45,203
Classified loans (includes nonaccrual, renegotiated, past due 90 days and other problem loans)	**$ 173,833**	$ 130,247	$ 115,121
Criticized loans	**114,321**	79,102	103,210
Total criticized and classified loans	**$ 288,154**	$ 209,349	$ 218,331
Asset Quality Ratios:			
Non-performing loans/total loans (1) (2)	**1.46%**	1.04%	0.87%
Under-performing assets/total loans and foreclosed properties (1)	**1.57**	1.25	0.96
Under-performing assets/total assets	**0.97**	0.76	0.58
Allowance for loan losses/under-performing assets	**86.29**	107.95	124.91

(1) Loans include residential loans held for sale.

(2) Non-performing loans include nonaccrual and renegotiated loans.

Loan charge-offs, net of recoveries, totaled $5.5 million for the three months ended September 30, 2008, an increase of $2.2 million from the three months ended September 30, 2007. Net charge-offs for the nine months ended September 30, 2008 totaled $27.4 million compared to $11.8 million for the nine months ended September 30, 2007. Included in the first nine months of 2008 is $15.6 million of charge-offs associated with the misconduct of a former loan officer in the Indianapolis market. Included in the nine months ended September 30, 2007 is $2.5 million of

charge-offs associated with commercial and commercial real estate loans which were transferred to held for sale and sold during the second and third quarters of 2007. Net charge-offs to average loans were 0.46% and 0.78% for the three and nine months ended September 30, 2008, as compared to 0.28% and 0.32% for the three and nine months ended September 30, 2007.

Under-performing assets totaled $73.6 million at September 30, 2008, an increase of $14.1 million compared to $59.4 million at September 30, 2007, and an increase of $28.3 million compared to $45.2 million at December 31, 2007. As a percent of total loans and foreclosed properties, under-performing assets at September 30, 2008, were 1.57%, an increase from the September 30, 2007 ratio of 1.25% and an increase from the December 31, 2007 ratio of 0.96%